FASTNET CORP
Form 10-Q
August 14, 2001

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 JUNE 30, 2001

[ ] 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 |X| No | |

The number of shares of the registrant's Common stock outstanding as of August 14, 2001 was 17,990,947.

FASTNET CORPORATION

FORM 10-Q

JUNE 30, 2001

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

FASTNET CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

DECEMBER 31,

	2000
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	$ 5,051,901
Marketable securities	18,455,543
Accounts receivable, net of allowance of $776,977 and $858,527	2,570,154
Other current assets	521,781
Total current assets	26,599,379
PROPERTY AND EQUIPMENT, net	19,631,011
INTANGIBLES, net	2,350,274
OTHER ASSETS	396,710
	$ 48,977,374
LIABILITIES AND SHAREHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Current portion of long-term debt	$ 17,541
Current portion of capital lease obligations	4,681,781
Accounts payable	2,576,087
Accrued expenses	3,804,893
Deferred revenues	3,113,321
Accrued restructuring	4,045,643
Total current liabilities	18,239,266
LONG-TERM DEBT	29,746
CAPITAL LEASE OBLIGATIONS	7,105,678
OTHER LIABILITIES	78,107
SHAREHOLDERS' EQUITY:	
Preferred stock (10,000,000 shares authorized, no shares outstanding at December 31, 2000 and June 30, 2001)	--
Common stock (50,000,000 shares authorized, 15,990,947 and 17,990,947 shares outstanding at December 31, 2000 and June 30, 2001)	64,414,205
Deferred compensation	(797,354
Note receivable	(437,500
Accumulated other comprehensive income	17,763
Accumulated deficit	(38,672,537
Less - Treasury stock, at cost	(1,000,000
Total shareholders' equity	23,524,577
	$ 48,977,374

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

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FASTNET CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	THREE MONTHS ENDED JUNE 30,		SIX
	2000	2001	2000
REVENUES	$ 3,168,815	$ 4,043,289	$ 6,199,1
OPERATING EXPENSES:			
Cost of revenues	3,143,893	2,930,508	5,642,0
Selling, general and administrative	5,046,754	2,988,527	8,725,7
Depreciation and amortization	1,113,252	1,957,641	2,115,2
	9,303,899	7,876,676	16,482,9
Operating loss	(6,135,084)	(3,833,387)	(10,283,8
OTHER INCOME (EXPENSE):			
Interest income	695,955	171,656	1,014,7
Interest expense	(135,036)	(242,126)	(523,1
Other	(1,290)	(867)	(4,7
	559,629	(71,337)	486,8
NET LOSS	$ (5,575,455)	$ (3,904,724)	$ (9,796,9
BASIC AND DILUTED NET LOSS PER COMMON SHARE	$ (0.37)	$ (0.23)	$ (0.
SHARES USED IN COMPUTING BASIC AND DILUTED NET LOSS PER COMMON SHARE	14,989,804	17,345,112	13,339,5

The accompanying notes are an integral part of these consolidated statement

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FASTNET CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

SIX MONTHS
JUNE 3

	2000
OPERATING ACTIVITIES:	
Net loss	$ (9,796,964)
Adjustments to reconcile net loss to net cash used in operating activities -	
Depreciation and amortization	2,115,241
Amortization of debt discount	255,802
Amortization of deferred compensation	213,650
Changes in operating assets and liabilities -	
Decrease (increase) in assets -	
Accounts receivable	(184,948)
Other assets	(680,585)
Increase (decrease) in liabilities -	
Accounts payable and accrued expenses	(161,036)
Deferred revenues	398,722
Accrued restructuring	--
Other liabilities	(779,553)
Net cash used in operating activities	(8,619,671)
INVESTING ACTIVITIES:	
Purchases of property and equipment	(3,717,428)
Cash acquired in business acquisition	--
Sales (purchases) of marketable securities, net	(35,695,013)
Net cash provided by (used) in investing activities	(39,412,441)
FINANCING ACTIVITIES:	
Proceeds from long-term debt	1,027,994
Repayments of long-term debt	(1,017,991)
Repayments of capital lease obligations	(791,353)
Proceeds from issuance of Common stock, net	49,646,878
Net cash provided by (used in) financing activities	48,865,528
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	833,416
CASH AND CASH EQUIVALENTS, beginning of period	953,840
CASH AND CASH EQUIVALENTS, end of period	$ 1,787,256

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

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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"), a Pennsylvania corporation, has been providing Internet access services to its customers since 1994. The Company is a growing business Internet communications, web hosting and colocation provider targeting small and medium sized enterprises in selected high growth secondary markets in the Northeastern area 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.

QUARTERLY FINANCIAL INFORMATION AND RESULTS OF OPERATIONS

The accompanying unaudited financial information as of June 30, 2000 and 2001 and for the six months ended June 30, 2000 and 2001 has been prepared in accordance with accounting principles generally accepted in the United States. 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 six months ended June 30, 2001 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.

MANAGEMENT'S USE OF ESTIMATES

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

LIQUIDITY AND GOING CONCERN

The Company's business plan has required substantial capital to fund operations, capital expenditures, expansion of sales and marketing capabilities, and acquisitions. The Company modified its business strategy in October 2000, to allow it to maintain operations without any additional funding in the foreseeable future. Simultaneous with the modification of its strategic plan, the Company recorded a charge primarily related to network and telecommunication optimization and cost reduction, facility exit costs, realigned marketing strategy, and involuntary employee terminations. As a result of its modified strategy, the Company has realized a reduction in its cash consumption both as a percentage of revenues and in nominal dollars.

