FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **2001-08-03** | Period of Report: **2001-06-30**
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FILER

NETNATION COMMUNICATIONS INC

CIK:**1091560**| IRS No.: **330803438** | State of Incorp.:**DE** | Fiscal Year End: **1231**
Type: **10-Q** | Act: **34** | File No.: **000-26881** | Film No.: **1696677**
SIC: **7389** Business services, nec

Mailing Address	Business Address
555 WEST HASTINGS STREET *VANCOUVER B C V6B 4N6* *CANADA*	*555 WEST HASTINGS ST* *SUITE 1410* *VANCOUVER B C V6B 4N6* *CANADA* *6046888946*

Form 10-Q

U.S. Securities and Exchange Commission
Washington, D.C. 20549

(MARK ONE)

[x] QUARTERLY REPORT UNDER 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: 000-26881

NETNATION COMMUNICATIONS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	33-08034 38
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer I.D. No.)

1410 - 555 WEST HASTINGS STREET
VANCOUVER, BRITISH COLUMBIA, CANADA, V6B 4N6
(Address of principal executive offices)
(Zip Code)

604/688-8946
(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 to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] No [ ]

The number of shares of the registrant's Common Stock outstanding as of August 2, 2001 was 15,238,321.

<TABLE>
<CAPTION>

NETNATION COMMUNICATIONS, INC.

FORM 10-Q
JUNE 30, 2001

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NETNATION COMMUNICATIONS, INC.

Condensed Consolidated Balance Sheets
(Expressed in U.S. dollars)

	June 30, 2001 (unaudited)	December 31, 2000 (audited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 875,209	$ 748,745
Accounts receivable	27,490	33,208
Prepaid expenses and deposits	98,753	131,879
Deferred expenses	486,083	541,000
	1,487,535	1,454,832
Deferred expenses, non current portion	96,375	125,044
Fixed assets, net of accumulated depreciation of $785,107		

(2000 - $471,391)	1,253,349	1,450,952
Investments	100,000	100,000
	$ 2,937,259	$ 3,130,828

LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

Current liabilities:		
Accounts payable and accrued liabilities	$ 313,244	$ 593,518
Contingent expenses (Note 4(b))	381,254	381,254
Customer deposits	78,557	64,517
Deferred revenue	1,826,570	1,901,042
Capital lease liability	13,867	13,867
	2,613,492	2,954,198
Deferred revenue, non current portion	234,429	301,287
Capital lease liability, non current portion	27,983	37,698
Stockholders' equity (deficit):		
Common stock		
Authorized:		
50,000,000 common shares with a par value of $0.0001 each		
Issued:		
15,238,321 (December 31, 2000 - 15,315,321) common shares	1,524	1,532
Additional paid-in capital	5,972,374	5,970,896
Deferred stock-based compensation	(477,148)	(666,732)
Accumulated other comprehensive income	14,601	14,601
Deficit	(5,449,996)	(5,482,652)
	61,355	(162,355)
	$ 2,937,259	$ 3,130,828

</TABLE>

See accompanying condensed notes to consolidated financial statements.

<TABLE>
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NETNATION COMMUNICATIONS, INC.

Condensed Consolidated Statements of Operations and Deficit

	Three month period ended June 30, 2001	2000	Six month period ended June 30, 2001	2000
	(unaudited)	(unaudited) (restated - Note 2)	(unaudited)	(unaudited) (restated - Note 2)
<S>	<C>	<C>	<C>	<C>
Sales	$ 1,615,550	$ 1,249,710	$ 3,190,336	$ 2,241,225
Cost of sales	519,496	499,114	1,023,814	899,806
Gross profit	1,096,054	750,596	2,166,522	1,341,419
Expenses:				
Sales and marketing	351,340	597,269	764,965	1,280,229
General and administration	570,147	685,111	1,054,057	1,119,816
Depreciation and amortization	159,971	103,407	314,844	158,867
	1,081,458	1,385,787	2,133,866	2,558,912
Net earnings (loss)	14,596	(635,191)	32,656	(1,217,493)

Deficit, start of period	(5,464,592)	(2,093,357)	(5,482,652)	(1,511,055)
Deficit, end of period	$ (5,499,996)	$ (2,728,548)	$ (5,499,996)	$ (2,728,548)
Earnings (loss) per share, basic and diluted	$ 0.00	$ (0.04)	$ 0.00	$ (0.08)
Weighted average number of common shares outstanding, basic	15,238,134	15,407,000	15,252,945	15,179,928
Weighted average number of common shares outstanding, diluted	15,327,190	15,407,000	15,357,768	15,179,928

</TABLE>

See accompanying condensed notes to consolidated financial statements.

