

Limelight Networks, Inc.
Form 10-Q
May 14, 2008

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2008

OR

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 001-33508
LIMELIGHT NETWORKS, INC.**

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

20-1677033

(I.R.S. Employer Identification No.)

**2220 W. 14th Street
Tempe, AZ 85281**

(Address of principal executive offices, including Zip Code)

(602) 850-5000

(Registrant's telephone number, including area code)

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

The number of shares outstanding of the registrant's common stock as of May 7, 2008: 82,826,547 shares.

LIMELIGHT NETWORKS, INC.
FORM 10-Q
Quarterly Period Ended March 31, 2008
TABLE OF CONTENTS

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>ITEM 1. FINANCIAL STATEMENTS</u>	1
<u>Condensed Consolidated Balance Sheets as of March 31, 2008 and December 31, 2007</u>	1
<u>Condensed Consolidated Statements of Operations for the Three Months Ended March 31, 2008 and 2007</u>	2
<u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2008 and 2007</u>	3
<u>Notes to Unaudited Condensed Consolidated Financial Statements for the Three Months Ended March 31, 2008 and 2007</u>	4
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	13
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	26
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	26
<u>PART II. OTHER INFORMATION</u>	
<u>ITEM 1. LEGAL PROCEEDINGS</u>	27
<u>ITEM 1A. RISK FACTORS</u>	28
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	39
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	39
<u>ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u>	39
<u>ITEM 5. OTHER INFORMATION</u>	39
<u>ITEM 6. EXHIBITS</u>	39
<u>SIGNATURES</u>	40
<u>EX-31.01</u>	

EX-31.02

EX-32.01

EX-32.02

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

LIMELIGHT NETWORKS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	March 31, 2008 (Unaudited)	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 120,254	\$ 113,824
Marketable securities	74,423	83,273
Accounts receivable, net of reserves of \$4,879 at March 31, 2008 and \$4,022 at December 31, 2007, respectively	22,115	21,407
Income taxes receivable	1,366	1,960
Prepaid expenses and other current assets	5,008	4,469
Total current assets	223,166	224,933
Property and equipment, net	43,963	46,968
Marketable securities, less current portion	32	87
Other assets	876	1,440
Total assets	\$ 268,037	\$ 273,428
 LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 4,929	\$ 8,523
Accounts payable, related parties	150	230
Deferred revenue, current portion	5,399	4,237
Provision for litigation	55,264	48,130
Other current liabilities	14,752	9,312
Total current liabilities	80,494	70,432
Deferred revenue, less current portion	7,328	8,189
Other long-term liabilities	771	770
Total liabilities	88,593	79,391
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock, \$0.001 par value; 7,500 shares authorized; 0 shares issued and outstanding		
Common stock, \$0.001 par value; 150,000 shares authorized at March 31, 2008; 82,825 and 82,541 shares issued and outstanding at March 31, 2008 and December 31, 2007, respectively	83	83
Additional paid-in capital	275,477	271,586
Accumulated other comprehensive income	64	106

Edgar Filing: Limelight Networks, Inc. - Form 10-Q

Accumulated deficit	(96,180)	(77,738)
Total stockholders' equity	179,444	194,037
Total liabilities and stockholders' equity	\$ 268,037	\$ 273,428

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

1

Table of Contents

LIMELIGHT NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	For the Three Months Ended March 31,	
	2008	2007
Revenues	\$ 30,202	\$ 23,353
Cost of revenue:		
Cost of services	14,659	9,809
Depreciation network	6,013	4,688
Total cost of revenue	20,672	14,497
Gross margin	9,530	8,856
Operating expenses:		
General and administrative	13,082	7,637
Sales and marketing	8,142	3,018
Research and development	1,590	1,285
Depreciation and amortization	247	137
Provision for litigation judgment	7,134	
Total operating expenses	30,195	12,077
Operating loss	(20,665)	(3,221)
Other income (expense):		
Interest expense	(21)	(573)
Interest income	1,891	89
Other income	170	
Total other income (expense)	2,040	(484)
Loss before income taxes	(18,625)	(3,705)
Income tax (benefit) expense	(183)	200
Net loss	\$ (18,442)	\$ (3,905)
Net loss allocable to common stockholders	\$ (18,442)	\$ (3,905)
Net loss per weighted average share:		
Basic	\$ (0.22)	\$ (0.18)
Diluted	\$ (0.22)	\$ (0.18)

Shares used in per weighted average share calculations:

Basic	82,623	21,945
Diluted	82,623	21,945

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

Table of Contents

LIMELIGHT NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	For the Three months Ended March 31, 2008 2007 (Unaudited)	
Cash flows from operating activities:		
Net loss	\$ (18,442)	\$ (3,905)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	6,260	4,824
Share-based compensation	3,960	5,071
Deferred income tax benefit	(234)	(467)
Provision for litigation	7,134	
Accounts receivable charges	1,562	677
Accretion of debt discount		41
Accretion of marketable securities	(453)	
Loss on marketable securities	55	
Changes in operating assets and liabilities:		
Accounts receivable	(2,271)	1,998
Prepaid expenses and other current assets	87	(1,809)
Income taxes receivable	594	310
Other assets	564	(119)
Accounts payable	(4,634)	(732)
Accounts payable, related parties	(80)	1
Deferred revenue	301	20
Other current liabilities	5,035	630
Other long term liabilities	1	
Net cash (used in) provided by operating activities	(561)	6,540
Cash flows from investing activities:		
Purchase of marketable securities	(34,725)	
Sale of marketable securities	44,200	
Purchases of property and equipment	(2,435)	(3,095)
Net cash provided by (used in) investing activities	7,040	(3,095)
Cash flows from financing activities:		
Borrowings on line of credit		1,500
Payments on capital lease obligations		(159)
Escrow funds returned from share repurchase		298
Excess tax benefits related to stock option exercises		23
Proceeds from exercise of stock options and warrants	107	31
Net cash provided by financing activities	107	1,693