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The Company has incurred losses since inception and expects to continue to incur losses in 2001. As of June 30, 2001, the Company's accumulated deficit was $46,542,565. As of June 30, 2001, cash and cash equivalents and marketable securities were $12,779,557. The Company believes that its existing cash and cash equivalents and marketable securities will be sufficient to meet its

working capital and capital expenditure requirements into 2002. However, the Company may be required to seek additional sources of financing. If additional funds are raised through the issuance of equity securities, existing shareholders may experience significant dilution. 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 further modifications to its strategic plan. These further modifications could harm the Company's business, financial condition, or results of operations.

The Company is subject to those risks associated with companies operating in the telecommunication services 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, dependence on major customers, risks from competition, new products and technological change, price and margin pressures and dependence on key personnel.

COMPREHENSIVE INCOME

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 by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from in the shareholders' equity section of the balance sheet. For the three and six months ended June 30, 2000 and 2001, comprehensive loss was as follows:

	THREE MONTHS ENDED		SIX MONTHS E	
	JUNE 30, 2000	JUNE 30, 2001	JUNE 30, 2000	
Net loss	$(5,575,455)	$(3,904,724)	$(9,796,964)	$(
Unrealized gain (loss) on marketable securities	(1,896)	5,734	(2,999)	
Comprehensive loss	$(5,577,351)	$(3,898,990)	$(9,799,963)	$(

REVENUE RECOGNITION

Revenues include one-time and recurring charges to customers for connectivity services.. One-time charges primarily relate to the initial connection fees and are recognized as revenue over the life of the customer contract. The Company recognizes recurring connectivity revenues over the period the services are provided. The Company offers contracts for Internet solutions that are generally paid for in advance by customers. Revenue recognition on these advance payments is deferred at the time of billing and recognized as revenue ratably over the service period.

Revenues are also derived from the resale of products, including hardware and software, colocation and web hosting services. The Company sells its colocation and 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 contractual period as services are provided. Incremental fees

for excess bandwidth usage and data storage are billed and recognized as revenues in the period in which customers utilize such services.

MAJOR CUSTOMERS

The Company derived revenues of approximately 24%, 13%, 25% and 14% for the three months ended June 30, 2000 and 2001 and the six months ended June 30, 2000 and 2001 respectively, from the Company's largest customer, WebTV. FASTNET expects to discontinue all services to WebTV by September 2001. As of June 30, 2001, the Company had outstanding accounts receivable from this customer of $312,133. No other customer accounted for more than 10% of total revenues for the periods presented.

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RECLASSIFICATIONS

Certain reclassifications have been made to the prior period to conform to the current period presentation.

(2) INITIAL PUBLIC OFFERING

On February 7, 2000, the Company completed its initial public offering of 4,000,000 shares of Common stock at a price of $12.00 per share. An additional 600,000 shares of Common stock were issued pursuant to the exercise of the underwriters' over-allotment option. The Company received net proceeds of $49,605,981 from the initial public offering and the exercise of the over-allotment option.

(3) ACQUISITION

On March 14, 2001, the Company acquired all the assets and substantially all the liabilities of Cybertech Wireless, Inc., ("Cybertech") a provider of fixed wireless Internet services headquartered in Rochester, NY, for 2,000,000 shares of common stock valued at $1,875,000. The results of operations from the acquired business have been included in the consolidated financial statements from the date of acquisition. The Company recorded the acquisition using the purchase method of accounting pursuant to Accounting Principles Board ("APB") No. 16, "Accounting for Business Combinations." The excess of the purchase price over the fair value of net assets acquired was preliminarily determined to be $1,200,397. This entire amount was preliminarily allocated to acquired technology and is being amortized on a straight-line basis over 3 years. Amortization expense for the six months ended June 30, 2001, was $120,124. Pro forma information for Cybertech is not material, and therefore, has not been presented..

The following table lists noncash assets that were acquired and liabilities that were assumed as a result of the acquisition:

Noncash assets:	
Accounts receivable	$ 82,402
Other current assets	660,183
Property and equipment	1,395,137
Intangibles	1,200,397
	$ 3,338,119
Assumed liabilities:	
Accounts payable	$ 1,013,626
Accrued expenses	226,231

Deferred revenues	181,083
Debt	250,000
Other liabilities	1,000
	1,671,940
Net noncash assets acquired	1,666,179
Purchase price paid in stock ...	(1,875,000)
Cash acquired	$ (208,821)

(4) CASH, CASH EQUIVALENTS AND MARKETABLE SECURITIES

FASTNET considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

Management determines the appropriate classification of its investments in debt and equity securities at the time of purchase and reevaluates such determinations at each balance sheet date. As of June 30, 2001, all of the Company's investments are classified as available for sale and are included in marketable securities in the accompanying consolidated balance sheets.

The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion as well as interest are included in interest income. Realized gains and losses are included in other income in the accompanying consolidated statements of operations. The cost of securities sold is based on the specific identification method.

The Company's investments in debt and equity securities are diversified among high-credit quality securities in accordance with the Company's investment policy.

(5) PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	DECEMBER 31, 2000	JUNE 30, 2001
Equipment	$ 17,811,184	$ 19,068,204
Computer equipment	1,815,519	2,100,725
Computer software	1,584,685	1,700,023
Furniture and fixtures	609,661	645,453
Leasehold improvements	2,961,217	3,225,481
	24,782,266	26,739,886
Less-Accumulated depreciation and amortization	(5,151,255)	(8,006,969)
	$ 19,631,011	$ 18,732,917

Depreciation and amortization expense for the three months ended June 30, 2000 and 2001 and the six months ended June 30, 2000 and 2001 was $741,375, $1,483,926, $1,371,489 and $2,855,714, respectively. The net carrying value of property and equipment under capital leases was $11,604,918 and $8,366,990 at

December 31, 2000 and June 30, 2001, respectively.