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NETNATION COMMUNICATIONS, INC.

Condensed Consolidated Statement of Stockholders' Equity (Deficiency)
(Expressed in U.S. Dollars)

Six month period ended June 30, 2001
(Unaudited)

	Common Stock		Additional Paid-In	Deferred Stock-based	Accumulated Other Comprehensive		
	Shares	Amount	Capital	Compensation	Income	Deficit	Total
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Balance at December 31, 2000	15,315,321	$ 1,532	$5,970,896	$ (666,732)	$ 14,601	$(5,482,652)	$(162,355)
Amortization of deferred compensation	-	-	-	189,584	-	-	189,584
Issuance of common stock for cash	1,000	-	2,250	-	-	-	2,250
Cancellation of common stock	(78,000)	(8)	(772)	-	-	-	(780)
Net earnings	-	-	-	-	-	32,656	32,656
Balance at June 30, 2001	15,238,321	$ 1,524	$5,972,374	$ (477,148)	$ 14,601	$(5,449,996)	$ 61,355

</TABLE>

See accompanying condensed notes to consolidated financial statements.

<TABLE>
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NETNATION COMMUNICATIONS, INC.

Condensed Consolidated Statements of Cash Flows
(Expressed in U.S. dollars)

	Six month	Six month

	period ended June 30, 2001	period ended June 30, 2000
	(unaudited)	(restated-Note 2) (unaudited)
<S>	<C>	<C>
Cash flows from operating activities:		
Net earnings (loss)	$ 32,656	$ (1,217,493)
Items not involving cash:		
Depreciation and amortization	314,844	158,867
Employee stock-based compensation	189,584	189,666
Change in operating assets and liabilities:		
Accounts receivable	5,718	(162,734)
Prepaid expenses and deposits	33,126	(99,219)
Deferred expenses	83,586	(512,763)
Accounts payable and accrued liabilities	(280,274)	498,602
Deferred revenue	(141,330)	1,461,506
Customer deposits	14,040	88,914
Net cash provided by operating activities	251,950	405,346
Cash flows from investing activities:		
Purchase of fixed assets	(117,241)	(1,101,392)
Net cash used for investing activities	(117,241)	(1,101,392)
Cash flows from financing activities:		
Proceeds from sale of common stock, net of offering costs	2,250	2,348,419
Lease financing	(9,715)	-
Cancellation of shares	(780)	-
Net cash provided by (used in) financing activities	(8,245)	2,348,419
Increase in cash and cash equivalents	126,464	1,652,373
Cash and cash equivalents, beginning of period	748,745	988,077
Cash and cash equivalents, end of period	$ 875,209	$ 2,640,450
Supplemental disclosure:		
Non-cash transaction		
Conversion of debentures into common stock	$ -	$ 1,100,000
Cash paid for		
Interest	$ 3,604	$ 142
Taxes	$ -	$ -

</TABLE>

See accompanying condensed notes to consolidated financial statements.

NETNATION COMMUNICATIONS, INC.

Condensed Notes to Consolidated Financial Statements
(Expressed in U.S. dollars)

Six-month periods ended June 30, 2001 and 2000
(Unaudited)

GENERAL:

NetNation Communications, Inc. (the "Company") was incorporated on May 7, 1998 under the laws of the State of Delaware as Collectibles Entertainment

Inc. ("Collectibles").

On April 7, 1999, Collectibles acquired all of the outstanding common shares of NetNation Communications Inc. ("NetNation Canada"). As Collectibles was inactive at the time of the transaction, this issuance was accounted for as a capital transaction of NetNation Canada, effectively as if NetNation Canada issued common shares to acquire the net monetary assets of Collectibles followed by a recapitalization. From April 7, 1999, the results of NetNation Canada are included on a consolidated basis with those of Collectibles. Subsequent to the transaction, Collectibles changed its name to NetNation Communications, Inc.

