

Edgar Filing: FASTNET CORP - Form 10-Q

FASTNET CORP  
Form 10-Q  
May 15, 2003

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

-----  
FORM 10-Q

(MARK ONE)

- [X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2003
- [ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

COMMISSION FILE NUMBER: 0-29255

FASTNET CORPORATION  
-----

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

PENNSYLVANIA  
-----

23-2767197  
-----

(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

(I.R.S. EMPLOYER  
IDENTIFICATION NO.)

3864 COURTNEY STREET  
TWO COURTNEY PLACE, SUITE 130  
BETHLEHEM, PA  
-----

18017  
-----

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(ZIP CODE)

(610) 266-6700  
-----

(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

N/A  
---

(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED  
SINCE LAST REPORT)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act) Yes [ ] No [X]

The number of shares of the registrant's Common stock outstanding as of May 12, 2003 was 25,572,323.

Edgar Filing: FASTNET CORP - Form 10-Q

FASTNET CORPORATION

FORM 10-Q

MARCH 31, 2003

INDEX

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

Consolidated Balance Sheets - March 31, 2003 and December 31, 2002....3

Consolidated Statements of Operations - Three Months Ended  
March 31, 2003 and 2002 .....4

Consolidated Statements of Cash Flows - Three Months Ended  
March 31, 2003 and 2002 .....5

Notes to Unaudited Consolidated Financial Statements .....6

Item 2. Management's Discussion and Analysis of Financial Condition and  
Results of Operations .....16

Item 3. Qualitative and Quantitative Disclosures About Market Risk .....24

Item 4. Controls and Procedures.....24

PART II. OTHER INFORMATION

Item 1. Legal Proceedings .....24

Item 2. Changes in Securities and Use of Proceeds .....24

Item 3. Defaults Upon Senior Securities .....25

Item 4. Submission of Matters to a Vote of Security Holders .....25

Item 5. Other Information .....25

Item 6. Exhibits and Reports on Form 8-K .....35

SIGNATURES.....35

CERTIFICATIONS.....36

EXHIBITS.....38

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

FASTNET CORPORATION AND SUBSIDIARIES

# Edgar Filing: FASTNET CORP - Form 10-Q

## CONSOLIDATED BALANCE SHEETS

	MARCH 31, 2003	DE
	-----	-----
	(Unaudited)	
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents .....	\$ 1,057,985	\$
Accounts receivable, net of allowance of \$2,016,907 and \$1,949,041 ...	4,578,060	
Receivables due from bankruptcy estate of acquiree (Note 2) .....	1,484,855	
Other current assets .....	971,355	
	-----	-----
Total current assets .....	8,092,255	1
PROPERTY AND EQUIPMENT, net .....	12,156,500	1
INTANGIBLES, net of accumulated amortization of \$3,580,736 and \$3,288,368..	2,908,264	
GOODWILL (NOTE 1) .....	14,571,017	1
OTHER ASSETS .....	706,769	
	-----	-----
	\$ 38,434,805	\$ 4
	=====	=====
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt .....	\$ 780,241	\$
Current portion of capital lease obligations .....	3,557,413	
Accounts payable .....	7,870,289	
Payable due to bankruptcy estate of acquiree .....	2,500,000	
Accrued expenses .....	3,901,273	
Deferred revenues .....	5,597,432	
Accrued restructuring costs .....	956,642	
	-----	-----
Total current liabilities .....	25,163,290	2
LONG-TERM DEBT .....	1,869,766	
CAPITAL LEASE OBLIGATIONS .....	40,735	
RESTRUCTURING COSTS .....	2,678,380	
OTHER LIABILITIES .....	98,113	
COMMITMENTS AND CONTINGENCIES (Notes 1, 8, 9 and 10)		
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred stock (10,000,000 shares authorized, 3,406,293 shares issued and outstanding) .....	2,253,871	
Common stock (50,000,000 shares authorized, 25,572,323 shares issued and outstanding) .....	76,180,713	7
Deferred stock compensation .....	(38,291)	

Edgar Filing: FASTNET CORP - Form 10-Q

Note receivable from shareholder .....	(496,569)	
Accumulated deficit .....	(68,315,203)	(6
Less - Treasury stock, 1,000,000 shares, at cost .....	(1,000,000)	(
	-----	----
Total shareholders' equity .....	8,584,521	1
	-----	----
	\$ 38,434,805	\$ 4
	=====	=====

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

3

FASTNET CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31,	
	2003	2002
	-----	-----
REVENUES .....	\$ 8,126,378	\$ 4,319,
OPERATING EXPENSES:		
Cost of revenues (excluding depreciation) .....	5,065,567	1,924,
Selling, general and administrative (excluding depreciation) ...	3,529,210	2,277,
Depreciation and amortization .....	2,014,774	1,898,
	-----	-----
	10,609,551	6,100,
	-----	-----
Operating loss .....	(2,483,173)	(1,780,
	-----	-----
OTHER INCOME (EXPENSE):		
Interest income .....	12,104	42,
Interest expense .....	(133,854)	(63,
Other .....	(8,487)	(5,
	-----	-----
	(130,237)	(26,
	-----	-----
NET LOSS .....	(2,613,410)	(1,807,
	-----	-----
Deemed Dividend - Beneficial Conversion Feature .....	--	(370,
NET LOSS APPLICABLE TO COMMON SHAREHOLDERS .....	\$ (2,613,410)	\$ (2,178,
	=====	=====

## Edgar Filing: FASTNET CORP - Form 10-Q

BASIC AND DILUTED NET LOSS PER COMMON SHARE .....	\$ (0.10)	\$ (0)
	=====	=====
SHARES USED IN COMPUTING BASIC AND DILUTED		
NET LOSS PER COMMON SHARE .....	25,380,879	20,684,
	=====	=====

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

4

### FASTNET CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	THR
	200
	-----
OPERATING ACTIVITIES:	
Net loss .....	\$ (2,613
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization .....	2,014
Amortization of debt discount .....	3
Amortization of deferred stock compensation .....	6
Stock-based compensation expense .....	10
Provision for doubtful accounts .....	128
Interest income on Note Receivable from shareholder .....	(6
Changes in operating assets and liabilities:	
Decrease (increase) in assets:	
Accounts receivable .....	1,179
Other current and non-current assets .....	(533
Increase (decrease) in liabilities:	
Accounts payable and accrued expenses .....	(433
Deferred revenues .....	(885
Accrued restructuring .....	(188
Other liabilities .....	(10
	-----
Net cash used in operating activities .....	(1,327
	-----
INVESTING ACTIVITIES:	
Purchases of property and equipment .....	(50
Cash paid for acquisitions, net .....	
Purchases of marketable securities, net .....	
	-----
Net cash used in investing activities .....	(50
	-----
FINANCING ACTIVITIES:	
Repayments of long-term debt .....	(9

**Edgar Filing: FASTNET CORP - Form 10-Q**

Repayments of capital lease obligations .....	(151)
	-----
Net cash used in investing activities .....	(161)
	-----
NET DECREASE IN CASH AND CASH EQUIVALENTS .....	(1,538)
CASH AND CASH EQUIVALENTS, beginning of period .....	2,596
	-----
CASH AND CASH EQUIVALENTS, end of period .....	\$ 1,057
	=====

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

FASTNET CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(1) THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BACKGROUND

FASTNET Corporation and its subsidiaries ("FASTNET" or the "Company") have been providing Internet access and enhanced products and services to its customers since 1994. The Company is an Internet services provider to businesses and residential customers located in selected primary and secondary markets in the mid-Atlantic region of the United States. The Company complements its Internet access services by delivering a wide range of enhanced products and services that are designed to meet the needs of its target customer base.

LIQUIDITY AND GOING CONCERN

References made to the "liquidity and capital resources" section contained elsewhere in this Form 10-Q.

The Company's business plan has required substantial capital to fund operations, capital expenditures, and acquisitions. The Company modified its business strategy in October 2000. Simultaneous with the modification of its strategic plan, the Company recorded a restructuring charge primarily related to network and telecommunication optimization and cost reduction, facility exit costs, realigned marketing strategy, and involuntary employee terminations. These actions reduced the Company's cash consumption. In December 2001 and December 2002, the Company recorded additional restructuring charges related to excess data center facilities and office space that are non-cancelable commitments of the Company. The Company intends to continue to pursue subleasing these facilities to minimize any potential cash expenditures; however, the Company may not be able to sublease these facilities.

The Company has incurred losses since inception and expects to continue to incur losses in 2003. As of March 31, 2003, the Company's accumulated deficit was \$68,315,203. As of March 31, 2003, cash and cash equivalents were \$1,057,985. The Company's working capital deficit is \$17,071,035 as of March 31, 2003. The Company cannot provide assurance that working capital will be sufficient to fund operations to the end of 2003. However, the Company believes that its existing cash and cash equivalents, cash flows from operations, anticipated debt and lease financing may be sufficient to meet its working

## Edgar Filing: FASTNET CORP - Form 10-Q

capital and capital expenditure requirements to the end of 2003, assuming satisfactory negotiation of capital lease obligations, which are included in current liabilities (see Note 8), the repayment of the receivables collected on behalf of the Company due to the estate of AppliedTheory and the renegotiation and or settlement of other liabilities such as property leases, acquisition debt and network term obligations. The Company is currently negotiating settlement of the equipment leases with the respective vendors related to the Netaxs, Inc. and AppliedTheory acquisitions. These leases have been accordingly classified as current liabilities. These settlement proposals include alternative capital lease terms including options for early retirement of the lease obligations, as well as an extension of the payment schedule. The Company has suspended payments of these capital lease obligations, and, as a result may be considered to be in default of the terms of the obligations. The Company may also suspend the payment of other debt and lease payments and enter into negotiations to obtain more favorable payment terms. The Company cannot give assurance as to the satisfactory outcome or timing of these negotiations.

Given the current climate of the economy and the technology sector, we believe that it will be extremely difficult for us to obtain additional financing on acceptable terms, if at all. As part of management's plans to address these liquidity issues, the Company has retained DH Capital, LLC as a financial advisor to assist in raising equity and evaluating strategic alternatives, including the sale of all or a part of our company. If we are unable to secure the necessary financing to continue to fund our operations, we may be required to reduce the scope of our operations by, among other things, closing certain markets and making further reductions in head count or suspend payments to suppliers. In addition, if we are unable to pay our contractual and other contingent commitments when due, our suppliers may suspend service to us. Any of these events could harm our business, financial condition, cash flows or results of operations. In addition, to the extent we are able to raise capital through the issuance of equity securities, including the issuance of Common stock or Preferred stock, such issuances likely will dilute our current shareholders.

In April 2003, the Company entered into a Loan and Security Agreement with a commercial lender. The Company may borrow up to \$1,000,000 based on 75% of eligible accounts receivable as defined in the agreement (see Note 9). As of April 30, 2003, we had approximately \$712,000 outstanding under this Equinox loan and security agreement. Future availability under this line of credit will be determined based upon our billings and collections. As a result of our current liquidity situation, we believe that we may be considered to be in default under this loan and security agreement, as we may be deemed to be in breach of several representations and warranties made to Equinox under the loan and security agreement, including, but not limited to, that we are not in default under any agreement to which we are a party and which default would have a material adverse effect on the Company; that we are not in default in the payment, when due, of any principal of or interest on any indebtedness from any borrowing; and that we are able to pay our debts as they mature. If we are determined to be in default under this agreement, Equinox will have the right to

6

institute certain remedies against us, including, but not limited to, requiring the immediate payment of outstanding indebtedness under the agreement; increasing the effective interest rate and related fees in connection with advances under the credit line; and electing to take possession of the collateral securing the outstanding indebtedness, which currently constitutes all of our assets. To the extent that an event of default is determined to have occurred under the agreement and that Equinox is unwilling to waive any such default, we do not believe that we would be able to repay the outstanding

## Edgar Filing: FASTNET CORP - Form 10-Q

indebtedness under the agreement. In addition, to the extent that Equinox elects to exercise any available remedies against us under the terms of the agreement, such events would have a material adverse effect on our operations and cash flows. The Company has continued to explore other financing alternatives, including an equipment term loan, to fund our ongoing operations. The Company cannot provide assurance as to the potential success of these efforts or the potential dilution to existing shareholders that may occur if it should raise equity or debt capital. Furthermore, additional financing may not be available when needed or, if available, such financing may not be on terms favorable to the Company. If such sources of financing are insufficient or unavailable, or if the Company experiences shortfalls in anticipated revenue or increases in anticipated expenses, the Company may need to make operational changes to decrease cash consumption. These changes may include closing certain markets and making further reductions in head count, among other things. Any of these events could harm the Company's business, financial condition, cash flows or results of operations.

Sufficient working capital will depend on several factors including improved and extended credit terms from vendors, improvement in accounts receivable turnover, satisfactory negotiations of capital lease obligations that are included in current liabilities (see Note 8), the renegotiation of acquisition indebtedness and repayment of the accounts receivables collected by ClearBlue on behalf of FASTNET due to the estate of AppliedTheory. The Company cannot give assurance as to the potential success or outcome of these initiatives. The Company is also pursuing the recovery of tax refunds, and customer cancellation fees, which may provide additional sources of working capital. However, the Company cannot give assurance of the potential collectibility or timing of these items.

The Company is subject to those risks associated with companies in the telecommunications industry. The Company's future results of operations involve a number of risks and uncertainties. Factors that could affect the Company's future operating results and cause actual results to vary materially from expectations include, but are not limited to, risks from competition, new products and technological change, price and margin pressures and capital availability.

### QUARTERLY FINANCIAL INFORMATION AND RESULTS OF OPERATIONS

The accompanying unaudited financial information for the three months ended March 31, 2003 and 2002 has been prepared in accordance with accounting principles generally accepted in the United States of America. In the opinion of management, all significant adjustments, consisting of only normal and recurring adjustments, have been included in the accompanying unaudited financial statements. Operating results for the three months ended March 31, 2003 are not necessarily indicative of the results that may be expected for the full year. While the Company believes that the disclosures presented are adequate to make the information not misleading, these Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the notes included in the Company's latest annual report on Form 10-K.

### PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of FASTNET and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

### USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America require management to make estimates and assumptions that affect the reported amounts of assets and

## Edgar Filing: FASTNET CORP - Form 10-Q

liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### COMPREHENSIVE LOSS

The Company follows Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income." SFAS No. 130 requires companies to classify items of other comprehensive income (loss) by their nature in a financial statement and display the accumulated balance of other comprehensive income (loss) separately in the shareholders' equity section of the consolidated balance sheets. For the three months ended March 31, 2003 and 2002, comprehensive loss was as follows:

7

	THREE MONTHS ENDED	
	MARCH 31, 2003	MARCH 31, 2002
	-----	-----
Net loss .....	\$(2,613,410)	\$(1,807,662)
Unrealized gain (loss) on marketable securities ...	--	(2,904)
	-----	-----
Comprehensive loss .....	\$(2,613,410)	\$(1,810,566)
	=====	=====

### REVENUE RECOGNITION

Revenues include one-time and ongoing charges to customers for accessing the Internet. One-time charges primarily relate to the initial connection fees and are recognized as revenue over the term of the customer contract. The Company recognizes ongoing access revenue over the period the services are provided. The Company offers contracts for Internet access that are generally billed in advance of providing service. These advance billings are recorded as deferred revenues and recognized to revenue ratably over the service period as they are earned.