(6) INTANGIBLE ASSETS

Intangible assets represent the purchase price of an acquired business over the fair value of the net tangible assets at the date of acquisition. Goodwill and intangible assets are being amortized on the straight-line basis over 3 years. The carrying value of goodwill and other intangibles are evaluated periodically based on fair values or undiscounted operating cash flow whenever significant events or changes occur which might impair recovery of recorded costs. The Company believes that no impairment of goodwill or other intangible exists at June 30, 2001. Amortization of goodwill and other intangible assets was approximately $371,877, $473,715, $743,752 and $863,878 for the three months ended June 30, 2000 and 2001 and the six months ended June 30, 2000 and 2001, and is included in depreciation and amortization expense (See Note 9).

(7) RESTRUCTURING CHARGE

On October 10, 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 "Restructuring Plan.") Selling and marketing efforts will be focused on markets located in Pennsylvania and New Jersey. The Restructuring Plan includes redesigning the network architecture intended to achieve an overall reduction in telecommunication expenses. In conjunction with the Restructuring Plan, the Company terminated 44 employees.

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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 costs in the markets being closed. These costs consist of both Internet backbone connectivity cost, as well as network and access costs.. Leasehold termination payments includes 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.

During the fourth quarter of 2000, the Company recorded a charge for $5,159,503. Of this restructuring charge, $2,043,263 has not been paid as of June 30, 2001 and is, accordingly, classified as accrued restructuring. The Company anticipates that the total amount accrued will be paid in 2001. The restructuring charges were determined based on formal plans approved by the Company's management and Board of Directors using the information available at the time. Management of the Company believes this provision will be adequate to cover any future costs incurred relating to the restructuring. In addition, the Company recorded a $3,233,753 asset impairment charge as a result of the Restructuring Plan in December 2000.

The activity in the restructuring charge accrual during the six months ended June 30, 2001 is summarized in the table below:

	ACCRUED RESTRUCTURING CHARGE AS OF	CASH PAYMENTS DURING THE SIX MONTHS ENDED	ACCRUED RESTRUCTURING CHARGE AS OF

	DECEMBER 31, 2000	JUNE 30, 2001	JUNE 30, 2001
Telecommunications exit and termination fees	$2,552,472	$1,133,481	$1,418,991
Leasehold termination costs	708,818	355,565	353,253
Sales and marketing contract terminations ..	522,520	391,362	131,158
Facility exit costs	261,833	121,972	139,861
	$4,045,643	$2,002,380	$2,043,263

(8) LEASE ARRANGEMENT

During the first quarter of 2000, the Company received a credit line of $3,000,000 from a vendor to purchase equipment. In April 2000, the same vendor added a second credit facility of $5,000,000 to the original credit facility. These credit facilities were used to secure computer-related equipment under three-year capital leases.

In June 1999, the Company entered into a $20,000,000 master equipment lease agreement with an equipment vendor. Leases under the agreement are payable in three monthly installments of 0.83% of the value of the equipment leased and 33 monthly installments of 0.0345% of the value of the equipment leased. Capital lease obligations related to the credit facilities as of June 30, 2001 totaled $4.1 million. In August 2001, the Company signed a Settlement and Release

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Agreement to settle the capital lease obligations. Pursuant to the agreement, the Company made a $2,000,000 cash payment in August 2001 to the vendor in exchange for full satisfaction of all of the Company's obligations related to this arrangement. Additionally, the Company received title to the equipment subject to this lease. An extraordinary gain on early extinguishment of debt will be recorded in the third quarter of 2001 of the excess capital lease obligation over the one-time cash payment

(9) RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141 "Business Combinations" and SFAS No. 142 "Goodwill and Other Intangible Assets." SFAS No. 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangibles will be evaluated against this new criteria and may result in certain intangibles being subsumed into goodwill, or alternatively, amounts initially recorded as goodwill may be separately identified and recognized apart from goodwill. SFAS No. 142 requires the use of a nonamortization approach to account for purchased goodwill and certain intangibles. Under a nonamortization approach, goodwill and certain intangibles will not be amortized into results of operations, but instead would be reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and certain intangibles is more than its fair value. The provisions of each statement which apply to goodwill and intangible assets acquired prior to June 30, 2001 will be adopted by the Company on January 1, 2002. We expect the adoption of these accounting standards will result in certain of our intangibles being subsumed into goodwill and will have the impact of reducing our amortization of goodwill and intangibles commencing January 1, 2002; however, impairment reviews may result in future

periodic write-downs.

(10) NET LOSS PER COMMON SHARE

The Company has presented net loss per 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 stock options. Outstanding 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 losses.

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. 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 PART II. THE FORWARD-LOOKING STATEMENTS ARE SUBJECT TO A NUMBER OF RISKS AND UNCERTAINTIES INCLUDING, BUT NOT LIMITED TO, OUR ABILITY TO: OFFER OUR CUSTOMERS IN THE NEW YORK REGION THE FULL SUITE OF PRODUCTS AND SERVICES THAT WE OFFER OUR OTHER CUSTOMERS; INCREASE OUR ACCESS AND ENHANCED REVENUES AS A PERCENTAGE OF OUR TOTAL REVENUES; UTILIZE CYBERTECHS' EMPLOYEE NETWORK KNOWLEDGE TO BUILD OUT WIRELESS NETWORKS IN SELECTED EXISTING FASTNET MARKETS; EXPAND OUR CUSTOMER BASE; MIGRATE CUSTOMERS FROM OUR COMPETITORS IF THE INDUSTRY CONTINUES TO CONSOLIDATE; GROW OUR REVENUES BY CAPTURING MARKET SHARE FROM OTHER PROVIDER AND THROUGH SALES OF ALTERNATIVE SERVICE OFFERINGS; REDUCE OUR COST OF REVENUES AND CASH CONSUMPTION RATE; MAINTAIN OPERATIONS WITHOUT ANY ADDITIONAL FUNDING INTO 2002. ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THE RESULTS DISCUSSED IN THE FORWARD-LOOKING STATEMENTS. THE INFORMATION CONTAINED HEREIN IS CURRENT ONLY AS OF THE DATE OF THIS FILING AND WE UNDERTAKE NO OBLIGATION TO UPDATE THE INFORMATION IN THIS FORM 10-Q IN THE FUTURE.