On November 24, 1999, DomainPeople Inc. ("DomainPeople"), a wholly-owned subsidiary of NetNation, was incorporated under the laws of the State of Delaware and was formed to offer domain name registration and related services. DomainPeople is accredited by the Internet Corporation for Assigned Names and Numbers, the regulatory body charged with administering accreditation, as a registrar for top-level domain names.

The Company's principal business activities are the provision of web-site hosting, domain name registration, and related services to small and medium sized businesses.

1. BASIS OF PRESENTATION:

These interim condensed consolidated financial statements have been prepared using generally accepted accounting principles in the United States. The interim financial statements include all adjustments, consisting solely of normal recurring adjustments, which in management's opinion are necessary for fair presentation of the financial results for interim periods. The financial statements have been prepared consistent with the accounting policies described in the Company's annual audited financial statements. Reference should be made to those statements included with the Company's annual report filed on Form 10-K. Certain comparative figures have been reclassified to conform to the presentation adopted in the current period.

These condensed consolidated financial statements include the accounts of the Company's wholly owned subsidiaries, NetNation Communications Inc., NetNation Communications UK Inc., NetNation Communications (USA) Inc., and DomainPeople Inc. All material intercompany balances and transactions have been eliminated.

2. SIGNIFICANT ACCOUNTING POLICIES:

Revenue recognition:

Revenue is recognized as web-site hosting, domain name registration and related services are provided. Revenue from web-site hosting set-up fees is recognized over the estimated period the hosting services are provided to customers, which is typically 12 months. Domain name registration and maintenance revenue is recognized ratably over the contract term which is between one and ten years.

In December 1999, the SEC issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB 101"). SAB 101 and related material indicates that the fair value of initial set-up fees should be recognized over the estimated period of service. The Company's contracts generally include such fees. The Company adopted SAB 101 effective the fourth quarter of fiscal 2000 and has, in accordance with its transition provisions, applied the change retroactively to January 1, 2000. The restatement resulted in a decrease in revenue and gross profit, with a corresponding increase in net loss, for the three and six months ended June 30, 2000 of $173,677 and $596,894, respectively. The comparative 2000 consolidated financial statements have been restated to reflect this adjustment.

Depreciation and amortization:

During the six month period ended June 30, 2001, the Company changed its amortization policy with respect to computer hardware, computer software, furniture, and office equipment to the straight-line method. These fixed assets are depreciated on a straight-line basis over three, three, five, and four years, respectively. Previously, these fixed assets were depreciated on a declining-balance basis at 30%, 30%, 20%, and 30%, respectively. The adoption of this policy did not have a material effect on the Company's financial position or results of operations.

3. STOCK OPTIONS:

A summary of the Company's stock option activity is as follows:

	Number of common shares	Weighted average exercise price
Outstanding, December 31, 2000	720,000	$ 3.76
Granted	234,000	2.25
Granted	36,000	2.13
Expired	(14,000)	2.25
Expired	(54,000)	2.31
Expired	(24,000)	4.13
Expired	(150,000)	4.63
Expired	(4,000)	7.69
Outstanding, June 30, 2001	744,000	$ 3.13

The options outstanding at June 30, 2001 expire between February 2, 2002 and August 13, 2005.

4. COMMITMENTS AND CONTINGENCIES:

(a) The Company is committed to total operating lease payments for rent for the remainder of 2001 and 2002 of approximately $140,000 and $93,000, respectively.

(b) As at December 1, 2000, the Company discontinued lease payments on the San Diego premises due to a number of circumstances. The status of this lease is in dispute, but to date it has not resulted in litigation. Should a legal action commence against the Company, the outcome of the proceedings is unknown. The remaining lease payments of $381,254 have been accrued in the consolidated financial statements.