Revenues are also derived from web hosting services. The Company sells its web hosting and related services for contractual periods ranging from one to twelve months. These contracts generally are cancelable by either party without penalty. Revenues from these contracts are recognized ratably over the contract period as services are provided. Incremental fees for excess bandwidth usage and data storage are billed and recognized as revenue in the period in which customers utilize such services.

Revenues also include professional services from web design and development related projects. Revenues from professional services and web design and development related projects are recognized as the services are provided by using the percentage-of-completion method. This method is used over a period of time that commences with an execution of the project agreement and ends when the project is complete. Any anticipated losses on contracts are recorded to earnings when identified. Amounts received or billed in excess of revenues recognized to date are classified as deferred revenues, whereas revenues recognized in excess of amounts billed are classified as unbilled accounts receivable and are included in accounts receivable in the accompanying consolidated balance sheets.

## Edgar Filing: FASTNET CORP - Form 10-Q

### STOCK-BASED COMPENSATION

The Company accounts for stock-based compensation to employees and directors using the intrinsic value method in accordance with Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. The Company accounts for stock-based compensation to non employees using the fair value method in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" and Emerging Issues Task Force Issue No. 96-18, "Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring or in Conjunction with Selling, Goods or Services."

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure", an amendment of FASB Statement No. 123. This Statement amends FASB Statement No. 123, "Accounting for Stock-Based Compensation", to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement No. 123 to require prominent disclosures in both annual and interim financial statements. The Company will continue to account for stock-based compensation in accordance with APB No. 25. As such, the Company does not expect this standard to have a material impact on its consolidated financial position or results of operations. The Company has adopted the disclosure-only provisions of SFAS No. 148 at March 31, 2003.

The following table illustrates the effect on net loss if the fair-value based method had been applied to all outstanding and unvested awards in each period:

	FOR THE QUARTER ENDED MARCH 31,	
	2003	2002
Net loss applicable to common shareholders - as reported ....	\$(2,613,410)	\$(2,178,021)
Add: stock-based compensation included in net loss .....	6,297	6,297
Deduct: total stock-based employee compensation .....	(145,506)	(160,281)
	\$ (2,752,619)	\$ (2,332,005)
Net loss - pro forma .....	\$ (2,752,619)	\$ (2,332,005)
Basic and diluted net loss per Common share - as reported ...	\$ (0.10)	\$ (0.11)
Basic and diluted net loss per Common share - pro forma .....	\$ (0.11)	\$ (0.11)

8

### MAJOR CUSTOMERS

The Company derived approximately 7% and of total revenues for the three months ended March 31, 2003 from one customer. As of March 31, 2003, the Company had outstanding accounts receivable from this customer of \$211,000.

### GOODWILL AND OTHER INTANGIBLE ASSETS

Effective January 1, 2002, the Company adopted SFAS No. 142,

## Edgar Filing: FASTNET CORP - Form 10-Q

"Goodwill and Other Intangible Assets". SFAS No. 142 no longer permits the amortization of goodwill and indefinite-live intangible assets. Instead, these assets must be reviewed annually for impairment in accordance with this statement. Accordingly, the Company has ceased amortization of all goodwill and indefinite-live intangible assets as of January 1, 2002. During the second quarter of 2002, the Company completed the transitional impairment test of goodwill and other intangible assets, which indicated that the goodwill and other intangible assets were not impaired. Other intangible assets that meet the new criteria continue to be amortized (see Note 5). As a result of the annual impairment test completed in December 2002, the Company recognized impairment charges of \$2,339,000 to reduce goodwill and \$1,411,000 to reduce identified intangible assets. The fair value of the identified intangible assets was determined using the expected present value of future cash flows. Fair value to measure the impairment of goodwill was estimated using primarily the market capitalization of the Company's Common stock over a reasonable period of time.

There were no changes in the carrying amount of goodwill during the three months ended March 31, 2003. In accordance with SFAS 142, the Company annually performs a goodwill impairment analysis. The Company will be performing its impairment test in the fourth quarter of 2003, unless a circumstance or event occurs prior to that date to warrant an evaluation. In conjunction with the impairment tests under SFAS No. 142, the Company will also test its identified intangible assets for impairment under SFAS No. 144. The Company is required to perform a impairment analysis of its identified intangible assets under SFAS No. 144 and record an impairment charge and writedown of such assets, if any, prior to recording an impairment charge for goodwill. The SFAS No. 142 and SFAS No. 144 impairment tests may require the Company to record a non-cash charge in the future to write-down a significant portion of its goodwill and identified intangible assets.

### RECENT ACCOUNTING PRONOUNCEMENTS

In June 2002, the Financial Accounting Standards Board issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", which requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred and nullifies EITF 94-3. The Company adopted SFAS No. 146 in January 2003. The adoption of this statement did not have a material effect on the Company's future results of operations.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirement for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an Interpretation of FASB Statements No. 5, 57 and 107 and a Rescission of FASB Interpretation No. 34." This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. The Interpretation also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation are applicable to guarantees issued or modified after December 31, 2002 and are not expected to have a material effect on our financial statements. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure", an amendment of FASB Statement No. 123. This Statement amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement No. 123 to require prominent disclosures in both annual and interim financial statements. Certain of these disclosure modifications are required for

## Edgar Filing: FASTNET CORP - Form 10-Q

fiscal years ending after December 15, 2002 and are included in the notes to these consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation Of Variable Interest Entities, and An Interpretation Of ARB No. 51." This Interpretation addresses the consolidation by business enterprises of variable interest entities as defined in the Interpretation. The Interpretation applies immediately to variable interests in variable interest entities created after January 31, 2003, and to variable interests in variable interest entities obtained after January 31, 2003. The Company did not believe that it has any variable interest entities.

### (2) 2002 ACQUISITIONS

All acquisitions have been accounted for using the purchase method of accounting pursuant to SFAS No. 141, "Business Combinations."

9

#### SUPERNET, INC.

On January 31, 2002, the Company acquired all the outstanding capital stock of SuperNet, Inc. ("SuperNet"), an Internet service provider headquartered in East Brunswick, New Jersey. SuperNet provides Internet access to businesses and residential customers, as well as web hosting and colocation services to customers located in the central New Jersey region. The total purchase price was \$1,593,000, including transaction costs. The purchase price consisted of 1,096,907 unregistered shares of the Company's Common stock valued at \$1,064,000, or \$0.97 per share, the fair market value at the date of acquisition. The excess of the purchase price over the fair value of net assets acquired was determined to be \$1,790,945. Based on an independent valuation, \$500,000 of the excess purchase price was allocated to customer relationships and the remaining \$1,290,945 was allocated to goodwill, none of which is deductible for tax purposes. The customer relationships are being amortized on a straight-line basis over a five-year period. In accordance with SFAS No. 142, the goodwill is not being amortized.

#### NETAXS, INC.

On April 4, 2002, the Company acquired all the outstanding capital stock of Netaxs, Inc. ("Netaxs"), an Internet access, web hosting and colocation provider located in the Philadelphia, Pennsylvania area. The aggregate consideration paid was \$984,690 in cash, the issuance of promissory notes to certain shareholders of Netaxs having an aggregate principal amount of \$2,514,898 (see Note 9), and 4,040,187 shares of unregistered Common stock valued at \$4,080,589, or \$1.01 per share, the fair value of the Company's Common stock at the date of acquisition. The principal due under the notes accrues interest at a rate of 7.09% per annum, and the notes are payable in monthly installments through October 2005. The excess of purchase price over the fair value of net assets acquired was estimated to be \$8,140,600. Based on an independent valuation, \$400,000 was allocated to customer relationships, \$100,000 to trade names and the remaining \$7,640,600 was allocated to goodwill. The customer relationships and trade names are being amortized on a straight-line basis over a three-year period. In accordance with SFAS No. 142, the goodwill is not being amortized.

#### APPLIEDTHEORY CORPORATION

On May 31, 2002, the Company, through a wholly-owned subsidiary,

Edgar Filing: FASTNET CORP - Form 10-Q

acquired selected assets of AppliedTheory Corporation and its subsidiaries ("AppliedTheory"). AppliedTheory was an Internet services business headquartered in Syracuse, New York. The United States Bankruptcy Court for the Southern District of New York approved the terms of the Asset Purchase Agreement by an order dated May 25, 2002, as a result of the voluntary petition for bankruptcy filed by AppliedTheory under Chapter 11 of the U.S. Bankruptcy Code. Under the terms of the Asset Purchase Agreement, the Company paid \$4,000,000 in cash for certain customers and fixed assets and assumed capital lease obligations and other liabilities. The Company agreed to use its good faith efforts to collect the accounts receivable of the acquired customer base in existence on the Closing Date (the "Closing Receivables") on behalf of AppliedTheory, and to remit to the Bankruptcy Court on or prior to December 31, 2002, no less than an aggregate of \$2,500,000 of the Closing Receivables. The Company has guaranteed this payment to the Bankruptcy Court. The Company had not remitted the \$2,500,000 of Closing Receivables at March 31, 2003. The Company is currently making a claim to reduce the amount of the Closing Receivables Guaranty and is involved in a dispute regarding whether certain collections including collections made by third parties, count against the Closing Receivables Guaranty.

Based upon collection information provided to the Company to date, ClearBlue, an unrelated acquirer of a substantial portion of the AppliedTheory business, has collected approximately \$1,320,000 of the Closing Receivables and the Estate of AppliedTheory (the "Estate") has collected approximately \$210,000. The Company has directly collected approximately \$815,000 of the AppliedTheory Closing Receivables purchased. The Company has requested ClearBlue to forward the amounts it has collected on FASTNET's behalf directly to the Estate. The Company has requested, but not yet received, confirmation of the amounts collected directly by the Estate. As a result, the receivables related to the ClearBlue and Estate collections have not been offset against the amount due to the Estate as of March 31, 2003. The Company expects to collect these amounts. However, if ClearBlue does not remit these payments to the Estate, the Company may be required to remit any shortfalls. See Note 10 for legal action in connection with this acquisition.

The excess of the purchase price over the fair value of net assets acquired was estimated to be \$5,027,062. Based on an independent valuation, \$3,800,000 was initially allocated to customer relationships and \$1,227,062 was allocated to goodwill. The Company recorded an impairment charge in the amount of \$1,411,000 in accordance with SFAS No. 144 during 2002 related to the AppliedTheory customer lists. The customer relationships are being amortized on a straight-line basis over a three-year period. In accordance with SFAS No. 142, the goodwill is not being amortized.

10

The following table lists noncash assets that were acquired and liabilities that were assumed as part of the above acquisitions:

	SuperNet ----- (January 2002)	Netaxs ----- (April 2002)	Applied Theory ----- (May 2002)
Noncash assets (liabilities) acquired:			
Accounts receivable .....	\$ 50,978	\$ 524,574	\$ 2,300,000
Other assets .....	4,380	225,971	--

Edgar Filing: FASTNET CORP - Form 10-Q

Property and equipment .....	64,124	2,537,037	4,112,752
Intangibles .....	1,790,945	8,140,600	5,027,062
Accounts payable .....	(207,569)	(1,762,499)	(250,000)
Accrued expenses .....	(181,586)	(2,448,237)	(619,384)
Deferred revenues .....	(77,003)	(679,069)	(2,379,939)
Debt and capital lease obligations..	--	(2,175,320)	(1,690,491)
Other liabilities .....	--	(969,857)	(2,500,000)
Acquired net assets .....	1,444,269	3,393,200	4,000,000
	-----	-----	-----
Less--Common stock issued .....	(1,064,000)	(4,080,589)	--
Less--Notes issued .....	--	(2,514,898)	--
	-----	-----	-----
Cash paid (acquired), net .....	\$ 380,269	\$ (3,202,287)	\$ 4,000,000
	=====	=====	=====

(3) CASH AND CASH EQUIVALENTS

The Company considers all highly liquid debt investments purchased with an original maturity of ninety days or less to be cash equivalents.

(4) PROPERTY AND EQUIPMENT

As of March 31, 2003 and December 31, 2002, property and equipment consists of the following:

	MARCH 31, 2003	DECEMBER 31, 2002
	-----	-----
Equipment .....	\$ 24,742,071	\$ 24,702,622
Computer equipment .....	2,571,735	2,569,726
Computer software .....	1,765,961	1,760,825
Furniture and fixtures .....	729,485	729,485
Leasehold improvements .....	2,619,490	2,615,855
	-----	-----
	32,428,741	32,378,514
Less--Accumulated depreciation ...	(20,272,241)	(18,650,318)
	-----	-----
	\$ 12,156,500	\$ 13,728,196
	=====	=====

Depreciation expense for the three months ended March 31, 2003 and 2002 was \$1,622,406 and \$1,660,214, respectively. The net carrying value of property and equipment under capital leases was \$1,612,570 and \$1,799,060 at March 31, 2003 and December 31, 2002, respectively.

(5) INTANGIBLE ASSETS

Intangible assets, other than goodwill, consist of the following:

	MARCH 31, 2003			DECEMBER 31, 2002
	GROSS			
USEFUL	CARRYING	ACCUMULATED	NET	
LIFE	AMOUNT	AMORTIZATION		
-----	-----	-----	-----	-----

Edgar Filing: FASTNET CORP - Form 10-Q

Customer relationships.....	3-5 years	\$ 5,789,000	\$ (3,301,244)	\$ 2,487,756	\$ 2,
Developed technology.....	5 years	600,000	(246,159)	353,841	
Trade names.....	3 years	100,000	(33,333)	66,667	
		-----	-----	-----	-----
Total.....		\$ 6,489,000	\$ (3,580,736)	\$ 2,908,264	\$ 3,
		=====	=====	=====	=====

11

Amortization of intangibles was \$292,368 and \$238,333 for the three months ended March 31, 2003 and 2002, respectively. Amortization expense is estimated as follows: \$1,169,491 for the year ended March 31, 2004; \$1,169,491 for the year ended March 31, 2005; \$427,645 for the year ended March 31, 2006, and \$141,637 for the year ended March 31, 2007.

(6) ACCRUED EXPENSES

	MARCH 31, 2003	DECEMBER 31, 2002
	-----	-----
Professional fees .....	\$ 392,554	\$ 481,533
Accrued compensation and related payroll taxes .....	910,819	1,482,260
Accrued interest .....	549,268	452,793
Other .....	2,048,632	2,305,305
	-----	-----
	\$3,901,273	\$4,721,891
	=====	=====

Approximately \$607,000 of the accrued compensation and payroll taxes as of March 31, 2003 relates to payroll taxes that were unpaid to the Internal Revenue Service ("IRS") as of the acquisition date of Netaxs. Effective September 30, 2002, the Company reached a settlement agreement with the note holders to reduce the balance of the notes issued to certain former shareholders of Netaxs by the amount of the initial liability recorded, which was \$1,060,000 (see Note 9). The Company has received conditional approval from the IRS of its proposed tax repayment plan and request for abatement of penalties subject to satisfaction of the liability in accordance with the proposed payment plan. Management of the Company believes that the amount recorded as a liability as of March 31, 2003 is sufficient to cover any future costs relating to this matter.