OVERVIEW

We are an Internet solutions provider offering broadband data communication services and enhanced products and services to businesses in selected high growth second tier markets in the Northeastern United States. Our services include high-speed data and Internet services, data center services, including managed and unmanaged web hosting and colocation services, small office home office (SOHO) Internet access, wholesale ISP services, and various professional services including web design and development. We focus our sales and marketing efforts on businesses in the markets we serve using the value proposition of leveraging our technical expertise with world-class customer care. We approach our customers from an access independent position, providing connectivity over a variety of available technologies. These include classic Telco provided point-to-point, frame relay, ISDN, SMDS, ATM, and DSL. We also offer FASTNET controlled last mile Internet access utilizing wireless transport.

On February 7, 2000, we completed an initial public offering of 4,000,000 shares of Common stock at a price of $12.00 per share. On March 7, 2000, we sold 600,000 shares of Common stock at a price of $12.00 per share pursuant to the exercise of the underwriter's over-allotment option. We received aggregate net cash proceeds of $49,605,981 from the initial public offering and exercise of the over-allotment option.

On March 14, 2001, we acquired all the assets and substantially all the liabilities of Cybertech Wireless, Inc. ("Cybertech"), a provider of wireless high speed Internet access, web hosting and SOHO access located in New York State. Cybertech has deployed wireless networks in Rochester, Syracuse, Albany and Buffalo. Once the integration is complete, we believe we will be able to offer our customers in the New York region the full suite of products and services offered to customers in our Pennsylvania and New Jersey markets. We will also utilize Cybertech's employee network deployment knowledge to build out wireless networks in selected existing FASTNET markets.

As of June 30, 2001, we provided Internet access and enhanced services to approximately 1,033 enterprise customers, 20,501 SOHO customers, and 8,085 customers using our web hosting and colocation services.

RECENT DEVELOPMENTS

In August 2001, the Company signed a Settlement and Release Agreement to settle certain capital lease obligations. Pursuant to the agreement, the Company made a $2,000,000 cash payment in August 2001 to the lender in exchange for full satisfaction of all of the Company's obligations related to this arrangement. Additionally, the Company received title to the equipment subject to this lease. An extraordinary gain on early extinguishments of debt will be recorded in the third quarter of 2001 of the excess capital lease obligation over the one-time cash payment.

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, 2001 as we seek to execute our revised business plan. Our net losses were $1,274,290, $5,601,071 and $31,140,920 for the years ended December 31, 1998, 1999, 2000 respectively, and $7,870,028 for the six months ended June 30, 2001.

MODIFICATION OF OUR STRATEGIC PLAN

On October 10, 2000, we modified our strategic plan. This modified plan called for the suspension of selling and marketing efforts in 12 of the 20 markets that were operational as of September 30, 2000.

Simultaneous with the modification of our strategic plan, we recorded a restructuring charge of $5,159,503 primarily related to network and telecommunication optimization and cost reduction, facility exit costs, realigned marketing strategy, and involuntary employee terminations

The activity in the restructuring charge accrual during the six months ended June 30, 2001 is summarized in the table below:

	ACCRUED RESTRUCTURING	CASH PAYMENTS DURING THE	ACCRUED RESTRUCTURING

	CHARGE AS OF DECEMBER 31, 2000	SIX MONTHS ENDED JUNE 30, 2001	CHARGE AS OF JUNE 30, 2001
Telecommunications exit and termination fees	$2,552,472	$1,133,481	$1,418,991
Leasehold termination costs	708,818	355,565	353,253
Sales and marketing contract terminations ..	522,520	391,362	131,158
Facility exit costs	261,833	121,972	139,861
	$4,045,643	$2,002,380	$2,043,263

RESULTS OF OPERATIONS

REVENUES

We provide services to our customers, which we classify in three general types: Internet access and enhanced services, SOHO Internet access, and Dialplex virtual private network (VPN) services. We target our Internet access and enhanced services to businesses located within our active markets. FASTNET offers a broad range of dedicated access solutions including T-1, T-3, Frame Relay, SMDS, enterprise class Digital Subscriber Line (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. We also classify our dedicated and shared web hosting and colocation services as part of our enhanced services. 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. Access and enhanced revenues are recognized as services are provided. We expect our access and enhanced 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. We believe as the industry consolidates that we will have opportunities to migrate customers from our competitors as their customers become dissatisfied with the level of

service provided by the consolidated organizations. In addition, the recent economic challenges have caused other providers to either cease operations or terminate certain product offerings. We seek to grow our revenues by capturing market share from other providers.

Our SOHO revenues consist of dial-up Internet access to both residential and small office business customers, SOHO DSL Internet access, and Integrated Services Digital Network (ISDN) Internet access. Customers using our SOHO 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 SOHO revenues to decrease as a percentage of total revenues. We have reduced selling and marketing efforts targeted to this customer base in response to increased competition from both

free Internet service providers and other providers.

We also offer our customers virtual private network (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 backbone providers and maintaining our network. Cost of revenues also includes engineering payroll, creative and programming staff payrolls for web design and development and, the cost of third party hardware and software that we sell to our customers, facility rental expense for in market network infrastructure, and rental expense on network equipment financed under operating leases.