(c) The Company contracted with Inovaware Corporation (formerly known as ISP Power) on January 17, 2000 to develop customized billing software. The contract called for three payments of $80,000 totalling $240,000 and the Company made the first payment in 2000. The Company claims that Inovaware Corporation was unable to complete development of the software in accordance with the terms of the contract, and has terminated the contract with Inovaware on the basis that Inovaware Corporation did not fulfill its contractual obligations. Inovaware Corporation is claiming the Company owes it the remaining $160,000, plus $40,000 for additional work under the terms of the contract. To date, Inovaware Corporation has not commenced legal action against the Company. Should Inovaware commence legal action against the Company, the outcome of the proceedings and the amount of potential damages are unknown. However, should Inovaware prevail in its claim, the Company could be required to pay damages which could have a material effect on the Company's operating results.

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

OVERVIEW

NetNation was incorporated under the laws of the State of Delaware on May 7, 1998, under the name Collectibles Entertainment Inc. ("Collectibles") for the purpose of operating an online sports card and other tradeable memorabilia distribution business. Collectibles changed its name to NetNation Communications, Inc. on April 14, 1999 in conjunction with the acquisition of a web-site hosting business based in Vancouver, Canada. The common shares of NetNation currently trade on the Nasdaq Small Capitalization Market under the ticker symbol "NNCI".

NetNation has four wholly-owned subsidiaries: NetNation Communications Inc., NetNation Communications UK Ltd., NetNation Communications (USA) Inc., and DomainPeople Inc.

NetNation entered into the web hosting business through its acquisition of the Canadian Subsidiary. The Canadian Subsidiary is a private company incorporated under the laws of the Province of British Columbia, Canada on February 19, 1997. The Canadian Subsidiary became a wholly owned subsidiary on April 7, 1999 pursuant to an agreement between the shareholders of the Canadian Subsidiary and Collectibles (the "Share Purchase Agreement"). Pursuant to the Share Purchase Agreement, Collectibles acquired 9,000,000 Class A common shares and 1,000,000 Class B preferred shares of the Canadian Subsidiary, being all of the issued and outstanding shares of the Canadian Subsidiary. The purchase price for the shares of the Canadian Subsidiary was $1,000,000 in Canadian currency, which was paid by the issuance of 10,000,000 common shares of Collectibles. Upon conclusion of the acquisition, Collectibles changed its name to NetNation.

NetNation is an internet infrastructure solutions provider focused on meeting the needs of small and medium-sized enterprises ("SMEs") and individuals who are establishing a commercial or informational presence on the Internet. NetNation competes in the shared and dedicated web hosting, server co-location and domain name registration markets. It's products and services are sold worldwide, directly to customers and through value added resellers ("VARs").

In May 1999, NetNation was selected as an official registrar of domain names by ICANN. The accreditation allows NetNation to register top-level domain names ("TLD's") ending in .com, .net and .org, which account for approximately 50% - 75% of the world's Internet addresses. NetNation, through its wholly-owned subsidiary, DomainPeople, became operational as a domain name registrar in December of 1999.

In August 2000, NetNation, through its wholly-owned subsidiary, DomainPeople, made a 5% minority interest investment in Afilias, LLC ("Afilias"), a company formed for the purpose of bidding for, developing, financing, marketing, owning and operating a registry to register and maintain Internet top-level domain names. In November 2000, Afilias obtained the exclusive rights to register and maintain the new ".info" top-level domain names. Since the original investment was made, DomainPeople's ownership percentage has been diluted to 4% as at June 30, 2001 as it has not made further investments.

RESULTS OF OPERATIONS

For the quarter ended June 30, 2001, NetNation achieved net earnings of $14,596 ($0.00 per share) as compared to a net loss of $635,191 ($0.04 per share) for the same period in 2000 and for the six month period ended June 30, 2001, net earnings of $32,656 ($0.00 per share) as compared to a net loss of $1,217,493 ($0.08 per share) for the same period in 2000.

Revenue

NetNation's second quarter 2001 revenue was generated mainly from providing web hosting services to SMEs and domain name registration. Also included in revenue was co-located server services but for the period, these were minor contributors. NetNation's web hosting customers normally pay a set-up fee plus regular charges, either monthly, quarterly or annually, thereafter. The Company offers a variety of hosting packages in addition to a number of value-added services and products. This enables customers to easily select and modify a solution that precisely meets their individual requirements.