(7) RESTRUCTURING CHARGES

In October 2000, the Company announced a restructuring to its business operations and this restructuring plan provided for the suspension of selling and marketing efforts in 12 of the 20 markets that were operational as of September 30, 2000 (the "2000 Restructuring Plan") and a reduction in force. Selling and marketing efforts are now focused on targeted markets located in Pennsylvania, New York and New Jersey. The 2000 Restructuring Plan included redesigning the network architecture intended to achieve an overall reduction in telecommunication expenses. The Company recorded a restructuring charge of \$5,193,503 in 2000 related to the 2000 Restructuring Plan.

The Company has ceased all sales and marketing activities in the 12 closed markets and is negotiating the exit of the facilities, where practicable. Telecommunication exit and termination costs relate to contractual obligations the Company is unable to cancel for network and related cost in the closed markets. These costs consist of both Internet backbone connectivity cost, as well as network and access costs. These services are no longer required in the

## Edgar Filing: FASTNET CORP - Form 10-Q

closed markets. Leasehold termination payments include carrying costs and rent expense for leased facilities located in non-operational markets. The Company is actively pursuing both sublease opportunities as well as full lease terminations.

Throughout 2001 and 2002, the Company reviewed the reserves that were established in 2000 as part of its 2000 Restructuring Plan. In the fourth quarters of 2001 and 2002, the Company recorded additional charges of \$1,335,790 and \$2,839,683, respectively, related to its excess and idle data centers and administrative offices. The amount of the charges were determined using assumptions regarding the Company's ability to sublet or dispose of these facilities. These decisions were made as the Company experienced significant difficulties in attempting to dispose of or sublet these facilities due to the continuing decline and overall slowdown in the economy and, in particular, the commercial real estate market. The Company has been continuing its efforts to dispose of or sublet these facilities. Included in the charge recorded in 2002 was the present value of the remaining lease payments and associated costs of the Company's executive offices. The Company decided in 2002 to vacate and offer its administrative offices for sublease and consolidate these employees into other FASTNET main office space effective July 1, 2003. The total amount of lease payments relating to these excess or idle facilities is approximately \$4.3 million through 2010.

The activity in the restructuring charge accrual during the three months ended March 31, 2003 is summarized in the table below:

12

	ACCRUED RESTRUCTURING AS OF DECEMBER 31, 2002 -----	CASH PAYMENTS DURING THE THREE MONTHS ENDED MARCH 31, 2003 -----	ACCRUED RESTRUCTURING AS OF MARCH 31, 2003 -----
Telecommunications exit and termination fees ...	\$ 233,980	\$ --	\$ 233,980
Sales and marketing contract terminations .....	2,321	--	2,321
Facility exit costs .....	3,587,108	(188,387)	3,398,721
	-----	-----	-----
	\$ 3,823,409	\$ (188,387)	\$ 3,635,022
	=====	=====	=====

During the second quarter of 2003, the Company ceased making payments on most of the leases included in the restructuring reserve and as a result, may be considered in default of these agreements.

### (8) CAPITAL LEASE OBLIGATIONS

The Company is currently engaged in discussions with certain vendors for the renegotiation of capital leases of approximately \$3.5 million. Accordingly, all outstanding amounts related to these leases have been classified as current. The Company is actively pursuing measures to restructure this liability. The Company is not currently making any payments on these obligations and as a result may be considered to be in default of the capital lease obligations.

Edgar Filing: FASTNET CORP - Form 10-Q

(9) DEBT

As of March 31, 2003 and December 31, 2002 debt consisted of the following:

	MARCH 31, 2003	DECEMBER 31, 2002
	-----	-----
NetReach Notes .....	\$ 743,430	\$ 743,430
NetAxs Notes .....	1,654,812	1,654,812
Other .....	251,765	257,308
	-----	-----
	2,650,007	2,655,550
Less--Current portion .....	(780,241)	(728,063)
	-----	-----
	\$ 1,869,766	\$ 1,927,487
	=====	=====

NetReach Notes  
-----

In conjunction with the NetReach acquisition, the Company issued various notes payable in the aggregate of \$760,000 (the "NetReach Notes"). Of the \$760,000 total notes payable, \$430,000 are convertible notes that convert into the Company's Common stock at a conversion price of \$2.00 per share. Additionally, if the closing price of the Company's Common stock is at least \$3.00 per share for any consecutive 30 calendar days, the Company shall have the right to convert all of the outstanding principal and interest due under the convertible notes into unregistered shares of the Company's Common stock at a conversion price equal to \$2.00 per share. The convertible notes bear interest at 8.0% and mature in October 2004. Additionally, several of the convertible notes were issued with warrants to purchase a total of 52,140 shares of the Company's Common stock at exercise prices ranging from \$1.89 to \$7.57 per share. The warrants expire at various dates from February 9, 2008 through October 17, 2008. The Company valued the warrants using the Black-Scholes option-pricing model and recorded a debt discount of \$29,581 related to the warrants. The discount is being expensed over the terms of the convertible notes. Interest expense related to the debt discount was \$2,465 for the quarters ended March 31, 2003 and 2002.

The remaining balance of the NetReach Notes of \$330,000 are demand notes. The demand notes bear interest at 8.0%. Of the total demand notes payable, \$215,000 is due no earlier than May 1, 2003 and \$115,000 are due no earlier than November 1, 2004. Interest expense related to the NetReach Notes (excluding the debt discount) was \$15,200 for the quarters ended March 31, 2003 and 2002. The Company has not satisfied the \$215,000 payment referenced above due May 1, 2003.

Netaxs Notes  
-----

In connection with the Netaxs acquisition in April 2002, the Company issued promissory notes to certain shareholders of Netaxs having an aggregate principal amount of \$2,514,898 ("Netaxs Notes"). The principal due under these

notes accrue interest at a rate of 7.09% per annum and is payable in monthly principal installments through October 2005. Subsequent to the Company's

## Edgar Filing: FASTNET CORP - Form 10-Q

acquisition of Netaxs, it was determined that Netaxs owed certain federal and state payroll related liabilities of approximately \$767,000, exclusive of penalty and interest charges. The Company determined that it has a right of offset of this liability against the promissory notes and the escrowed indemnity property of the former shareholders of Netaxs. The Company and the former principal shareholders of Netaxs have reached agreement to offset payments of these liabilities against the notes. Effective October 2002, the Company began making payments under a repayment plan proposed by the Company to the taxing authorities. In October 2002, the Company remitted an initial payment of \$309,000 to the taxing authorities and is remitting \$45,000 per month through June 2003, exclusive of penalties and interest. Accordingly, the note balances have been reduced by approximately \$1,060,000, including penalties and interest, which is estimated to be due to the tax authorities.

Interest expense related to the Netaxs notes was \$24,723 for the quarter ended March 31, 2003. Future maturities on the notes as of March 31, 2003 are \$305,801 through March 31, 2004, \$770,738 through March 31, 2005, and \$318,274 through March 31, 2006.

In connection with the Netaxs acquisition, the Company acquired certain notes payable due to a shareholder of the Company and a company owned by a shareholder of the Company. The notes bear interest at 10% per annum. The balance of these notes is \$253,220 as of March 31, 2003. Interest expense related to the notes was \$6,399 for the quarter ended March 31, 2003, respectively. Future maturities on the notes as of March 31, 2003 are \$17,467 through March 31, 2004, \$18,099 through March 31, 2005, \$13,709 through March 31, 2006, \$15,145 through March 31, 2007, \$16,731 through March 31, 2008 and \$172,069 thereafter.

### Note Payable

-----

In April 2003, the Company, as borrowers entered into a loan and security agreement with a commercial finance lender. Pursuant to the terms and conditions of the loan and security agreement, the lender may, in its sole discretion, make revolving credit advances to FASTNET and issue letters of credit on behalf of FASTNET eligible up to a maximum principal amount of \$1,000,000, but in no event greater than 75% of the value of qualified accounts receivable of FASTNET as defined in the loan and security agreement. The obligations under the loan and security agreement are secured by all of the assets of FASTNET. The interest rate is equal to the greater of either 8.00%, or the sum of the Prime Rate plus 4.50% and interest on the unpaid principal balance of the loans is payable in arrears on the last day of each month. FASTNET is charged interest based upon a minimum loan balance of \$750,000. The term of the loan and security agreement is initially for a period of two years; provided however, the lender may terminate the loan and security agreement at any time upon 60 days notice and FASTNET may terminate the loan and security agreement at any time upon 30 days notice. Refer to Note 1 for additional information regarding this loan. See discussion in liquidity and capital resources and capital resources regarding the Company's compliance with this loan agreement.

### Other Convertible Note

-----

On October 25, 2000, the Company entered into an agreement with an investor to provide the Company with financial advisory services. The agreement was amended on February 12, 2001 and expired on June 30, 2001. In exchange for these services, the Company issued a convertible note for \$250,000. This note is due on October 24, 2003 and is convertible into 221,239 shares of Common stock. No interest or dividends are payable on this note. Accordingly, a discount was recorded on the note and is being amortized over the term of the note. As of

Edgar Filing: FASTNET CORP - Form 10-Q

March 31, 2003, the recorded balance of the note was \$224,449.

(10) COMMITMENTS AND CONTINGENCIES

On January 24, 2003, the Official Committee of Unsecured Creditors for the estate of AppliedTheory filed an adversary proceeding against the Company for the recovery of approximately \$1.2 million in liabilities due Finova Capital, one of the estate's secured creditors. The core allegation of the Committee is that the Company's bid at auction for the assets purchased by the Company from AppliedTheory included the assumption of that indebtedness, which constituted direct financing leases, and that the Company should be estopped from denying its liability after the closing of the acquisition. The Company has asserted that these liabilities are not direct financing leases and that, as a result of post-auction due diligence, the Asset Purchase Agreement had been changed, with approval of the Bankruptcy Court, to exclude the Finova liability. As a result, the Company contends that the estate of AppliedTheory closed the revised deal and thereby releasing any claims regarding these Finova liabilities against the Company. As of March 31, 2003, it is too early to determine the outcome of these proceedings. The Company has not recorded a liability for this potential claim.

From time to time, the Company is involved in certain other legal actions arising in the ordinary course of business. In management's opinion, based on the advice of counsel, the outcome of such actions is not expected to have a material adverse effect on the Company's future financial position, results of operations or cash flows.

14

The Company leases office space, telecommunications services and equipment under capital and operating leases expiring through 2010. Rent expense under the operating leases was \$641,047 and \$318,766, during the quarters ended March 31, 2003 and 2002, respectively. The interest rates implicit in the capital leases range from 10.5% to 22.2%. Future minimum lease payments, including restructured leases, remaining as of March 31, 2003, are as follows:

	CAPITAL LEASES	OPERATING LEASES	TELECOMMUNICATION COMMITMENTS
	-----	-----	-----
2003 .....	3,570,655	1,527,189	8,440,711
2004 .....	40,735	1,874,142	10,046,917
2005 .....	--	1,387,726	6,413,167
2006 .....	--	490,999	1,465,806
2007.....	--	506,917	826,183
Thereafter .....	--	1,325,712	--
	-----	-----	-----
Total minimum lease payments ....	3,611,390	\$ 7,112,685	\$ 27,192,785
	=====	=====	=====
Less - Current portion .....	(3,570,655)		
	-----		
	\$ 40,755		
	=====		

11) SHAREHOLDERS' EQUITY

## Edgar Filing: FASTNET CORP - Form 10-Q

In the three months ended March 31, 2003 and 2002, the Company recorded deferred stock compensation expense of \$6,297 and \$6,297 respectively, for the amortization of defined stock compensation.

### (12) PREFERRED STOCK

As of March 31, 2003 and December 31, 2002, the Company had authorized 10,000,000 shares of no par value Preferred stock. In September and November 2001, the Company issued 3,406,293 shares of Series A Convertible Preferred stock ("2001 Series A Preferred") in two separate tranches. On September 5, 2001, the Company sold 2,506,421 shares of 2001 Series A Preferred at a purchase price of \$0.91 per share to several investors for gross proceeds of \$2,287,109 ("First Closing"). In conjunction with the sale of the 2001 Series A Preferred at the First Closing, the Company issued warrants to purchase 626,605 shares of Common stock at \$1.27 per share. The warrants expire in five years. Additionally, a founder of the Company sold 456,169 shares of Common stock to one of the 2001 Series A Preferred investors for \$0.50 per share for proceeds to the founder of \$228,085. On November 12, 2001, the Company sold an additional 790,283 shares of 2001 Series A Preferred at a purchase price of \$0.91 per share for gross proceeds of \$712,891 and issued additional warrants to purchase 197,571 shares of Common stock at \$1.27 per share to the same investors involved in the First Closing ("Second Closing"). The same founder noted above sold an additional 143,831 shares of Common stock to the same 2001 Series A Preferred investors for \$0.50 per share for proceeds to the founder of \$71,916. Additionally, the Company issued 109,589 shares of 2001 Series A Preferred to a law firm utilized by the Company in exchange for \$100,000 of professional services rendered, the fair value of the equity issued.

The Company allocated the proceeds from the First Closing to the 2001 Series A Preferred, warrants to purchase Common stock, and Common stock sold by a founder based on the relative fair values of each instrument. The fair value of the warrants issued in the First Closing was determined based on the Black-Scholes option-pricing model using a life of five years, a volatility of 100% and a risk-free interest rate of 4.529%. Accordingly, approximately \$1,802,000 of the 2001 Series A Preferred proceeds was allocated to the 2001 Series A Preferred, \$338,000 was allocated to the warrants and \$148,000 was allocated to the shares of Common stock sold by the founder. The fair values of the warrants and the Common stock have been recorded as Common stock on the accompanying consolidated balance sheets. After considering the allocation of the proceeds based on the relative fair values, it was determined that the 2001 Series A Preferred has a beneficial conversion feature ("BCF") in accordance with Emerging Issues Task Force ("EITF") Issue No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios" and EITF Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments." The Company recorded the BCF related to the First Closing of approximately \$980,000 as a discount to the 2001 Series A Preferred in the year ended December 31, 2001. The value of the BCF was recorded in a manner similar to a deemed dividend over the period from the date of issuance to the earliest known date of conversion, which was September 4, 2002. The Company allocated the proceeds from the Second Closing in the same manner as discussed above. The fair value of the warrants issued in the Second Closing was determined based on the Black-Scholes option-pricing model using a life of five years, a volatility of 100% and a risk free interest rate of 3.957%. Approximately, \$517,000 of the 2001 Series A Preferred proceeds from the Second Closing was allocated to the 2001 Series A Preferred, \$264,000 was allocated to the warrants and \$41,000 was allocated to the shares of Common stock sold by the founder. The Company recorded a BCF related to the Second Closing of approximately \$397,000 as a discount to the 2001 Series A Preferred in the year ended December 31, 2001. The value of the BCF was recorded in a manner similar to a deemed dividend over the period from the date of issuance to the earliest date of conversion, which was September 4, 2002. The Company recorded a deemed dividend - BCF of \$0 and \$370,359 in the three months ended

## Edgar Filing: FASTNET CORP - Form 10-Q

March 31, 2003 and the quarter ended March 31, 2002, respectively.