THE THREE MONTHS ENDED JUNE 30, 2001 COMPARED TO THE THREE MONTHS ENDED JUNE 30, 2000

REVENUES. Revenues increased by $874,000, or 28%, to $4.0 million for the three months ended June 30, 2001 from $3.2 million for the three months ended June 30, 2000. This increase in revenues is primarily a result of an increase in the number of business customers using our dedicated Internet access and enhanced products and services. Our dedicated Internet access customer base grew by 89% from 547 as of June 30, 2000, to 1,033 as of June 30, 2001. Additionally, revenues increased due to the acquisition of Cybertech in March 2001. Our revenue growth from our business and enterprise customers for the three months ended June 30, 2001 was partially offset by the following factors. We lost 33 directly connected business customers using our DSL services due to the business failure of NorthPoint Communications, Inc. We anticipate that revenues generated from DSL services will continue to decline as a percentage of our dedicated access revenues as uncertainty about other national DSL providers grows following recent announcements. We expect, however, that part of this decline will be offset by sales of alternative service offerings that we provide. We experienced a decline in revenues from Microsoft's WebTV Networks, our largest customer and largest user of our wholesale dial-up service. The revenues from this customer declined by $263,000 or 34% from $774,000 for the three months ended June 30, 2000 to $511,000 for the three months ended June 30, 2001. FASTNET expects to discontinue all services to WebTV by September 2001. Our decision to discontinue service is based on our commitment to improve gross margins as well as to remain focused on our core markets.

COST OF REVENUES. Cost of revenues decreased by $213,000, or 7%, from $3.1 million for the three months ended June 30, 2000 to $2.9 million for the three months ended June 30, 2001. Gross margin increased from 1% for the three months ended June 30, 2000 to 28% for the three months ended June 30, 2001. The decrease in cost of revenues and the improvement in gross margin was primarily due to the reduction in the size and improvement in the efficiency of our network along with reduced pricing on network elements. Offsetting the decrease in cost of revenues was the additional cost of revenues associated with the acquisition of Cybertech. Additionally, the Company reflected credits resulting from telecommunication providers billing errors of $253,000 during the three months ended June 30, 2001. If these credits had not been included, gross margins would have been 21%.

SELLING, GENERAL, AND ADMINISTRATIVE. Selling, general and administrative expenses decreased by $2.1 million, or 41%, from $5.1 million for the three months ended June 30, 2000 to $3.0 million for the three months ended June 30, 2001. Selling, general and administrative personnel decreased by 37

employees from 123 employees at June 30, 2000 to 86 employees at June 30, 2001. The June 30, 2001 employee count includes those employees that were retained as part of the Cybertech acquisition. Advertising and promotional expenses decreased by $756,000 from $880,000 for the three months ended June 30, 2000 to $124,000 for the three months ended June 30, 2001. This decrease resulted from the elimination or reduction of advertising expenses in markets where the Company discontinued its direct field sales efforts. The remaining decline in selling, general, and administrative expenses relates to the Company's continued general cost containment efforts as well as internal systems optimizations during the three months ended June 30 2001.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization increased by $844,000, or 76%, from $1.1 million for the three months ended June 30, 2000 to $2.0 million for the three months ended June 30, 2001. This increase is due to additional depreciation relating to networking equipment acquired during 2000 and the six months ended June 30, 2001 and the depreciation on the assets acquired from the Cybertech transaction. In addition, there was an increase in amortization related to the Cybertech transaction. Amortization expense related to Cybertech was $103,000 for the three months ended June 30, 2001.

OTHER INCOME/EXPENSE. Interest income decreased by $524,000 from $696,000 for the three months ended June 30, 2000 to $172,000 for the three months ended June 30, 2001. This decrease in interest income resulted from the increased use of our marketable securities to fund operations coupled with a decrease in the related investment returns. Interest expense increased by $107,000 from $135,000 for the three months ended June 30, 2000 to $242,000 for the three months ended June 30, 2001. The increase in interest expense is primarily the result of equipment that we financed to expand our network infrastructure. We expect interest income to decrease as we use our cash and marketable securities to fund operations. Interest expense is expected to decrease as a result of the early extinguishments of $4.1 million of capital lease obligations in August 2001.

THE SIX MONTHS ENDED JUNE 30, 2001 COMPARED TO THE SIX MONTHS ENDED JUNE 30, 2000

REVENUES. Revenues increased by $1.5 million, or 24%, to $7.7 million for the six months ended June 30, 2001 from $6.2 million for the six months ended June 30, 2000. This increase in revenues is primarily a result of an increase in the number of business customers using our dedicated Internet access and enhanced products and services. Our dedicated Internet access customer base grew by 89% from 547 as of June 30, 2000 to 1,033 as of June 30, 2001. Additionally, revenues increased due to the acquisition of Cybertech in March 2001. Our revenue growth from our business and enterprise customers for the first six months of 2001 was partially offset by the following factors. We lost 33 directly connected business customers using our DSL services due to the business failure of Northpoint Communications, Inc. We anticipate that sales of DSL services will continue to decline as a percentage of our dedicated access revenues as uncertainty about other national DSL providers grows following recent announcements. We expect, however, that part of this decline will be offset by sales of alternative service offerings that we provide. We experienced a decline in revenues from WebTV, our largest customer and user of our wholesale dial-up service. The revenues from this customer declined by $450,000 from $1.5 million for the six months June 30, 2000, to $1.1 million for the six months ended June 30, 2001. FASTNET expects to discontinue all services to WebTV by September 2001. Our decision to discontinue service is based on our commitment to improve gross margins as well as to remain focused on our core markets.