NetNation's accreditation as an official registrar of domain names has enabled it to register domain names without the involvement of an intermediary. As an accredited registrar, NetNation has assumed responsibility for ensuring that current information obtained from customers is supplied to the central registry. Amounts billed in advance of the provision of domain name registration services are deferred and recorded as revenue on a straight-line basis over the term of registration. The unrecognized portion of the fees has been recorded as deferred revenue. The deferred revenue amount on the balance sheet as at June 30, 2001 includes $1,427,258 related to domain name registration.

The following table compares the composition of sales for the three months ended June 30, 2001 to the three months ended June 30, 2000 and the six months ended June 30, 2001 to the six months ended June 30, 2000:

Sales	Three months ended June 30, 2001	Three months ended June 30, 2000	Six months ended June 30, 2001	Six months ended June 30, 2000
Shared hosting	56%	59%	56%	73%
Domain name registration	30%	21%	31%	11%
Dedicated hosting	8%	9%	8%	8%
Server co-location	6%	11%	5%	8%
Total sales	100%	100%	100%	100%

NetNation's revenue of $1,615,550 for the quarter ended June 30, 2001 was an increase of $365,840 or 29% over the same period in 2000. For the six months ended June 30, 2001, revenue of $3,190,336 was an increase of $949,111 or 42% over the same period in 2000. The increase was due to the increase in the number of web sites hosted and a full year of growth in the domain name registration segment of NetNation's business.

Cost of sales

Cost of sales of $519,496 for the quarter ended June 30, 2001 was an increase of $20,382 or 4% over the same period in 2000. For the six months ended June 30, 2001, cost of sales of $1,023,814 was an increase of $124,008 or 14%. As a percentage of sales, cost of sales decreased from 40% in the second quarter of 2000 to 32% in the second quarter of 2001. For the six months ended June 30, 2001, as a percentage of sales, cost of sales decreased from 40% in 2000 to 32% in the same period in 2001. The majority of cost of sales consists of personnel costs for the network operations center and technical support, bandwidth costs, and the costs to register domain names for the Company's customers. Domain name registration fees paid to the central registry are recognized as an expense over the term of registration. The improvement in cost of sales as a percentage of sales was due mainly to the economies of scale experienced for personnel costs.

Sales and marketing expenses

Sales and marketing expenses for the quarter ended June 30, 2001 decreased $245,929 or 41% from the same period in 2000. For the six months ended June 30, 2001, sales and marketing expenses decreased $515,264 or 40% from the same period in 2000. As a percentage of sales, sales and marketing expenses decreased from 48% in the second quarter of 2000 to 22% in the second quarter of 2001. For the six months ended June 30, 2001, as a percentage of sales, sales and marketing expenses decreased from 57% in 2000 to 24% in the same period in 2001. The decrease was mainly due to a reduction in advertising expenses of $555,866 for the six months due to a more focused approach to the media and venues chosen to place advertisements. NetNation's advertising is focused in media types that are believed to best engage the attention of it's target market, SMEs. Sales and marketing expense consists mainly of salaries, bonuses, commissions and advertising costs.

General and administration expenses

General and administration expenses for the quarter ended June 30, 2001 decreased $114,964 or 17% compared to the same period in 2000. For the six months ended June 30, 2001, general and administration expenses decreased $65,759 or 6% compared to the same period in 2000. As a percentage of sales, general and administration expenses decreased from 55% in the second quarter of 2000 to 35% in the second quarter of 2001. For the six month period ended June 30, 2001, as a percentage of sales, general and administration decreased from 50% in 2000 to 33% in the same period in 2001. The improvement in general and administration expenses as a percentage of sales was due to the economies of scale for the various costs included in general and administration expenses such as administrative personnel, rent, general office expenses, legal costs, and investor relations expenses.

Depreciation and amortization

Depreciation and amortization for the second quarter of 2001 increased $56,564 or 55% compared to the second quarter of 2000. For the six months ended June 30, 2001, depreciation increased $155,977 or 98% compared to the same period in 2000. This increase was related to the significant investment in the network operation center and computer equipment during 2000.

LIQUIDITY AND CAPITAL RESOURCES

During the six months ended June 30, 2001, operating activities generated net cash of $251,950 compared to $405,346 for the same period in 2000. The main reason for the decrease in cash from operations was the reduction in accounts payable and accrued liabilities and the decrease in deferred revenues for domain name registrations and web hosting services.