15

In addition, the terms and agreements relating to the sale of our Series A Convertible Preferred stock contain customary covenants limiting our flexibility, including covenants limiting our ability to incur additional debt, create or issue any shares of capital stock with rights senior to the holders of the Series A Convertible Preferred stock, make distributions or declare dividends, consolidate, merge or acquire other businesses and sell assets, pay dividends and other distributions, effect stock splits, and issue additional equity securities.

### (13) NET LOSS PER COMMON SHARE

The Company has presented net loss per common share pursuant to SFAS No. 128, "Earnings Per Share." Basic net loss per Common share was computed by dividing net loss by the weighted average number of shares of Common stock outstanding during the period. Diluted net loss per Common share reflects the potential dilution from the exercise or conversion of securities into Common stock, such as Preferred stock and Common stock options. Outstanding convertible Preferred stock, Common stock options and warrants are excluded from the diluted net loss per Common share calculations as the impact on the net loss per Common share using the treasury stock method is antidilutive due to the Company's net loss. The number of shares excluded from this calculation was approximately 5,887,000 for the three months ended March 31, 2003.

### (14) RELATED PARTY TRANSACTIONS

In June 1999, the Company entered into a financial arrangement, as amended, with a financial advisor, who is an affiliate of a significant shareholder of the Company ("Financial Advisor"). This agreement provided for a payment of \$320,000 due to the Financial Advisor on February 1, 2001 related to the private placement of securities, and a \$500,000 payment due upon the earlier of the consummation of an initial public offering or February 1, 2001. This \$500,000 payment was related to general strategic and advisory services rendered during the three months ended September 30, 1999. The \$500,000 was repaid in March 2000. Approximately \$310,000 remains unpaid as of March 31, 2003 and is included in accrued expenses on the accompanying consolidated balance sheets as of March 31, 2003.

In October 2000, the Company issued a \$250,000 convertible note and a warrant to purchase 120,000 shares of Common stock to the Financial Advisor for professional services rendered (see Note 9).

In November 2001, the Company issued 109,589 shares of 2001 Series A Preferred and 27,397 warrants to purchase Common stock to a legal firm used by the Company in exchange for \$100,000 of professional services rendered. The Company paid this firm approximately \$0 and \$42,042 in the three months ended March 31, 2003 and 2002, respectively.

A property owner of one of the Company's facilities is also a holder of a note acquired in connection with the NetReach acquisition. The Company paid the landlord \$20,608 and \$46,161 in the three months ended March 31, 2003 and 2002, respectively.

A customer of the Company is a shareholder. Revenues from this customer for the quarter ended March 31, 2003 were approximately \$93,000 or 1% of total revenues, while the Company currently has accounts receivable of \$494,000 with

## Edgar Filing: FASTNET CORP - Form 10-Q

this customer. A member of the Company's Board of Directors is also an officer of this customer.

In May, 2002 the Company entered into a management consulting agreement with a management consulting firm controlled by a compensated member of the Company's Board of Directors with a minimum fee due under the contract of \$2,500 per month. The agreement provides for various business financial planning, and acquisition consulting services to be provided as requested by the Company on a monthly basis. The Company paid this firm \$41,649 for the quarter ended March 31, 2003, and the firm earned, but was not issued options valued at \$10,530.

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

THE FOLLOWING DISCUSSION AND ANALYSIS SHOULD BE READ IN CONJUNCTION WITH OUR FINANCIAL STATEMENTS AND THE RELATED NOTES TO THE FINANCIAL STATEMENTS APPEARING ELSEWHERE IN THIS FORM 10-Q. THE FOLLOWING INCLUDES A NUMBER OF FORWARD-LOOKING STATEMENTS THAT REFLECT OUR CURRENT VIEWS WITH RESPECT TO FUTURE EVENTS AND FINANCIAL PERFORMANCE. WE USE WORDS SUCH AS ANTICIPATES, BELIEVES, EXPECTS, FUTURE, AND INTENDS, AND SIMILAR EXPRESSIONS TO IDENTIFY FORWARD-LOOKING STATEMENTS, AND SUCH FORWARD-LOOKING STATEMENTS INCLUDE, BUT ARE NOT LIMITED TO THE FOLLOWING: PLANS TO INCREASE COLLECTION ACTIVITY; OUR PLANS TO VACATE CERTAIN LEASED PROPERTY DURING THE SECOND QUARTER OF 2003; REDUCTIONS IN NON-ESSENTIAL GENERAL AND ADMINISTRATIVE COSTS INCLUDING PERSONNEL COSTS; POSSIBLE EXIT OF CERTAIN UNPROFITABLE MARKETS AND OR SERVICES; RENEGOTIATION OF PAYMENT TERMS OF DEBT AND SUBLEASE CERTAIN PROPERTIES; AND RECOGNITION OF DEFERRED REVENUE. READERS ARE CAUTIONED THAT ANY SUCH FORWARD-LOOKING STATEMENTS ARE NOT GUARANTEES OF FUTURE PERFORMANCE AND INVOLVE RISKS AND UNCERTAINTIES, INCLUDING: OUR ABILITY TO CONTINUE AS A GOING CONCERN; OUR ABILITY TO OBTAIN ADDITIONAL FINANCING; OUR ABILITY TO INCREASE REVENUES AND REDUCE COST OF REVENUES; ELEVATED LEVELS OF CHURN AMONGST OUR CUSTOMERS; OUR ABILITY TO SUCCESSFULLY EXECUTE OUR CURRENT BUSINESS STRATEGY; THE SUCCESSFUL RESOLUTION OF THE ADVERSARY PROCEEDING INSTITUTED AGAINST US BY THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF THE ESTATE OF APPLIEDTHEORY; SUCCESSFUL RESOLUTION OF DISPUTES RELATING TO OUR REQUIREMENT TO MAKE CERTAIN PAYMENTS UNDER OUR GUARANTEE OF UP TO \$2.5 MILLION IN ACCOUNTS RECEIVABLE TO THE ESTATE OF APPLIEDTHEORY; OUR ABILITY TO NEGOTIATE IMPROVED CREDIT TERMS FROM OUR VENDORS; OUR ABILITY TO IMPROVE OUR ACCOUNTS RECEIVABLE TURNOVER; THE NEED TO RECORD ADDITIONAL RESTRUCTURING CHARGES; AND THE OTHER FACTORS AFFECTING OPERATING RESULTS. YOU SHOULD NOT PLACE UNDUE RELIANCE ON THESE FORWARD-LOOKING STATEMENTS, WHICH APPLY ONLY AS OF THE DATE OF THIS QUARTERLY REPORT ON FORM 10-Q. THESE FORWARD-LOOKING STATEMENTS ARE SUBJECT TO RISKS AND UNCERTAINTIES THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM HISTORICAL RESULTS OR OUR PREDICTIONS, INCLUDING, WITHOUT LIMITATION, THOSE FACTORS SET FORTH IN ITEM 5 OF PART II OF THIS FORM 10-Q.

16

### OVERVIEW

We are an Internet Service Provider (ISP) offering narrow and broadband data communication services and enhanced products and services to individuals and businesses primarily in primary and second-tier markets in the mid-Atlantic portion of the United States. Our services include high-speed data and Internet services, data center services, including web hosting and managed and unmanaged colocation services, small office-home office (SOHO) Internet access, wholesale ISP services, and various professional services including eSolutions, web design and development. We focus our sales and marketing efforts on businesses in the markets we serve using the value proposition of combining our technical expertise with dedicated customer care. We approach our customers from an access

## Edgar Filing: FASTNET CORP - Form 10-Q

carrier neutral position, providing connectivity over a variety of available technologies. These include classic Telco provided point-to-point, ISDN, SMDS, ATM, and DSL and non-classic such as Layer 2 Ethernet. We also offer FASTNET controlled last mile Internet access utilizing wireless transport.

### OUR HISTORY OF OPERATING LOSSES

We have incurred operating losses in each year since our inception and expect our losses to continue through December 31, 2003 as we seek to execute our revised business plan. Our operating losses were \$16,664,495, \$14,135,388, and \$32,044,023 for the years ended December 31, 2002, 2001 and 2000, respectively, and \$2,483,173 for the three months ended March 31, 2003.

### MODIFICATION OF OUR STRATEGIC PLAN

In October 2000, we modified our business plan. This plan called for the suspension of selling and marketing in various markets outside Pennsylvania, New Jersey and New York and an associated reduction in force. The Company recorded a restructuring charge for the associated costs of network and facility exit. The Company continually reviews the reserves established by this plan. During 2002, we contracted with a customer to lease a large number of our idle data centers; however, in the fourth quarter of 2002, this customer failed to meet its commitments under the contract. We do not believe that this customer will be able to meet such commitments in the future. As a result of this development and due to the continuing weakened demand for telecommunications facilities, we determined that it was unlikely that we would be able to sublet these facilities. We are continuing to attempt to dispose of or sublet these facilities; however, due to the extended period of time that has elapsed since the reserve was established and the efforts that have been made since to sublet the facilities, we determined that we may not be able to sublet or terminate these leases and recorded an additional restructuring charge of approximately \$2.8 million in the fourth quarter of 2002 representing the present value of the balance of the payments under the leases, the future expected operating costs and possible exit costs. We also plan to vacate our leased property located at 268 Brodhead Road in Bethlehem, Pennsylvania at the end of the second quarter of 2003. We are currently listing this property for sublease. The remaining lease cost beginning July 1, 2003 has been included in the restructuring reserve recorded in the fourth quarter of 2002. The total amount of lease payments relating to these excess or idle facilities is approximately \$4.3 million through 2010.

The activity in the restructuring charge accrual during the three months ended March 31, 2003 is summarized in the table below:

17

	ACCRUED RESTRUCTURING AS OF DECEMBER 31, 2002	CASH PAYMENTS DURING THE THREE MONTHS ENDED MARCH 31, 2003	ACCRUED RESTRUCTURING AS OF MARCH 31, 2003
	-----	-----	-----
Telecommunications exit and termination fees ...	\$ 233,980	\$ --	\$ 233,980
Sales and marketing contract terminations .....	2,321	--	2,321
Facility exit costs .....	3,587,108	(188,387)	3,398,721

Edgar Filing: FASTNET CORP - Form 10-Q

----- \$ 3,823,409 =====	----- \$ (188,387) =====	----- \$ 3,635,022 =====
--------------------------------	--------------------------------	--------------------------------

RESULTS OF OPERATIONS

REVENUES

We classify our revenue into these major categories: revenues from the sale of enterprise level (Business Class) Internet access and enhanced products and services; narrow band dial up Internet access, revenue from hosting services which includes shared web hosting services, dedicated hosting services and colocation services; and revenues from e-Solutions, web design and development services. We target our Internet access and enhanced services to businesses located within the mid-Atlantic portion of the United States. FASTNET offers a broad range of dedicated access solutions including T-1, T-3, Frame Relay, SMDS ATM dark fiber, enterprise class DSL services and fixed broadband wireless. Our enhanced services are complementary to dedicated Internet access and include Total Managed Security and the sale of third party hardware and software. Our business plan focuses on the core service offering of Internet access coupled with add-on sales of enhanced products and services as our customers' Internet needs expand. Internet access and enhanced product revenues are recognized as services are provided. We expect our Internet access and enhanced product revenues to increase as a percentage of our total revenues as we continue to focus additional resources on marketing and promoting these services.

The market for data and related services is becoming increasingly competitive. We seek to continue to expand our customer base by both increasing market penetration in our existing markets and by increasing average revenue per customer by selling additional enhanced products and services. We have had a historically low churn rate with our dedicated Internet customers. Our churn rate increased during 2002 and the first quarter of 2003 as we increased the amount of customers gained through acquisition and experienced significant post acquisition churn. We seek to grow our revenues by capturing market share from other providers.

Our dial up revenues consist of dial-up Internet access to both residential and small office business customers, and revenue from the sale of wholesale dialup access to customers that use our Dialplex Virtual Private Network (VPN or wholesale Internet access services) to provide service to their subscribers. Customers using our narrowband services generally sign service contracts for one to two years. We typically bill these services in advance of providing services. As a result, revenues are deferred until such time as services are rendered. In the future as we execute our business plan, we expect narrowband revenues to decrease as a percentage of total revenues. As a result of recent acquisitions over the past twelve months, we have reduced selling and marketing efforts targeted to this customer base in order to focus more resources on our dedicated access customers.

We also offer our customers virtual private network, or VPN solutions. VPN's allow business customers secure, remote access to their internal networks through a connection to FASTNET's network. The cost of these services varies with the scope of the services provided.

COST OF REVENUES

Our cost of revenues primarily consists of our Internet connectivity charges and network charges. These are our costs of directly connecting to multiple Internet backbones and maintaining our network including customer connections. Cost of revenues also includes engineering payroll, creative and programming staff payrolls for web design and development, facility rental

## Edgar Filing: FASTNET CORP - Form 10-Q

expense for network infrastructure, and rental expense on network equipment financed under operating leases.

THE THREE MONTHS ENDED MARCH 31, 2003 COMPARED TO THE THREE MONTHS ENDED MARCH 31, 2002

18

REVENUES. Revenues for the quarter ended March 31, 2003 increased approximately \$3,806,000 or 88%, as compared to the quarter ended March 31, 2002 due to an increase in the number of customers resulting from the Company's recent acquisitions, which are as follows:

Acquisition -----	Date of Acquisition -----
SuperNet, Inc.	January 31, 2002
Netaxs, Inc.	April 4, 2002
Dedicated Customers of AppliedTheory Corporation	May 31, 2002

Due to the type of customer base and size of these recent acquisitions, the Company experienced substantial growth in its revenue derived from dedicated access customers. The percentage of revenues generated from dedicated access customers increased from approximately 35% for the quarter ended March 31, 2002 to approximately 63% for the quarter ended March 31, 2003. Revenue from dedicated customers increased approximately \$3,630,000, or approximately 138%, from the quarter ended March 31, 2002.

Revenues for the quarter ended March 31, 2003 decreased approximately \$1,222,000 or 13% as compared to the quarter ended December 31, 2002. This reduction in revenue was due to cancellations and reductions in service level of various high bandwidth customers during the past six months that were obtained in connection with the AppliedTheory and Netaxs acquisitions. A substantial portion of the customer loss has occurred within the Company's operations in upstate New York. This development has caused the Company's upstate operations to negatively affect overall profitability and cash flow.

COST OF REVENUES. Cost of revenues increased \$3,141,000 or approximately 163% for the quarter ended March 31, 2003 as compared to the quarter ended March 31, 2002. This increase was primarily due to the cost of the networks to support the customers acquired in the NetAxs and AppliedTheory acquisitions.