COST OF REVENUES. Cost of revenues increased by $438,000, or 8%, from $5.6 million for the six months ended June 30, 2000 to $6.1 million for the six months ended June 30, 2001. Gross margin improved by 191% from 9% for the six months ended June 30, 2000 to 21% for the six months ended June 30, 2001. The increase in cost of revenues is due to the time lag in the expected benefits from the reduction in our network infrastructure and the additional telecommunications services purchased to support the anticipated growth in the wholesale dial-up subscribers that was not achieved. Also included in this increase is the cost of revenues of Cybertech which were not included in our operating results prior to March 15, 2001. The improvement in gross margin is due to the reduction in the size and improvement in the efficiency of our network along with reduced pricing on network elements. Offsetting the decrease in cost of revenues was the additional cost of revenues associated with acquisition of Cybertech. Additionally, the Company reflected credits resulting from telecommunication providers billing errors of $253,000 during the six months ended June 30, 2001. If these credits had not been included, gross margins would have been 18%

SELLING, GENERAL, AND ADMINISTRATIVE. Selling, general and administrative expenses decreased by $3.0 million, or 34%, from $8.7 million for the six months ended June 30, 2000 to $5.7 million for the six months ended June 30, 2001. The decrease is partially due to $705,000 of non-recurring charges that were included in the six months ended June 30 2000 relating to non-cash compensation charges. Selling, general and administrative personnel decreased by 37 employees from 123 employees at June 30, 2000 to 86 employees at June 30, 2001. The June 30, 2001 employee count includes those employees that were retained as part of the Cybertech acquisition. Advertising and promotional expenses decreased by $913,000 from $1.2 million for the six months ended June 30, 2000, to $263,000 for the six months ended June 30, 2001. This decrease resulted from the elimination or reduction of these expenses in markets where we had discontinued our direct field sales efforts. The remaining decline in selling, general, and administrative expenses relates to general cost containment efforts the company continued during the first six months of 2001.

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DEPRECIATION AND AMORTIZATION. Depreciation and amortization increased by $1.6 million, or 76%, from $2.1 million for the six months ended June 30, 2000 to $3.7 million for the six months ended June 30, 2001. This increase is comprised of additional depreciation related to networking equipment acquired during 2000 and the six months ended June 30, 2001 and the depreciation on the assets acquired from the Cybertech transaction. In addition, there was an increase in amortization of $121,000 for the six months ended June 30, 2001 related to the Cybertech acquisition.

OTHER INCOME/EXPENSE. Interest income decreased by $536,000 from $1.0 million for the six months ended June 30, 2000 to $479,000 for the six months ended June 30, 2001. This decrease in interest income resulted from the use of marketable securities to fund operations coupled with a decrease in the related investment returns. Interest expense decreased by $23,000 from $523,000 for the six months ended June 30, 2000 to $500,000 for the six months ended June 30, 2001. The decrease in interest expense is primarily the result of a one-time charge for the amortization of debt discount of $255,802 related to the warrant issued in connection with the January 19, 2000 bridge financing recorded in the first six months of 2000. We expect interest income to decrease as we use our cash and marketable securities to fund operations. Interest expense is expected to decrease as a result of the early extinguishments of $4.1 million of capital lease obligations in August 2001.

CASH FLOWS ANALYSIS

	SIX MONTHS ENDED JUNE 30, 2000	SIX MONTHS ENDED JUNE 30, 2001
Other Financial Data:		
Cash flows used in operating activities	$ (8,620,000)	$ (8,993,000)
Cash flows provided by (used in) investing activities	(39,412,000)	10,185,000
Cash flows provided by (used in) financing activities	48,866,000	(1,299,000)
Net increase (decrease) in cash and cash equivalents	$ 834,000	$ (107,000)

Cash flows from operating activities increased by $373,000 from cash used of $8.6 million for the six month period ended June 30, 2000 to cash used of $9.0 million for the six month period ended June 30, 2001. This increase in cash used in operations is primarily the result of payments made to reduce our accrued restructuring charge, partially offset by a reduction in net loss.

Cash flows from investing activities increased by $49.6 million from cash used of $39.4 million for the six months ended June 30, 2000 to cash provided of $10.2 million for the six months ended June 30, 2001. This increase in cash flows is primarily attributable to the Company's sales rather than purchases of marketable securities and a decrease in purchases of property and equipment.

Cash flows from financing activities decreased by $50.2 million from cash provided of $48.9 million for the six months ended June 30, 2000 to cash used of $1.3 million during the six months ended June 30, 2001. The decrease in cash flows from financing activities is primarily the result of the cash inflows from the Company's Initial Public Offering and exercise of the underwriters' over allotment partially offset by an increase in payment for capital lease obligations.

LIQUIDITY AND CAPITAL RESOURCES

The business plan we executed at the time of our IPO required substantial capital to fund operations, capital expenditures, expansion of sales and marketing capabilities, and acquisitions. We modified our business strategy in October 2000 to allow us to maintain operations without any additional funding into 2002. Simultaneous with the modification of our strategic plan, we recorded a non-recurring charge primarily related to network and telecommunication optimization and cost reduction, facility exit costs, realigned marketing strategy, and involuntary employee terminations. These actions have, to date, resulted in a reduction of our cash consumption rate. As of June 30, 2001, we had $12.8 million in cash and marketable securities. While we may pursue additional sources of funding, we believe that the cash and investments we have available will be sufficient to fund operations into 2002.