Net cash used in investing activities for the six months ended June 30, 2001 of $117,241 was a decrease of $984,151 from the same period in 2000. In 2000 there were significant investment in the network operations center which accounted for the greater expenditures in 2000 compared to 2001. Similar costs may be incurred in the future for expanding the network operations center when appropriate.

Net cash used in financing activities for the six months ended June 30, 2001 was $8,245 compared to net cash provided by financing activities of $2,348,419 for the same period in 2000. In 2000, $2,348,419 was raised from the net proceeds of a private placement of common stock.

As at June 30, 2001, the Company has cash and cash equivalents of $875,209 compared to $748,745 as at December 31, 2000. The increase reflects positive cash flows from operations for the six months ended June 30, 2001 less the investment in fixed assets. The Company will continue to seek additional equity financing when required provided that the equity market conditions are acceptable.

FORWARD-LOOKING STATEMENTS

The statements included in the discussion and analysis above that are not historical or factual are "forward-looking statements" (as such term is defined in the Private Securities Litigation Reform Act of 1995). The safe harbor provisions provided in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, apply to forward-looking statements made by the Company. These statements can be identified by the use of forward-looking terminology such as "believes," "expects," "may," "intends, " "will," "should," or "anticipates" or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy that involve risks and uncertainties. Management cautions the reader that these forward-looking statements addressing the timing, costs and scope of expansion of operations or investments and other matters contained herein or therein from time to time regarding matters that are not historical facts, are only predictions. No assurance can be given that future results indicated, whether expressed or implied, will be achieved. These forward-looking statements are based upon a variety of assumptions relating to the business of the Company, which may or may not be realized. Because of the number and range of the assumptions underlying Company's forward-looking statements, many of which are subject to significant uncertainties and contingencies that are beyond the reasonable control of the Company, some of the assumptions will not materialize and unanticipated events and circumstances may occur subsequent to the date of this report. These forward-looking statements are based on current expectations, and the Company assumes no obligation to update this information. Therefore, the actual experience of the Company and results achieved during the period covered by any particular forward-looking statements may differ substantially from those projected. Consequently, the inclusion of forward-looking statements are not and should not be regarded as a representation by the Company, or any other person, that these statements will be realized. The actual results may vary materially. There can be no assurance that any of these expectations will be realized or that any of the forward-looking statements contained in this report will prove to be accurate.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

No significant changes in the quantitative and qualitative disclosures about market risk have occurred from the discussion contained in our report on Form 10-K for the year ended December 31, 2000, which was filed with the Commission on April 2, 2001.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

As at December 1, 2000, the Company discontinued lease payments on the San Diego premises due to a number of circumstances. The status of this lease is in dispute, but to date it has not resulted in litigation. Should a legal action commence against the Company, the outcome of the proceedings is unknown. The remaining lease payments of $381,254 have been accrued in the consolidated financial statements.

The Company contracted with Inovaware Corporation (formerly known as ISP Power) on January 17, 2000 to develop customized billing software. The contract called for three payments of $80,000 totalling $240,000 and the Company made the first payment in 2000. The Company claims that Inovaware Corporation was unable to complete development of the software in accordance with the terms of the

contract, and has terminated the contract with Inovaware on the basis that Inovaware Corporation did not fulfill its contractual obligations. Inovaware Corporation is claiming the Company owes it the remaining $160,000, plus $40,000 for additional work under the terms of the contract. To date, Inovaware Corporation has not commenced legal action against the Company. Should Inovaware commence legal action against the Company, the outcome of the proceedings and the amount of potential damages are unknown. However, should Inovaware prevail in its claim, the Company could be required to pay damages which could have a material effect on the Company's operating results.

To the knowledge of the officers and directors of NetNation, there are no other pending legal proceedings or litigation and none of its property is the subject of a pending legal proceeding. Further, NetNation's officers and directors know of no legal proceedings against NetNation or its property contemplated by any governmental authority.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES
Not applicable.

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

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Reports on Form 8-K

No reports on Form 8-K were filed by the Company during the first quarter of 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.

NETNATION COMMUNICATIONS, INC.

Date: August 2, 2001

\--
Joseph Kibur
Chief Executive Officer

Date: August 2, 2001

\--
Calvin Mah
Chief Financial Officer