Cost of revenues as a percentage of revenues, increased from approximately 45% for the quarter ended March 31, 2002 to approximately 62% for the quarter ended March 31, 2003 primarily due to the higher network cost associated with the high speed network acquired in connection with the AppliedTheory transaction and the effects of high bandwidth customer attrition associated with customers gained from some of our recent acquisitions. The Company believes that it has realized most of the anticipated network synergies to date since the integration of its network with the networks acquired in the NetAxs and AppliedTheory transactions is nearly complete. The Company has recently identified additional potential opportunities for increased gross margin generated from customer access costs and is initiating a plan to realize those additional margins. The eventual outcome of this plan is not clear at this time.

SELLING, GENERAL, AND ADMINISTRATIVE. Selling, General and Administrative expenses for the quarter ended March 31, 2003 increased

## Edgar Filing: FASTNET CORP - Form 10-Q

\$1,252,000, or approximately 55%, as compared to the quarter ended March 31, 2002. The increase was attributable to the following: a) additional personnel related expenses relating to the NetAxs and AppliedTheory acquisitions; b) increases in the Company's existing sales force; and c) increases to the allowance for uncollectible accounts that the Company attributes to negative changes in the economy. As a percentage of the Company's revenues, the selling, general and administrative expenses declined from approximately 53% for the quarter ended March 31, 2002 to approximately 43% for the quarter ended March 31, 2003 as the Company realized increased administrative efficiencies resulting from the recent acquisitions.

**DEPRECIATION AND AMORTIZATION.** Depreciation and amortization remained relatively consistent for the quarter ended March 31, 2003 as compared to the quarter ended March 31, 2002. This result was due to an increase in depreciation expense related to the additional assets acquired from NetReach, SuperNet, NetAxs and AppliedTheory offset by assets that have been fully amortized or depreciated as of March 31, 2003.

**OTHER INCOME/EXPENSE.** Interest income decreased from \$42,000 for the quarter ended March 31, 2002 to \$12,000 for the quarter ended March 31, 2003. This decrease in interest income resulted from the use of certain marketable securities to fund operations, coupled with a decrease in the related investment returns. Interest expense increased from approximately \$63,000 for the quarter ended March 31, 2002 to \$134,000 for the quarter ended March 31, 2003. The increase in interest expense relates to assumed capital lease obligations from the Netaxs and AppliedTheory acquisitions, and interest expense for notes in connection with the NetAxs acquisition.

**DEEMED DIVIDEND.** The amount recorded for Deemed Dividend - Beneficial Conversion Feature declined from \$370,000 for the quarter ended March 31, 2002 to \$0 for the quarter ended March 31, 2003 due to the full amortization of the beneficial conversion feature in the quarter ended September 30, 2002.

19

### CASH FLOWS ANALYSIS

The following table set forth cash flows data for the periods indicated:

	THREE MONTHS ENDED MARCH 31, 2003	
	2003	2002
Other Financial Data:		
Cash flows used in operating activities .....	\$(1,327,351)	\$(1,291,987)
Cash flows used in investing activities .....	(50,227)	(1,343,751)
Cash flows used in financing activities .....	(161,373)	(1,945,529)
	-----	-----
Net decrease in cash and cash equivalents ...	\$(1,538,951)	\$(4,581,267)
	=====	=====

Cash used in operating activities increased approximately \$35,000 from cash used of approximately \$1,292,000 for the three months ended March 31, 2002 to cash used of approximately \$1,327,000 for the three months ended March 31,

## Edgar Filing: FASTNET CORP - Form 10-Q

2003. This increase is primarily the result of amounts necessary to fund an increased operating loss and deposit placed with a new credit card processor.

We have a working capital deficit of approximately \$17,071,000 as of March 31, 2003. The increase in the working capital deficit from \$15,606,000 at December 31, 2002 was primarily attributable to amounts paid for liabilities included in the restructuring reserve, capital lease payments and amounts used to fund the Company's operating losses, while the increase in the working capital deficit from the prior period is primarily attributable to cash to fund acquisitions, cash to fund operating losses and liabilities received from recent acquisitions.

Cash flows from investing activities decreased by approximately \$1,294,000 from cash used of approximately \$1,344,000 for the three months ended March 31, 2002 to cash used of approximately \$50,000 for the three months ended March 31, 2003. This decrease resulted from the sale of marketable securities required to fund our operating losses and cash used in the acquisition of SuperNet during the three months ended March 31, 2002.

Cash flows for financing activities decreased by approximately \$1,784,000 from cash used of approximately \$1,946,000 for the three months ended March 31, 2002 to cash used of approximately \$161,000 for the three months ended March 31, 2003. This decrease in cash used in financing activities is primarily the result of a payment of a capital lease obligation settlement in the quarter ended March 31, 2002.

### LIQUIDITY AND CAPITAL RESOURCES

Our cash and cash equivalents balances declined approximately \$1,500,000 from \$2,600,000 at December 31, 2002 to approximately \$1,100,000 at March 31, 2003. The decrease in cash was primarily used to fund the Company's operating loss and satisfy a deposit requirement related to the Company's credit card processor.

In connection with the acquisition of the AppliedTheory customer base, we guaranteed to the Bankruptcy Court the collection of at least \$2,500,000 from the accounts receivable attributable to the customers that we acquired. These receivables have been recorded at their estimated net realizable value of approximately \$1,484,000 as of March 31, 2003. Under the guarantee, we were required to satisfy the guarantee of \$2,500,000 no later than December 31, 2002. We have not made the payment and have disputed a significant portion of the guarantee and have claimed certain offsets to the obligation. Based upon collection information provided to us to date, ClearBlue, an unrelated acquirer of a substantial portion of the AppliedTheory business, has collected approximately \$1,320,000 of the \$2,500,000 and the estate of AppliedTheory has collected approximately \$210,000. We have directly collected approximately \$815,000 of the AppliedTheory receivables purchased. During the fourth quarter of 2002, we requested that ClearBlue remit to us the cash it had collected with respect to accounts receivable attributable to customers acquired by FASTNET. In December 2002, we provided our consent to allow ClearBlue to remit directly to the estate of AppliedTheory the funds it had collected; however, ClearBlue has not done so to date. As a result, the receivables applicable to the ClearBlue and estate collections have not been offset against the amount due the estate as of March 31, 2003. We expect to collect these amounts; however, if ClearBlue does not remit these payments to us, or the estate, we may be required to remit any shortfalls (see Note 10 to our unaudited Consolidated Financial Statements).

Our net accounts receivable balance decreased from \$5,900,000 as of December 31, 2002 to \$4,600,000 at March 31, 2003, a decrease of approximately \$1,300,000. This decrease was primarily due to the collection of certain

## Edgar Filing: FASTNET CORP - Form 10-Q

material annual contract billings, improved turnover of accounts receivable and our historically low first calendar quarter billing level. We are continuing to seek additional improvement in the turnover of our accounts receivable resulting from increased customer contact, stricter enforcement of our payment terms and increased integration of our payment and service delivery systems. Our available working capital, operating efficiency and ability to fund operations will be partially dependent, among other things, on the success and outcome of these events and strategies.

Our working capital deficit at December 31, 2002 of \$15,606,000 increased to \$17,071,000 at March 31, 2003. The increase was primarily due to amounts paid for liabilities included in the restructuring reserve, capital lease payments and amounts used to fund the Company's operating losses. The deficit is primarily attributable to the equipment capital leases obligations from the Netaxs and AppliedTheory acquisitions, cash required to fund acquired deferred revenue that was recognized during 2002 attributable to the AppliedTheory acquisition, funds paid for the acquisitions, and increased amounts payable due to the pre-acquisition liabilities and transaction costs of the Netaxs and AppliedTheory acquisitions. We are currently negotiating settlement of these equipment leases with the respective vendors and these leases have been classified as current liabilities. Our settlement proposals include alternative capital lease terms including options for early retirement of the debt as well as an extension of the payment schedule. We have suspended payments of these capital lease obligations and as a result may be considered to be in default of the terms of the obligations. We may also have to suspend payments of other debt and lease payments in an effort to preserve available cash balances, which may pose certain risks. We cannot give assurance as to the satisfactory outcome or timing of these negotiations and cannot predict how certain vendors will react if their payments are suspended. We are also exploring certain equity capital alternatives and have entered into discussions with various lenders to provide us with additional sources of working capital to fund our ongoing operations. We cannot give assurance as to the potential success of these efforts or the potential dilution to existing shareholders that may occur if we should raise equity or debt capital.

In April 2003, we, together with our subsidiaries, as borrowers, entered into a loan and security agreement, as amended, with Equinox Business Credit Corp. ("Equinox"). Pursuant to the terms and conditions of the loan and security agreement, the lender may, in its sole discretion, make revolving credit advances to FASTNET and its subsidiaries and issue letters of credit on behalf of FASTNET and its subsidiaries up to a maximum principal amount of \$1,000,000, but in no event greater than 75% of the value of the accounts receivable of FASTNET and its subsidiaries based upon a lending criteria set forth in the loan and security agreement. The obligations under the loan and security agreement are secured by all of the assets of FASTNET and its subsidiaries. The interest rate is equal to the greater of either 8.00% or the sum of the Prime Rate plus 4.50% and interest on the unpaid principal balance of the loans is payable in arrears on the last day of each month. FASTNET is subject to a minimum loan balance of \$750,000. The term of the loan and security agreement is initially for a period of two years; provided however, the lender may terminate the loan and security agreement at any time upon 60 days notice and FASTNET may terminate the loan and security agreement at any time upon 30 days notice.

As of April 30, 2003, we had approximately \$712,000 outstanding under this Equinox loan and security agreement. Future availability under this line of credit will be determined based upon our billings and collections. As a result of our current liquidity situation, we believe that we may be considered to be

## Edgar Filing: FASTNET CORP - Form 10-Q

in default under this loan and security agreement, as we may be deemed to be in breach of several representations and warranties made to Equinox under the loan and security agreement, including, but not limited to, that we are not in default under any agreement to which we are a party and which default would have a material adverse effect on the Company; that we are not in default in the payment, when due, of any principal of or interest on any indebtedness from any borrowing; and that we are able to pay our debts as they mature. If we are determined to be in default under this agreement, Equinox will have the right to institute certain remedies against us, including, but not limited to, requiring the immediate payment of outstanding indebtedness under the agreement; increasing the effective interest rate and related fees in connection with advances under the credit line; and electing to take possession of the collateral securing the outstanding indebtedness, which currently constitutes all of our assets. To the extent that an event of default is determined to have occurred under the agreement and that Equinox is unwilling to waive any such default, we do not believe that we would be able to repay the outstanding indebtedness under the agreement. In addition, to the extent that Equinox elects to exercise any available remedies against us under the terms of the agreement, such events would have a material adverse effect on our operations and cash flows.

As a result of the loss of and reductions in service levels of certain high bandwidth customers primarily located in upstate New York and acquired in connection with the AppliedTheory acquisition, the Company's operations in upstate New York suffer from excess capacity. This excess capacity is negatively impacting the Company's overall profitability and cash flow. In light of this

21

development, management has developed a plan which if successful will extend and or reduce the payment of debt, shed excess costs and remove aspects of our operations that do not contribute positive cash flow to the operations as a whole. The goal of this plan is to restore the Company to positive cash flow. A significant aspect of this plan is the renegotiation of commitments related to the Company's operations outside the New York City metro to Washington DC corridor (which includes the Pennsylvania Lehigh Valley market). The plan also includes the reduction of executive, administrative and sales staff by approximately 25 individuals considered not essential to the delivery of service to our customers, the renegotiation of obligations including network commitments, network facilities, lease agreements for unused office space; debt incurred in our recent acquisitions; and the exit of unprofitable markets and or services and improvements in our billing and collection procedures. We cannot give assurance as to our ability to implement any of these proposed capital expenditure reductions, or that the implementation of any of these actions will have a positive impact on our overall profitability and cash flow.

As of March 31, 2003, we had a working capital deficit of \$17.1 million and an accumulated deficit of \$68.3 million. For the quarter ended March 31, 2003, we used cash for operating activities of \$1.3 million and had a net loss of \$2.6 million.

We are currently evaluating the timing and amount of capital that our operations will require. We will be required to obtain additional financing during 2003 if some or all of the following events do not occur:

- o Our revenues do not increase as anticipated, or we experience elevated levels of customer churn;
- o We are unable to reach satisfactory resolution on our negotiation of capital lease obligations that are included in current

## Edgar Filing: FASTNET CORP - Form 10-Q

liabilities (see Note 8 to our unaudited Consolidated Financial Statements)

- o We are unable to renegotiate the terms of acquisition indebtedness, network commitments and various lease agreements;
- o We are found to be in default under the terms of our loan and security agreement with Equinox, and we are unable to reach satisfactory resolution regarding our ability to repay the full amount of our outstanding indebtedness under the agreement on an accelerated basis;
- o There is no improvement in our accounts receivable turnover;
- o We do not obtain improved credit terms from our vendors;
- o We do not obtain repayment of the accounts receivables collected by ClearBlue on behalf of FASTNET that are due to the bankruptcy estate of AppliedTheory; or
- o We are unsuccessful in defending against litigation instituted against us by the Official Committee of Unsecured Creditors that relates to liabilities owed to Finova Capital in connection with the AppliedTheory transaction, and we are required to make payments of additional disputed amounts under our guarantee of accounts receivable to the Estate of AppliedTheory of up to \$2.5 million.

Given the current climate of the economy and the technology sector, we believe that it will be extremely difficult for us to obtain additional financing on acceptable terms, if at all. We have retained DH Capital, LLC as a financial advisor to assist us in raising equity and evaluating strategic alternatives, including the sale of all or a part of our Company. If we are unable to secure the necessary financing to continue to fund our operations, we may be required to reduce the scope of our operations by, among other things, closing certain markets and making further reductions in head count or suspend payments to suppliers. In addition, if we are unable to pay our contractual and other contingent commitments when due, our suppliers may suspend service to us. Any of these events could harm our business, financial condition, cash flows or results of operations. In addition, to the extent we are able to raise capital through the issuance of equity securities including the issuance of Common stock or Preferred Stock, such issuances likely will dilute our current shareholders.

We believe that our property and equipment are sufficient for the operation of our existing business for the next twelve months and do not anticipate the need to make material capital expenditures related to any planned expansion of our business.

Subsequent to our acquisition of Netaxs, it was determined that Netaxs owed certain federal and state payroll related liabilities of approximately \$767,000, exclusive of penalty and interest charges. We have determined that we have a right of full offset of this liability against the promissory notes and other amounts issued to the former shareholders of Netaxs including amounts held in escrow. Netaxs, along with the former shareholders of Netaxs, we have reached agreement to offset payments of these liabilities against the notes. As a result, we have suspended payment of the principal and interest due under the promissory notes pending satisfaction of the payroll liabilities. During 2002, we began making payments under a payment plan proposed to the taxing authorities in a manner consistent with the principal and interest due under the Netaxs promissory notes. As a result, we do not anticipate that this arrangement will have a material impact on our working capital needs. We expect to complete our obligation under the payment plan during the third quarter of 2003, and will reevaluate the initial reduction of Netaxs notes as compared to actual capital expended for these obligations.