During the fourth quarter of 2000, the Company recorded a charge for $5,159,503. Of this restructuring charge, $2,043,263 has not been paid as of June 30, 2001 and is, accordingly, classified as accrued restructuring. The Company anticipates that the entire amount accrued will be paid in 2001. The restructuring charges were determined based on formal plans approved by the Company's management and Board of Directors using the information available at the time. Management of the Company believes this provision will be adequate to

cover any future costs incurred relating to the restructuring.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAF No. 141 "Business Combinations" and SFAS No. 142 "Goodwill and Other Intangible Assets." SFAS No. 141 required business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangibles will be evaluated against this new criteria and may result in certain intangibles being subsumed into goodwill, or alternatively, amounts initially recorded as goodwill may be separately identified and recognized apart from goodwill. SFAS No. 142 requires the use of a nonamortization approach to account for purchased goodwill and certain intangibles. Under a nonamortization approach, goodwill and certain intangibles will not be amortized into results of operations, but instead would be reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and certain intangibles is more than its fair value. The provisions of each statement which apply to goodwill and intangible assets acquired prior to June 30, 2001 will be adopted by the Company on January 1, 2002. We expect the adoption of these accounting standards will result in certain of our intangibles being subsumed into goodwill and will have the impact of reducing our amortization of goodwill and intangibles commencing January 1, 2002; however, impairment reviews may result in future periodic write-downs.

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 June 30, 2001 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 June 30, 2001. 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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not involved currently in any legal proceedings that either individually or taken as a whole, are likely to have a material adverse effect on our business, financial condition and results of operations.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

(a) None.

(b) None.

(c) On March 14, 2001 we issued 2,000,000 share of our Common stock to Cybertech Wireless Inc., in connection with our purchase of the assets and substantially all of the liabilities of Cybertech. This sale was made under the exemption from registration provided under Section 4(2) of the Securities Act.

(d) Use of Proceeds of the Initial Public Offering

Our initial public offering, or IPO, was completed in February 2000. The proceeds received net of underwriting discounts and commissions, and other transaction costs were approximately $49,606,000.

From the effective date of the Registration Statement through June 30, 2001, we utilized the proceeds from the initial public offering and underwriters' over-allotment as follows:

Net IPO Proceeds	$ 49,606,000
Repayment of debt	4,723,000
Payment of other obligations	794,000
Capital Expenditures	10,282,000
Working Capital Requirements	23,605,000
Total remaining	$ 10,202,000

Unused proceeds of the initial public offering are currently invested in debt and equity securities diversified among high-credit quality securities in accordance with our investment policy.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDER

We held our Annual Meeting of Stockholders June 22, 2001. Following are descriptions of the matters voted on and the results of such meeting:

	Votes For	Votes Against	Votes Withheld	Br Non
1. Election of Directors:				
Stephen A. Hurly	13,961,349	--	210,745	
Sonny C. Hunt	13,782,734	--	389,360	
Douglas L. Michels	13,958,224	--	213,870	
David J. Farber	13,863,349	--	308,745	
R. Barry Borden	13,858,314	--	313,780	
Alan S. Kessman	13,959,384	--	212,710	
David K. Van Allen	13,681,914	--	490,180	
2. Amendment of the Company's				

	Equity Compensation Plan to increase the number of authorized shares of Common Stock reserved for issuance from 3,000,000 to 4,000,000	10,793,795	309,659	30,950
3.	Approval of the Company's 2001 Employee Stock Purchase Plan	10,982,784	121,455	30,135
4.	Proposal to ratify the appointment of Arthur Andersen, LLP as independent auditors of the Company for the year ending December 31, 2001	14,119,595	25,130	27,369

ITEM 5. OTHER INFORMATION

FACTORS AFFECTING FUTURE OPERATING RESULTS

WE ONLY BEGAN TO IMPLEMENT OUR REVISED STRATEGIC BUSINESS PLAN IN OCTOBER 2000. AS A RESULT, YOU MAY NOT BE ABLE TO EVALUATE OUR BUSINESS PROSPECTS BASED ON OUR HISTORICAL RESULTS.

In October 2000, 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. Consequently, the evaluation of our future business prospects is difficult because our historical results for the time that we were implementing our revised strategy is limited. Our success will depend upon:

- our ability to attract and sell additional products and services to our target customers;
- our ability to enter into selected product or service partnerships; and
- our ability to open new markets through acquisitions of financially sound ISPs within these new markets.

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.

ON OCTOBER 10, 2000, WE INITIATED OUR REVISED STRATEGIC PLAN. IF WE ARE UNABLE TO ACHIEVE THE EXPECTED COST SAVINGS AND REDUCTION IN CASH CONSUMPTION UNDER THIS PLAN, WE MAY HAVE TO FURTHER MODIFY OUR BUSINESS PLAN AND OUR BUSINESS COULD BE HARMED.

If we do not achieve the expected cost savings and reduction in cash consumption under this plan, then we will need to seek additional capital from public or private equity or debt sources to fund our business plan. Given the existing capital market conditions, it may be difficult or impossible to raise additional capital in the public market in the future. In addition, we cannot be certain that we will be able to raise additional capital through debt or private financing at all or on terms acceptable to us. Raising additional equity capital and issuing shares of Common stock for acquisitions likely will dilute current

shareholders. If alternative sources of financing are insufficient or unavailable, we may be required to further modify our growth and operating plans in accordance with the extent of available financing.

IF WE ARE UNABLE TO INTEGRATE CYBERTECH WIRELESS INC. WITH FASTNET, WE MAY NOT REALIZE OUR PLANNED COST SAVINGS.

We must be able to integrate the networks of FASTNET and Cybertech 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 Cybertech into the back-office operations of FASTNET, and expand Cybertech's product portfolio to include wireline connectivity services and enhanced products and services or we may not be able to achieve the operating efficiencies we anticipate.

FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999, AND THE SIX MONTHS ENDED JUNE 30, 2001 OUR LARGEST CUSTOMER ACCOUNTED FOR 20%, 21%, AND 14% OF OUR TOTAL REVENUES. WE PLAN TO TERMINATE SERVICE TO THIS CUSTOMER BEGINNING SEPTEMBER 2001.