## Edgar Filing: FASTNET CORP - Form 10-Q

### CONTRACTUAL OBLIGATION AND COMMERCIAL COMMITMENTS

This information detailed in our Form 10-K in the year ended December 31, 2002. There have been no significant changes in this information for the quarter ended March 31, 2003.

### CRITICAL ACCOUNTING POLICIES

The critical accounting policies which, we believe, affect our more significant judgments and estimates used in the preparation of our consolidated financial statements are detailed in our Annual Report on Form 10-K for the year ended December 31, 2002. There have not been any changes to our critical accounting policies during the three months ended March 31, 2003.

### RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations", which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The standard applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, and development and (or) normal use of the asset. SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset and this additional carrying amount is depreciated over the life of the asset. The liability is accreted at the end of each period through charges to operating expense. If the obligation were settled for other than the carrying amount of the liability, a gain or loss on settlement would be recognized. The Company is required and has adopted the provisions of SFAS No. 143 in 2003. To accomplish this, the Company identified all legal obligations for asset retirement obligations, if any, and determined the fair value of these obligations on the date of adoption. The adoption of SFAS No. 143 is not expected to have a significant impact on the Company's results of operations, financial position or cash flows.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity." The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The adoption of SFAS No. 146 is not expected to have a material effect on our financial statements.

In September 2002, the Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue No. 02-13, "Deferred Income Tax Considerations in Applying the Goodwill Impairment Test in FASB Statement No. 142, Goodwill and Other Intangible Assets". The EITF consensus requires that deferred income taxes, if any, be included in the carrying amount of a reporting unit for the purposes of the first step of the SFAS No. 142 goodwill impairment test. It also provides guidance for determining whether to estimate the fair value of a reporting unit by assuming that the unit could be bought or sold in a non-taxable transaction versus a taxable transaction and the income tax bases to use based on this determination. EITF No. 02-13 is effective for goodwill impairment tests performed after September 12, 2002. The adoption of this

## Edgar Filing: FASTNET CORP - Form 10-Q

statement had an impact on the Company's consolidated financial statements for the year ended December 31, 2002.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtness to Others", an interpretation of FASB Statements No. 5, 57, and 107 and a rescission of FASB Interpretation No. 34. This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. The Interpretation also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation are applicable to guarantees issued or modified after December 31, 2002 and are not expected to have a material effect on our financial statements. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure", an amendment of FASB Statement No. 123. This Statement amends FASB Statement No. 123, Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement No. 123 to require prominent disclosures in both annual and interim financial statements. Certain of the disclosure modifications are required for fiscal years ending after December 15, 2002 and are included in the notes to these consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities", An Interpretation of ARB No. 51. This Interpretation addresses the consolidation by business enterprises of variable

23

interest entities as defined in the Interpretation. The Interpretation applies immediately to variable interests in variable interest entities created after January 31, 2003, and to variable interests in variable interest entities obtained after January 31, 2003. The Company does not believe that it has any variable interest entities.

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

Our financial instruments primarily consist of debt. All of our debt instruments bear interest at fixed rates. Therefore, a change in interest rates would not affect the interest incurred or cash flows related to our debt. A change in interest rates would, however, affect the fair value of the debt. The following sensitivity analysis assumes an instantaneous 100 basis point move in interest rates from levels at March 31, 2003 with all other factors held constant. A 100 basis point increase or decrease in market interest rates would result in a change in the value of our debt of less than \$50,000 at March 31, 2003. Because our debt is neither publicly traded nor redeemable at our option, it is unlikely that such a change would impact our financial statements or results of operations.

All of our transactions are conducted using the United States dollar. Therefore, we are not exposed to any significant market risk relating to currency rates.

### ITEM 4. CONTROLS AND PROCEDURES

## Edgar Filing: FASTNET CORP - Form 10-Q

An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, was carried out by us within 90 days prior to the filing of this Quarterly Report on Form 10-Q, under the supervision and with the participation of our management, including our President and Chairman and Chief Financial Officer. Based on that evaluation, the President and Chairman and Chief Financial Officer concluded that our disclosure controls and procedures are functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. A controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls systems are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a Company, have been detected. Subsequent to the date of the most recent evaluation, there were no significant changes in our internal controls or in other factors that could significantly affect the internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

### PART II. OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

On January 24, 2003, the Official Committee of Unsecured Creditors for the estate of AppliedTheory Corporation instituted an adversary proceeding against FASTNET with the United States Bankruptcy Court for the Southern District of New York. The Committee is seeking judicial declaration that FASTNET is liable to satisfy the bankruptcy estate's obligations to one of the estate's secured creditors, Finova Capital. The core allegation of the Committee is that FASTNET's bid at auction for the assets purchased by FASTNET from AppliedTheory included the assumption of approximately \$1.2 million in liabilities owed to Finova, which constitute direct financing leases, and that FASTNET should be estopped from denying its liability after the closing of the acquisition. FASTNET has asserted that these liabilities are not direct financing leases and that, as a result of post-auction due diligence, the Asset Purchase Agreement had been changed, with approval of the Bankruptcy Court, to exclude these Finova liabilities. As a result, FASTNET contends that the estate of AppliedTheory closed the revised deal and thereby released any claims regarding these Finova liabilities against FASTNET. We believe that our defense to this claim is valid. However, should the Committee succeed in its claim, the judgment and the associated cost to defend the claim would result in a substantial reduction in our working capital and could have a material negative impact on our cash flows and financial condition.

#### ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

(a) None.

(b) None.

24

(c) None

(d) None

#### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

## Edgar Filing: FASTNET CORP - Form 10-Q

None.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

### ITEM 5. OTHER INFORMATION

#### FACTORS AFFECTING FUTURE OPERATING RESULTS

IF WE FAIL TO RAISE NEEDED CAPITAL TO FUND OUR OPERATIONS OR WE ARE UNABLE TO ACHIEVE THE SAVINGS AND REDUCTION IN CASH CONSUMPTION, WE MAY BE UNABLE TO CONTINUE AS A GOING CONCERN.

Our independent auditors have included an explanatory paragraph in their audit report included in our Annual Report Form 10-K describing conditions that raise substantial doubt about our ability to continue as a going concern. We have incurred losses and negative cash flows from operations since our inception. As of March 31, 2003, we had a working capital deficit of \$17.1 million, and an accumulated deficit of \$68.3 million. For the quarter ended March 31, 2003, we used cash for operating activities of \$1.3 million and had a net loss of \$2.6 million. We also had, at March 31, 2003, obligations for future payments under contracts and other contingent commitments for the fiscal year 2003 totaling \$20.0 million.

As of April 30, 2003, we had \$712,000 outstanding under this Equinox loan and security agreement. As a result of our current liquidity situation, we believe that we may be considered to be in default under this loan and security agreement, as we may be deemed to be in breach of several representations and warranties made to Equinox under the loan and security agreement, including, but not limited to, that we are not in default under any agreement to which we are a party and which default would have a material adverse effect on the Company; that we are not in default in the payment, when due, of any principal or interest on any indebtedness from any borrowing; and that we are able to pay our debts as they mature. If we are determined to be in default under this agreement, Equinox will have the right to institute certain remedies against us, including, but not limited to, requiring the immediate payment of outstanding indebtedness under the agreement; increasing the effective interest rate and related fees in connection with advances under the credit line; and electing to take possession of the collateral securing the outstanding indebtedness, which currently constitutes all of our assets. To the extent that an event of default is determined to have occurred under the agreement and that Equinox is unwilling to waive any such default, we do not believe that we would be able to repay the outstanding indebtedness under the agreement. In addition, to the extent that Equinox elects to exercise any available remedies against us under the terms of the agreement, such events would have a material adverse effect on our operations and cash flows.

We are currently evaluating the timing and amount of capital that our operations will require. We will be required to obtain additional financing during 2003 if some or all of the following events do not occur:

- o Our revenues do not increase as anticipated, or we experience elevated levels of customer churn;
- o We are unable to reach satisfactory resolution on our negotiation of capital lease obligations that are included in current liabilities (see Note 8 to our unaudited Consolidated Financial Statements);
- o We are unable to renegotiate the terms of acquisition indebtedness, network commitments and various lease agreements;
- o We are found to be in default under the terms of our loan and security agreement with Equinox, and we are unable to reach

## Edgar Filing: FASTNET CORP - Form 10-Q

satisfactory resolution regarding our ability to repay the full amount of our outstanding indebtedness under the agreement on an accelerated basis;

- o There is no improvement in our accounts receivable turnover;
- o We do not obtain improved credit terms from our vendors;
- o We do not obtain repayment of the accounts receivables collected by ClearBlue on behalf of FASTNET that are due to the bankruptcy estate of AppliedTheory; or
- o We are unsuccessful in defending against litigation instituted against us by the Official Committee of Unsecured Creditors that relates to liabilities owed to Finova Capital in connection with the AppliedTheory transaction, and we are required to make payments of additional disputed amounts under our guarantee of accounts receivable to the Estate of AppliedTheory of up to \$2.5 million.

25

Given the current climate of the economy and the technology sector, we believe that it will be difficult for us to obtain additional financing on acceptable terms, if at all. As a result, management has developed a plan to attempt to extend and or reduce the payment of debt, shed excess costs and remove aspects of our operations that do not contribute positive cash flow to the operations as a whole, including, renegotiation of commitments related to the Company's operations outside the New York City metro to Washington DC corridor (which includes the Pennsylvania Lehigh Valley market) and a possible sale or exit or such operations; the reduction of staff by approximately 25 individuals considered not essential to the delivery of service to our customers; the renegotiation of obligations including network commitments, network facilities, lease agreements for unused office space, and debt incurred in our recent acquisitions; and the exit of unprofitable markets and or services and improvements in our billing and collection procedures. We are also taking steps to reduce our non-essential General and Administrative costs in order to reduce our monthly cash flow requirements and are seeking to exit certain unprofitable markets and services where applicable. We cannot give assurance as to our ability to implement any of these proposed capital expenditure reductions, or that the implementation of any of these actions will have a positive impact on our overall profitability and cash flow. If we are unable to secure the necessary financing, we may be required to reduce the scope of our operations by, among other things, closing certain markets and making further reductions in head count or suspend payments to suppliers. In addition, if we are unable to pay our contractual and other contingent commitments when due, our suppliers may suspend service to us. Any of these events could harm our business, financial condition, cash flows or results of operations. In addition, to the extent we are able to raise capital through the issuance of equity securities, including the issuance of Common Stock or Preferred Stock, such issuances likely will dilute our current shareholders.

IF WE ARE UNABLE TO SUCCESSFULLY RENEGOTIATE THE PAYMENT TERMS OF CERTAIN OF OUR CAPITAL LEASES, WE MAY BE CONSIDERED TO BE IN DEFAULT OF A SIGNIFICANT AMOUNT OF OUR CAPITAL LEASE OBLIGATIONS.

We are currently attempting to renegotiate certain of our capital leases totaling approximately \$3.5 million, which we acquired in connection with our acquisitions of Netaxs and of certain assets of AppliedTheory. While we have been actively engaged in discussions with the vendors of these capital leases to obtain modified payment terms, we have continued to not make any payments on these obligations. As a result, we may be considered to be in default of these capital lease obligations and we have classified all outstanding amounts related

## Edgar Filing: FASTNET CORP - Form 10-Q

to these leases as current on our balance sheet as of December 31, 2002. We cannot assure you that we will be able to successfully renegotiate these capital leases, and if not, that we will be able to cure any default or that the lessors will not seek repayment or the other remedies that are available to them. Potential lender remedies could include, among other things, accelerating our obligations under affected leases and repossessing the equipment and otherwise seeking to enforce their security interests in such equipment and other secured assets, which may be crucial to the operations of the business. Any such events could have a material adverse effect upon us and, to the extent that payments of all outstanding amounts related to the capital leases are accelerated, could have a significant adverse impact on our available cash for operations.

OUR BUSINESS COULD BE ADVERSELY AFFECTED BY CHANGES IN SUPPLIERS OF OUR LEASED-LINE CONNECTIONS, OUR INABILITY TO RENEGOTIATE TERM COMMITMENTS WITH SUCH SUPPLIERS OR DELAYS IN DELIVERY OF SERVICES FROM SUCH SUPPLIERS.

We are dependent on third party suppliers for our leased-line connections or bandwidth. The term of these contracts are of varying lengths and may in certain instances exceed the term of the contract with the customer. As a result, from time to time during the terms of our customer contracts, we may be required to extend the terms of our current leased-line connection contracts, replace existing commitment with orders from new customers, enter into new contracts with third-party suppliers in order to maintain adequate levels of bandwidth or seek to terminate contracts with vendors based upon network utilization and customer related cancellations. To the extent that these suppliers increase prices, are unwilling to renegotiate terms or have difficulty in delivering their services, we may incur a loss and or be required to develop alternative sources for such services. If we are unable to negotiate extended terms with our current third-party suppliers, or we are unable to enter into new contracts with other third-party suppliers, replace the commitment with orders from new customers, in a timely manner or under terms that are acceptable to us, our ability to fulfill our obligations under our customer contracts may be hindered and could have an adverse effect on our business.

WE HAVE IMPLEMENTED A REVISED STRATEGIC BUSINESS PLAN. AS A RESULT, WE MAY NOT BE ABLE TO ACHIEVE THE DESIRED RESULTS UTILIZING THIS NEW PLAN.

We announced our revised business plan and strategy in response to changes in market conditions, the low probability of obtaining additional financing for the existing business plan, and competitive factors. Due to our current level of working capital, we are now less focused on acquisitions and more focused on growth through organic sales activities. Our business strategy is dependent upon our continued ability to:

26

- o Increase revenues organically through our existing financial resources;
- o Attract and sell additional products and services to our target customers and;
- o Enter into selected product or service partnerships.

Our ability to successfully implement our business strategy, and the expected benefits to be obtained from our strategy, may be adversely affected by a number of factors, such as unforeseen costs and expenses, technological change, economic downturns, changes in capital markets, competitive factors or other events beyond our control.

IF WE ARE UNABLE TO INTEGRATE THE OPERATIONS WE HAVE ACQUIRED WITH FASTNET, WE

## Edgar Filing: FASTNET CORP - Form 10-Q

MAY NOT REALIZE OUR PLANNED COST SAVINGS.

A key element of our business strategy during 2001 and 2002 was to grow through acquisitions. We must be able to integrate the networks of FASTNET and these acquired operations to gain the efficiencies we hope to achieve. We also must be able to retain and manage key personnel, integrate the back-office operations of these acquired operations into the back-office operations of FASTNET, and expand our consolidated company product portfolio across our increased customer base from these acquired operations or we may not be able to achieve the operating efficiencies we anticipate.

To integrate our newly acquired operations successfully, we must:

- o Install and standardize adequate operational and control systems;
- o Deploy standard equipment and telecommunications facilities;
- o Employ qualified personnel to provide technical and marketing support in new as well as existing locations;
- o Eliminate redundancies in overlapping network systems and personnel;
- o Incorporate acquired technology and products into our existing service offerings;
- o Implement and maintain uniform standards, procedures and policies;
- o Standardize marketing and sales efforts under the common FASTNET brand, and, where applicable, maintain the brand name integrity of products and services that continue to be marketed and sold under the brand names utilized by the acquired operations; and
- o Continue the expansion of our managerial, operational, technical and financial resources.

The process of consolidating and integrating acquired operations takes a significant period of time, places a significant strain on our managerial, operating and financial resources, and could prove to be even more expensive and time-consuming than we have predicted. We may increase expenditures in order to accelerate the integration and consolidation process with the goal of achieving longer-term cost savings and improved profitability.

The key integration challenges we face in connection with our acquisitions include:

- o Acquired operations, facilities, equipment, service offerings, networks, technologies, brand names and sales, marketing and service development efforts may not be effectively integrated with our existing operations;
- o Anticipated cost savings and operational benefits may not be realized;
- o In the course of integrating an acquired operation, we may discover facts or circumstances that we did not know at the time of the acquisition that adversely impact our business or operations, or make the integration more difficult or expensive;
- o Integration efforts may divert our resources from our existing business;
- o Standards, controls, procedures and policies may not be maintained;
- o Employees who are key to the acquired operations may choose to leave; and we may experience unforeseen delays and expenses.

WE ARE SUBJECT TO RESTRICTIVE COVENANTS THAT LIMIT OUR FLEXIBILITY.

The terms and agreements relating to the sale of our Series A Convertible Preferred stock contain customary covenants limiting our flexibility, including covenants limiting our ability to incur additional debt, create or issue any shares of capital stock with rights senior to the holders of

## Edgar Filing: FASTNET CORP - Form 10-Q

the Series A Convertible Preferred stock, make distributions or declare dividends, consolidate, merge or acquire other businesses and sell assets, pay dividends and other distributions, effect stock splits, and issue additional equity securities. Such covenants may make it difficult for us to pursue our business strategies. Such restrictive covenants may make it difficult for us to

27

pursue our business strategies without the consent of parties to these agreements, which we may not be able to obtain. Our ability to satisfy the financial and other restrictive covenants may be affected by events beyond our control.

Our loan and security agreement with Equinox Business Credit Corp. contains covenants limiting our flexibility, including, but not limited to, covenants limiting our ability to incur additional debt, make liens, make investments, consolidate, merge or acquire other businesses and sell assets, pay dividends and other distributions, make capital expenditures and enter into transactions with affiliates. Failure to comply with the terms of the loan would entitle the bank to accelerate the loan and foreclose on certain of our assets. Equinox would be repaid from the proceeds of the liquidation of those assets before the assets would be available for distribution to other creditors and, lastly, to the holders of FASTNET's capital stock.

In addition, it is likely that we will be required to obtain financing through the acquisition of additional indebtedness, such as through bank borrowings. The instruments relating to these debt instruments may contain additional covenants limiting our flexibility, including, but not limited to, covenants limiting our ability to incur additional debt, make liens, make investments, consolidate, merge or acquire other businesses and sell assets, pay dividends and other distributions, make capital expenditures and enter into transactions with affiliates. Failure to comply with the terms of these debt instruments may entitle the lender(s) to accelerate the payment of the indebtedness and foreclose on certain of our assets that may be used to secure the indebtedness. Any of our secured lenders would be available for distribution to other creditors and, lastly, to the holders of FASTNET's capital stock.

IN THE FUTURE, WE MAY BE UNABLE TO EXPAND OUR SALES, TECHNICAL SUPPORT AND CUSTOMER SUPPORT INFRASTRUCTURE, WHICH MAY HINDER OUR ABILITY TO GROW AND MEET CUSTOMER DEMANDS.

In October 2000, we terminated personnel across all departments of the Company. This involuntary termination may make it more difficult to attract and retain employees. If, in the future, we are unable to expand our sales force and our technical support and customer support staff, our business could be harmed since this more limited staff could limit our ability to obtain new customers, sell products and services and provide existing customers with a high level of technical support.

IT IS UNLIKELY THAT INVESTORS WILL RECEIVE A RETURN ON OUR COMMON STOCK THROUGH THE PAYMENT OF CASH DIVIDENDS.

We have never declared or paid cash dividends on our Common stock and have no intention of doing so in the foreseeable future. We have had a history of losses and expect to operate at a net loss for the next several years. These net losses will reduce our shareholders' equity. For the quarter ended March 31, 2003, we had a net loss of approximately \$2.6 million. We cannot predict what the value of our assets or the amount of our liabilities will be in the future.

## Edgar Filing: FASTNET CORP - Form 10-Q

OUR OPERATING RESULTS FLUCTUATE DUE TO A VARIETY OF FACTORS AND ARE NOT A MEANINGFUL INDICATOR OF FUTURE PERFORMANCE.

Our operating results have fluctuated in the past and may fluctuate significantly in the future, depending upon a variety of factors, including:

- o Timing of the introduction of new products and services;
- o Changes in pricing policies and product offerings by us or our competitors;
- o Fluctuations in demand for Internet access and enhanced products and services; and
- o Potential customers perception of the financial soundness of the Company.

Therefore, we believe that period-to-period comparisons of our operating results are not necessarily meaningful and cannot be relied upon as indicators of future performance. If our operating results in any future period fall below the expectations of analysts and investors, the market price of our Common stock would likely decline.

WE MAY BE UNABLE TO MAINTAIN THE STANDARDS FOR LISTING ON THE NASDAQ SMALLCAP MARKET, WHICH COULD MAKE IT MORE DIFFICULT FOR INVESTORS TO DISPOSE OF OUR COMMON STOCK AND COULD SUBJECT OUR COMMON STOCK TO THE "PENNY STOCK" RULES.

If we are unable to maintain the standards for listing on the NASDAQ SmallCap Market, our Common stock may be delisted from this market and may be traded on the OTC Bulletin Board, which may make it more difficult for investors to dispose of our Common stock and could subject us to the "penny stock" rules

28

implemented by the SEC. On February 19, 2003 our Common stock was transferred to the NASDAQ Small Cap Market from the NASDAQ National Market as a result of our failure to maintain the minimum continued listing standards of the NASDAQ National Market, including minimum bid price and market value of publicly held shares. The NASDAQ SmallCap Market also requires that listed companies maintain standards for continued listing, including a minimum bid price for shares of a company's stock and a minimum market value of publicly held shares. For example, the NASDAQ SmallCap Market requires that listed companies maintain a minimum bid price of at least \$1.00 and a minimum market value of publicly held shares of \$5 million.

Our Common stock currently does not meet the NASDAQ minimum-listing standard of a \$1.00 minimum bid price. On April 15, 2003, we received notice from NASDAQ that, due to failure to maintain the \$1.00 per share minimum price, we have been granted a 180-day grace period ending on October 13, 2003 from meeting the NASDAQ Small Cap Market listing requirements. We intend to pursue all available options to meet these NASDAQ listing requirements. If our Common Stock is delisted from the NASDAQ SmallCap Market, sales of our Common stock would likely be conducted on an electronic bulletin board established for securities that do not meet the NASDAQ listing requirements, such as the OTC Bulletin Board or in quotations published by the National Quotation Bureau, Inc. that are commonly referred to as the "pink sheets". This may have a negative impact on the liquidity and price of our Common stock and investors may find it more difficult to purchase or dispose of, or to obtain accurate quotations as to the market value of, our Common stock. As a result, it could be more difficult

## Edgar Filing: FASTNET CORP - Form 10-Q

to sell, or obtain an accurate quotation as to the price of our Common stock.

In addition, if our Common stock were delisted, it would be subject to the so-called penny stock rules. The SEC has adopted regulations that define a "penny stock" to be any equity security that has a market price of less than \$5.00 per share, subject to certain exceptions. For any transaction involving a penny stock, unless exempt, the rules impose additional sales practice requirements on broker-dealers subject to certain exceptions.

For transactions covered by the penny stock rules, a broker-dealer must make a special suitability determination for the purchaser and must have received the purchaser's written consent to the transaction prior to the sale. The penny stock rules also require broker-dealers to deliver monthly statements to penny stock investors disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks. Prior to the transaction, a broker-dealer must provide a disclosure schedule relating to the penny stock market. In addition, the broker-dealer must disclose the following:

- o Commissions payable to the broker-dealer and the registered representative; and
- o Current quotations for the security as mandated by the applicable regulations.

If our Common stock were delisted and determined to be a "penny stock," a broker-dealer may find it to be more difficult to trade our Common stock, and an investor may find it more difficult to acquire or dispose of our Common stock in the secondary market.

THE MARKET PRICE AND TRADING VOLUME OF OUR COMMON STOCK MAY BECOME VOLATILE.

The market price of our Common stock has fluctuated significantly in the past, and may become highly volatile again in the future. In addition, the trading volume in our Common stock may fluctuate, and significant price variations can occur as a result. We cannot assure you that the market price of our Common stock will not fluctuate or continue to decline significantly in the future. In addition, the U.S. equity markets have from time to time experienced significant price and volume fluctuations that have particularly affected the market prices for the stocks of technology and telecommunications companies. These broad market fluctuations may materially adversely affect the market price of our Common stock in the future. Such variations may be the result of changes in our business, operations or prospects, announcements of technological innovations and new products by competitors, new contractual relationships with strategic partners by us or our competitors, proposed acquisitions by us or our competitors, financial results that fail to meet public market analyst expectations, regulatory considerations and domestic and international market and economic conditions.

OUR OPERATING RESULTS AND FINANCIAL CONDITION MAY BE ADVERSELY AFFECTED BY FINANCIAL ACCOUNTING OF OUR RECENT ACQUISITIONS, INCLUDING DILUTIVE ISSUANCES OF SECURITIES, INCURRENCE OF DEBT, AND THE RECORDING OF SIGNIFICANT IMPAIRMENT CHARGES FOR INTANGIBLE ASSETS AND GOODWILL.

The purchase price for many of the acquired businesses of our recent acquisitions may have exceeded the current fair value of the net identifiable assets of the acquired businesses. As a result, material adjustments to goodwill and other intangible assets were required to be recorded which resulted in significant charges in past periods and could result in significant charges in future periods. These charges, in addition to the financial impact of such acquisitions, could have a material adverse effect on our business, financial condition and results of operations.

SFAS No. 142 "Goodwill and Other Intangible Assets" no longer permits the amortization of goodwill and indefinite-live intangible assets. Instead, these assets must be reviewed annually for impairment in accordance with this statement. Accordingly, we have ceased amortization of all goodwill and indefinite-live intangible assets as of January 1, 2002. We have performed our annual goodwill impairment test and identified intangible asset impairment through the use of an independent valuation firm. This analysis resulted in impairment charges of \$3.7 million in December 2002. We are required to perform a fair market value analysis of our identified intangible assets under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" and record an impairment charge and write down of such assets, if any, prior to recording an impairment charge for goodwill. The annual SFAS No. 142 and SFAS No. 144 impairment tests require us to record a non-cash charge to write down a significant portion of our goodwill and identified intangible assets. The recording of such charges may have an adverse effect on our results of operations and financial condition.

FUTURE SALES OF OUR COMMON STOCK, OR PREFERRED STOCK, COULD REDUCE THE PRICE OF OUR STOCK AND OUR ABILITY TO RAISE CASH IN FUTURE EQUITY OFFERINGS.

No prediction can be made as to the effect, if any, that future sales of shares of Common stock, or Preferred Stock, which may be convertible into Common stock, or the availability for future sale of shares of Common stock or securities convertible into or exercisable for our Common stock will have on the market price of our Common stock. Sale, or the availability for sale, of substantial amounts of Common stock by existing shareholders under Rule 144, through the exercise of registration rights or the issuance of shares of Common Stock upon the exercise of stock options or warrants, or the perception that such sales or issuances could occur, could adversely affect prevailing market prices for our Common stock and could materially impair our future ability to raise capital through an offering of equity securities.

WE FACE SIGNIFICANT AND INCREASING COMPETITION IN OUR INDUSTRY, WHICH COULD CAUSE US TO LOWER PRICES RESULTING IN REDUCED REVENUES.

The growth of the Internet access and related services market and the absence of substantial barriers to entry have attracted many start-ups as well as existing businesses from the telecommunications, cable, and technology industries. As a result, the market for Internet access and related services is very competitive. We anticipate that competition will continue to intensify as the use of the Internet grows. Current and prospective competitors include:

- o National Internet service providers and regional and local Internet service providers;
- o National and regional long distance and local telecommunications carriers;
- o Cable operators and their affiliates;
- o Providers of web hosting, colocation and other Internet-based business services;
- o Computer hardware and other technology companies that bundle Internet connections with their products; and

## Edgar Filing: FASTNET CORP - Form 10-Q

- o Terrestrial wireless and satellite Internet service providers.

We believe that the number of competitors we face is significant and is constantly changing. As a result, it is extremely difficult for us to accurately identify and quantify our competitors. In addition, because of the constantly evolving competitive environment, it is extremely difficult for us to determine our relative competitive position at any given time.

As a result of vertical and horizontal integration in the industry, we currently face and expect to continue to face significant pricing pressure and other competition in the future. Advances in technology and changes in the marketplace and the regulatory environment will continue, and we cannot predict the effect that these ongoing or future developments may or may not have the effect on pricing of company products and services.

Many of our competitors have significantly greater market presence, brand-name recognition, and financial resources than we do. In addition, all of the major long distance telephone companies, also known as interexchange carriers, offer Internet access services. The recent reforms in the federal regulation of the telecommunications industry have created greater opportunities for local exchange carriers, including incumbent local exchange carriers and competitive local exchange carriers, to enter the Internet access market. In

30

order to address the Internet access requirements of the current business customers of long distance and local carriers, many carriers are integrating horizontally through acquisitions of or joint ventures with Internet service providers, or by wholesale purchase of Internet access from Internet service providers. In addition, many of the major cable companies and other alternative service providers, such as those companies utilizing wireless electric power and satellite-based service technologies, have announced their plans to offer Internet access and related services. Accordingly, we may experience increased competition from traditional and emerging telecommunications providers. Many of these companies, in addition to their substantially greater network coverage, market presence, and financial, technical and personnel resources, also already provide telecommunications and other services to many of our target customers. Furthermore, they may have the ability to bundle Internet access with basic local and long distance telecommunications services, which we do not currently offer. This bundling of services may harm our ability to compete effectively with them and may result in pricing pressure on us that would reduce our earnings.

OUR GROWTH DEPENDS ON THE CONTINUED ACCEPTANCE BY OUR TARGET CUSTOMERS OF THE INTERNET FOR COMMERCE AND COMMUNICATION.