While the termination of our relationship with WebTV, effective September 2001, will reduce our quarter over quarter revenue growth rate and may contribute to a negative quarter over quarter growth rate for the third quarter of 2001, we believe that we have proactively planned to eliminate the expenses associated with this low margin revenue stream, thereby preventing any material adverse effect on our gross margins. If we are unable to completely eliminate all of the expense related to this revenue stream then our continued expected improvements in gross margin, which is the focus of our revised business model, could be adversely effected.

WE HAVE A HISTORY OF LOSSES AND ARE UNABLE AT THIS TIME TO PREDICT IF AND WHEN WE WILL BE ABLE TO TURN PROFITABLE.

We have incurred net losses since our inception. For the years ended December 31, 1998, 1999, 2000, and the six months ended June 30, 2001 we had losses of $1.3 million, $5.6 million $31.1 million, and $7.9 million respectively.

In order to achieve profitability, we must develop and market products and services that gain broad commercial acceptance by our target customers in our target markets. We cannot give any assurances that our products and services will ever achieve broad commercial acceptance among our customers. Although our revenues have increased each year since we began operations, we cannot give any assurances that this growth in annual revenues will continue or lead to our profitability in the future. Moreover, our revised business plan may not enable us to reduce expenses or increase revenues sufficiently to permit us to turn profitable. Therefore, we cannot predict with certainty whether we will be able to obtain or sustain positive operating cash flow or that our revised business plan will allow us to generate positive cash flow into the future.

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 stockholders' equity. For the six months ended June 30, 2001, we had a net loss of $7.9 million. We cannot predict what the value of our assets or the amount of our liabilities will be in the future.

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:

- the timing of costs including those relating to construction of infrastructure and acquisitions to enter a new market;
- the timing of the introduction of new products and services;
- changes in pricing policies and product offerings by us or our competitors;
- fluctuations in demand for Internet access and enhanced products and services; and
- 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.

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

The market price of our Common stock has fluctuated significantly in the past, and is likely to continue to be highly volatile. In addition, the trading volume in our Common stock has fluctuated, 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 small capitalization, 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.

WE MAY BE UNABLE TO MAINTAIN THE STANDARDS FOR LISTING ON THE NASDAQ NATIONAL 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.

Our Common stock is listed on the Nasdaq National Market. Nasdaq requires listed companies to maintain standards for continued listing, including either a minimum bid price for shares of a company's stock or a minimum tangible net worth. For example, Nasdaq requires listed companies to maintain a minimum bid price of at least $1.00.. If a company's stock does not close with a minimum bid price of at least a $1.00 for 30 consecutive trading days, then the registrant will be out of compliance with one aspect of the Nasdaq continued listing standard. In this event, the Nasdaq's rules allow the registrant 90 days

in which to regain compliance with the Nasdaq's listing standard by having its

stock close with a minimum bid price of $1.00 or more for ten consecutive trading days. If a registrant is unable to cure the non-compliance within 90 days, then the company will be subject to delisting, pending an opportunity to appeal. Maintaining compliance with each aspect of the Nasdaq's listing stanadars is an on-going process for each listed company. If we were to be delisted from the Nasdaq National Market then trading in our stock would then be conducted on the Nasdaq SmallCap Market unless we are unable to meet the requirements for inclusion. If we were unable to meet the requirements for inclusion in the SmallCap Market, our Common stock would be traded on an electronic bulletin board established for securities that do not meet the Nasdaq listing requirements or in quotations published by the National Quotation Bureau, Inc. that are commonly referred to as the "pink sheets". As a result, it could be more difficult to sell, or obtain an accurate quotation as to the price of our Common stock and certain institutional investors might not be able to hold 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:

- commissions payable to the broker-dealer and the registered representative; and

- 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.

FUTURE SALES OF OUR COMMON 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 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 stockholders 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.

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.

On October 10, 2000, we terminated 44 employees 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 would be harmed because this would limit our ability to obtain new customers, sell products and services and provide existing customers with a high level of technical support.

WE COULD 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:

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- national Internet service providers and regional and local Internet service providers, including providers of free dial-up Internet access;
- national and regional long distance and local telecommunications carriers;
- cable operators and their affiliates;
- providers of Web hosting, colocation and other Internet-based business services;
- computer hardware and other technology companies that bundle Internet connections with their products; and
- 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 ongoing or future developments may have on us or the pricing of our 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 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 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 SMALL AND MEDIUM SIZED ENTERPRISES OF THE INTERNET FOR COMMERCE AND COMMUNICATION.

If the use of the Internet by small and medium sized 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:

- lack of inexpensive, high-speed connection options;
- a limited number of reliable local access points for business users;
- lack of affordable electronic commerce solutions;
- limited internal resources and technical expertise;
- inconsistent quality of service; and
- 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 MCI WorldCom, Inc., and other telecommunication companies as our 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 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:

- downtime due to malfunction or failure of hardware or software;
- overload conditions;
- power loss or telecommunications failures;
- human error;

- natural disasters; and
- sabotage or other intentional acts of vandalism.

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 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 COULD 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 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, in February 1999, the Federal Communications Commission concluded that at least a substantial portion of dial-up Internet traffic is jurisdictionally interstate, which could ultimately eliminate the reciprocal compensation payment requirement for Internet traffic. Should this occur our 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 a mechanism for covering the costs of terminating calls to Internet service providers, but in the interim state commissions will determine whether carriers will receive compensation for such calls. If the new compensation mechanism that may be 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 and results of operations.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

None.

(b) No reports were filed on Form 8-K during the three month period ended June 30, 2001.

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: August 14, 2001

/s/ Stephen A. Hurly

Stephen A. Hurly
Chief Executive Officer

Date: August 14, 2001

/s/ Stanley F. Bielicki

Stanley F. Bielicki
Chief Financial Officer