If the use of the Internet by businesses and enterprises for commerce and communication does not continue to grow, our business and results of operations will be harmed. Our products and services are designed primarily for the rapidly growing number of business users of the Internet. Commercial use of the Internet by small and medium sized enterprises is still in its early stages. Despite growing interest in the commercial uses of the Internet, many businesses have not purchased Internet access and related services for several reasons, including:

- o Lack of inexpensive, high-speed connection options;
- o Limited number of reliable local access points for business users;

## Edgar Filing: FASTNET CORP - Form 10-Q

- o Lack of affordable electronic commerce solutions;
- o Limited internal resources and technical expertise;
- o Inconsistent quality of service; and
- o Difficulty in integrating hardware and software related to Internet based business applications.

In addition, we believe that many Internet users lack confidence in the security of transmitting their data over the Internet, which has hindered commercial use of the Internet. Technologies that adequately address these security concerns may not be developed.

The adoption of the Internet for commerce and communication applications, particularly by those enterprises that have historically relied upon alternative means, generally requires the understanding and acceptance of a new way of conducting business and exchanging information. In particular, enterprises that have already invested substantial resources in other means of conducting commerce and exchanging information may be reluctant or slow to adopt a new strategy that may make their existing personnel and infrastructure obsolete.

OUR SUCCESS DEPENDS ON THE CONTINUED DEVELOPMENT OF INTERNET INFRASTRUCTURE.

The recent growth in the use of the Internet has caused periods of performance degradation, requiring the upgrade by providers and other organizations with links to the Internet of routers and switches, telecommunications links and other components forming the infrastructure of the Internet. We believe that capacity constraints caused by rapid growth in the use of the Internet may impede further development of the Internet to the extent that users experience increased delays in transmission or reception of data or transmission errors that may corrupt data. Any degradation in the performance of the Internet as a whole could impair the quality of our products and services. As a consequence, our future success will be dependent upon the reliability and continued expansion of the Internet.

WE RELY ON A LIMITED NUMBER OF VENDORS AND SERVICE PROVIDERS, SOME OF WHICH ARE OUR COMPETITORS. THIS MAY ADVERSELY AFFECT THE FUTURE TERMS OF OUR RELATIONSHIPS.

We rely on other companies to supply key components of our network infrastructure, which are available only from limited sources. For example, we currently rely on routers, switches and remote access devices from Lucent Technologies, Inc., Cisco Systems, Inc. and Nortel Networks Corporation. We could be adversely affected if any of these products were no longer available on commercially reasonable terms, or at all. From time to time, we experience delays in the delivery and installation of these products and services, which

can lead to the loss of existing or potential customers. We do not know that we will be able to obtain such products in the future cost-effectively and in a timely manner. Moreover, we depend upon a limited number of companies as our primary backbone providers. These companies also sell products and services that compete with ours. Our agreements with our primary backbone providers are fixed price contracts with terms ranging from one to three years. Our backbone providers operate national or international networks that provide data and Internet connectivity and enable our customers to transmit and receive data over

## Edgar Filing: FASTNET CORP - Form 10-Q

the Internet. Our relationship with these backbone providers could be adversely affected as a result of our direct competition with them. Failure to renew these relationships when they expire or enter into new relationships for such services on commercially reasonable terms or at all could harm our business, financial condition and results of operations.

WE NEED TO RECRUIT AND RETAIN QUALIFIED PERSONNEL OR OUR BUSINESS COULD BE HARMED.

Competition for highly qualified employees in the Internet service industry is intense because there are a limited number of people with an adequate knowledge of and significant experience in our industry. Our success depends largely upon our ability to attract, train and retain highly skilled management, technical, marketing and sales personnel and upon the continued contributions of such people. Since it is difficult and time consuming to identify and hire highly qualified employees, we cannot assure you of our ability to do so. Our failure to attract additional highly qualified personnel could impair our ability to grow our operations and services to our customers.

WE COULD EXPERIENCE SYSTEM FAILURES AND CAPACITY CONSTRAINTS, WHICH COULD RESULT IN THE LOSS OF OUR CUSTOMERS OR LIABILITY TO OUR CUSTOMERS.

The continued operation of our network infrastructure depends upon our ability to protect against:

- o Downtime due to malfunction or failure of hardware or software;
- o Overload conditions;
- o Power loss or telecommunications failures;
- o Human error;
- o Natural disasters;
- o Sabotage or other intentional acts of vandalism; and
- o Circuit outages caused by administrative or financial reasons.

Any of these occurrences could result in interruptions in the services we provide to our customers and require us to spend substantial amounts of money repairing and replacing equipment. In addition, we have finite capacity to provide service to our customers under our current infrastructure. Because utilization of our network is constantly changing depending upon customer use at any given time, we maintain a level of capacity that we believe to be adequate to support our current customer base. If we obtain additional customers in the future, we will need to increase our capacity to maintain the quality of service that we currently provide our customers. If customer usage exceeds our capacity and we are unable to increase our capacity in a timely manner, our customers may experience interruptions in or decreases in quality of the services we provide. As a result, we may lose current customers or incur significant liability to our customers for any damages they suffer due to any system downtime as well as the possible loss of customers.

OUR NETWORK MAY EXPERIENCE SECURITY BREACHES, WHICH COULD DISRUPT OUR SERVICES.

Our network infrastructure may be vulnerable to computer viruses, break-ins and similar disruptive problems caused by our customers or other Internet users. Computer viruses, break-ins or other problems caused by third parties could lead to interruptions, delays or cessation in service to our customers. There currently is no existing technology that provides absolute security, and the cost of minimizing these security breaches could be

## Edgar Filing: FASTNET CORP - Form 10-Q

prohibitively expensive. We may face liability to customers for such security breaches. Furthermore, such incidents could deter potential customers and adversely affect existing customer relationships.

WE FACE POTENTIAL LIABILITY FOR INFORMATION DISSEMINATED THROUGH OUR NETWORK.

It is possible that claims could be made against Internet service providers in connection with the nature and content of the materials

32

disseminated through their networks. The law relating to the liability of Internet service providers due to information carried or disseminated through their networks is not completely settled. While the U.S. Supreme Court has held that content transmitted over the Internet is entitled to the highest level of protection under the U.S. Constitution, there are federal and state laws regarding the distribution of obscene, indecent, or otherwise illegal material, as well as material that violates intellectual property rights which may subject us to liability. Several private lawsuits have been brought in the past and are currently pending against other entities which seek to impose liability upon Internet service providers as a result of the nature and content of materials disseminated over the Internet. If any of these actions succeed, we might be required to respond by investing substantial resources or discontinuing some of our service or product offerings, which could harm our business.

NEW LAWS AND REGULATIONS GOVERNING OUR INDUSTRY COULD HARM OUR BUSINESS.

We are subject to a variety of risks that could materially affect our business due to the rapidly changing legal and regulatory landscape governing Internet access providers. For example, the Federal Communications Commission currently exempts Internet access providers from having to pay per-minute access charges that long-distance telecommunications providers pay local telephone companies for the use of the local telephone network. In addition, Internet access providers are currently exempt from having to pay a percentage of their gross revenues as a contribution to the federal universal service fund. Should the Federal Communications Commission eliminate these exemptions and impose such charges on Internet access providers, this would increase our costs of providing dial-up Internet access service and could have a material adverse effect on our business, financial condition and results of operations.

We face risks due to possible changes in the way our suppliers are regulated which could have an adverse effect on our business. For example, most states require local exchange carriers to pay reciprocal compensation to competing local exchange carriers for the transport and termination of Internet traffic. However, the Federal Communications Commission has concluded that at least a substantial portion of dial-up Internet traffic is jurisdictionally interstate, and has adopted plans for gradually eliminating the reciprocal compensation payment requirement for Internet traffic. If the FCC completes its planned elimination of reciprocal compensation payments, telephone carriers might no longer be entitled to receive payment from the originating carrier to terminate traffic delivered to us. The Federal Communications Commission has launched an inquiry to determine an alternative mechanism for covering the costs of terminating calls to Internet service providers. In the interim, state commissions will determine whether carriers will receive compensation for such calls. If the new compensation mechanism adopted by the Federal Communications Commission increases the costs to our telephone carriers for terminating traffic to us, or if states eliminate reciprocal compensation payments, our telephone carriers may increase the price of service to us in order to recover such costs. This could have a material adverse effect on our business, financial condition

## Edgar Filing: FASTNET CORP - Form 10-Q

and results of operations.

Although the U.S. Supreme Court has held that content transmitted over the Internet is entitled to the highest level of protection under the U.S. Constitution, a recently-adopted Pennsylvania statute subjects Internet service providers to fines and potential imprisonment and felony charges for failing to disable access to child pornography within five days of notification by the state Attorney General's office. We could be subject to this law after its effective date of April 20, 2002. Although it is not possible for us to predict the outcome, it is possible that this law could be ruled unconstitutional.

OUR PRIOR USE OF ARTHUR ANDERSEN LLP AS OUR INDEPENDENT PUBLIC ACCOUNTANT COULD IMPACT OUR ABILITY TO ACCESS THE CAPITAL MARKETS.

Arthur Andersen LLP ("Andersen") audited our consolidated financial statements as of and for each of the two years in the period ended December 31, 2001. On March 14, 2002, Andersen was indicted on federal obstruction of justice charges arising from the government's investigation of Enron Corporation. Following this event, our Audit Committee directed management to consider the need to appoint new independent public accountants. On July 31, 2002, at the direction of the Board of Directors, acting upon the recommendation of the Audit Committee, we dismissed Andersen and appointed KPMG LLP as our new independent auditors for fiscal year 2002. On June 15, 2002, a jury found Andersen guilty on the government's charges.

SEC rules require us to present our audited financial statements in various SEC filings, along with Andersen's consent to our inclusion of its audit report in those filings. However, Andersen is unable to provide a consent to us for inclusion in our future SEC filings relating to its report on our consolidated financial statements as of and for each of the three years in the period ended December 31, 2001. Additionally, Andersen is unable to provide us with assurance services, such as advice customarily given to underwriters of our securities offerings and other similar market participants. The SEC recently has provided regulatory relief designed to allow companies that file reports with the SEC to dispense with the requirement to file a consent of Andersen in certain circumstances. Notwithstanding this relief, the inability of Andersen to provide its consent or to provide assurance services to us in the future could negatively affect our ability to, among other things, access the public capital markets. Any delay or inability to access additional financing through these markets the public markets as a result of this situation could have a material adverse impact on our business. Also, an investor's ability to seek potential

33

recoveries from Andersen related to any claims that an investor may assert as a result of the audit performed by Andersen may be limited significantly both as a result of an absence of a consent and the diminished amount of assets of Andersen that are or may in the future be available to satisfy claims.

AS A RESULT OF OUR LATE FILING OF A CURRENT REPORT ON FORM 8-K, IT MAY BE MORE TIME CONSUMING AND COSTLY FOR US TO CONSUMMATE ADDITIONAL OFFERS AND SALES OF EQUITY AND DEBT SECURITIES IN ACCORDANCE WITH APPLICABLE SECURITIES LAWS. AS A RESULT, OUR ABILITY TO RAISE CAPITAL THROUGH THE PUBLIC CAPITAL MARKETS MAY BE HINDERED.

In the event that we determine it is necessary to raise additional capital to fund its activities, we may explore the possibility of accessing the public capital markets. Because of our inability to timely file a Current Report on Form 8-K in connection with the Netaxs acquisition, under the SEC's rules

## Edgar Filing: FASTNET CORP - Form 10-Q

relating to public offerings of securities, we are not currently eligible to issue securities under a Form S-3 and will not be eligible to use Form S-3 to register additional securities in connection with a public offering prior to May 2004 and until we have made timely filings of periodic reports with the SEC for at least twelve calendar months after. Under the SEC's rules relating to the registration of securities to be sold in a public offering, a registration statement on Form S-3, as opposed to a Form S-1, permits issuers to provide more streamlined disclosure by incorporating by reference previously filed information with the SEC. As a result of the Company's inability to use Form S-3 in connection with the registration of securities, the process of registering debt or equity securities of the Company before August 2003 will be more costly and require significantly more time to consummate. In the event that our ability to access the public capital markets is limited in time, or becomes too costly for us to complete, we may be unable to raise additional capital in this manner.

34

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

#### (a) Exhibits

- 10.1 Loan and Security Agreement, dated as of April 8, 2003, among Equinox Business Credit Corp., as lender, and FASTNET Corporation, Netaxs Corp., Netreach, Inc., DASLIC Holdings Company, Supernet, Inc., FASTNET Acquisition Corp., and FASTNET Acquisition, Inc., as borrowers. (Incorporated herein by reference to the Company's Current Report on Form 8-K, dated April 8, 2003, and filed with the Securities and Exchange Commission on April 11, 2003.
- 10.2 Amendment No. 1 to Loan and Security Agreement, dated April 10, 2003 by and between the Company and Equinox Business Credit Corp. Netaxs Corp., NetReach Inc., DASLIC Holding Companies, SuperNet Inc., FASTNET Acquisition Corp. and FASNET Acquisition, Inc.
- 99.1 Certification of President and Chairman of the Company pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99.2 Certification of Chief Financial Officer of the Company pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

#### SIGNATURES

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

FASTNET Corporation:

Date: May 15, 2003

/s/ R. Barry Borden

-----  
R. Barry Borden  
Chairman and President  
(Principal Executive Officer)

Edgar Filing: FASTNET CORP - Form 10-Q

Date: May 15, 2003

/s/ Ward Schultz

-----  
Ward Schultz  
Chief Financial Officer (Principal  
Financial & Accounting Officer)

35

CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, R. Barry Borden, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended March 31, 2003 of FASTNET Corporation (this "Report");

2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this Report (the "Evaluation Date"); and

c) presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors;

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this Report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent

## Edgar Filing: FASTNET CORP - Form 10-Q

to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 15, 2003

/s/ R. Barry Borden

-----  
R. Barry Borden  
President and Chairman  
(Principal Executive Officer)

36

### CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Ward Schultz, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended March 31, 2003 of FASTNET Corporation (this "Report") ;

2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this Report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors;

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's

Edgar Filing: FASTNET CORP - Form 10-Q

internal controls; and

6. The registrant's other certifying officer and I have indicated in this Report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 15, 2003

/s/ Ward Schultz

-----  
Ward Schultz  
Chief Financial Officer  
(Principal Financial Officer)

37

EXHIBIT INDEX

-----

- 10.1 Loan and Security Agreement, dated as of April 8, 2003, among Equinox Business Credit Corp., as lender, and FASTNET Corporation, Netaxs Corp., Netreach, Inc., DASLIC Holdings Company, Supernet, Inc., FASTNET Acquisition Corp., and FASTNET Acquisition, Inc., as borrowers. (Incorporated herin by reference to the Company's Current Report on Form 8-K, dated April 8, 2003, and filed with the Securities and Exchange Commission on April 11, 2003.
- 10.2 Amendment No. 1 to Loan and Security Agreement, dated April 10, 2003 by and between the Company and Equinox Business Credit Corp. Netaxs Corp., NetReach Inc., DASLIC Holding Companies, SuperNet Inc., FASTNET Acquisition Corp. and FASNET Acquisition, Inc.
- 99.1 Certification of President and Chairman of the Company pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99.2 Certification of Chief Financial Officer of the Company pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

38