Edgar Filing: Limelight Networks, Inc. - Form 10-Q

Effect of exchange rate changes on cash	(156)	
Net increase in cash and cash equivalents	6,430	5,138
Cash and cash equivalents at beginning of period	113,824	7,611
Cash and cash equivalents at end of period	\$ 120,254	\$ 12,749
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$	\$ 534
Cash paid for income taxes	\$ 49	\$ 335
Property and equipment purchases remaining in accounts payable	\$ 873	\$
Property and equipment purchases remaining in other current liabilities	\$ 406	\$
Other asset purchases remaining in accounts payable	\$ 173	\$

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

Table of Contents**LIMELIGHT NETWORKS, INC.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****1. Nature of Business**

Limelight Networks, Inc. (the Company) is a provider of high-performance content delivery network (CDN) services. The Company delivers content for traditional and emerging media companies, or content providers, including businesses operating in the television, music, radio, newspaper, magazine, movie, videogame, software and social media industries.

2. Summary of Significant Accounting Policies and Use of Estimates***Basis of Presentation***

The condensed consolidated financial statements include accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated. The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). These principles require management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, together with amounts disclosed in the related notes to the condensed consolidated financial statements. Actual results and outcomes may differ from management's estimates, judgments and assumptions. Significant estimates used in these financial statements include, but are not limited to, revenues, accounts receivable and related reserves, useful lives and realizability of long-term asset, capitalized software, provision for litigation, income and other taxes and the fair value of stock-based compensation. Estimates are periodically reviewed in light of changes in circumstances, facts and experience. The effects of material revisions in estimates are reflected in the condensed consolidated financial statements prospectively from the date of the change in estimate. The accompanying interim condensed consolidated balance sheet as of March 31, 2008, the condensed consolidated statements of operations for the three months ended March 31, 2008 and 2007, and the condensed consolidated statements of cash flows for the three months ended March 31, 2008 and 2007, are unaudited. The condensed consolidated balance sheet information as of December 31, 2007 is derived from the audited consolidated financial statements which were included in our Annual Report on Form 10-K filed with the SEC on March 25, 2008. The consolidated financial information contained in this Quarterly Report on Form 10-Q should be read in conjunction with the audited consolidated financial statements and related notes contained in the Annual Report on Form 10-K filed on March 25, 2008.

The results of operations presented in this Quarterly Report on Form 10-Q are not necessarily indicative of the results that may be expected for the year ending December 31, 2008 or for any future periods. In the opinion of management, these unaudited condensed consolidated financial statements include all adjustments of a normal recurring nature that are necessary, in the opinion of management, to present fairly the results of all interim periods reported herein.

As of January 1, 2008 the Company adopted statement No. 157, *Fair Value Measurements* (SFAS No. 157) for financial instruments. Although the adoption of SFAS No. 157 did not materially impact its financial condition, results of operations, or cash flow, the Company is now required to provide additional disclosures as part of its financial statements. See footnote 15 for additional disclosure regarding SFAS No. 157.

As of January 1, 2008 the Company adopted statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). The adoption of SFAS No. 159 did not materially impact its financial condition, results of operations, or cash flow.

Revenue Recognition

The Company recognizes service revenues in accordance with the SEC's Staff Accounting Bulletin No. 104, *Revenue Recognition*, and the Financial Accounting Standards Board's (FASB) Emerging Issues Task Force Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*. Revenue is recognized when the price is fixed or determinable, persuasive evidence of an arrangement exists, the service is performed and collectability of the resulting receivable is reasonably assured.

At the inception of a customer contract for service, the Company makes an assessment as to that customer's ability to pay for the services provided. If the Company subsequently determines that collection from the customer is not

reasonably assured, the Company records an allowance for doubtful accounts and bad debt expense for all of that customer's unpaid invoices and ceases recognizing revenue for continued services provided until cash is received.

The Company primarily derives revenue from the sale of content delivery network services to customers executing contracts having terms of one year or longer. These contracts generally commit the customer to a minimum monthly level of usage on a calendar month basis and provide the rate at which the customer must pay for actual usage above the monthly minimum. For these

Table of Contents

services, the Company recognizes the monthly minimum as revenue each month provided that an enforceable contract has been signed by both parties, the service has been delivered to the customer, the fee for the service is fixed or determinable and collection is reasonably assured. Should a customer's usage of the Company's services exceed the monthly minimum, the Company recognizes revenue for such excess in the period of the usage. The Company typically charges the customer an installation fee when the services are first activated. The installation fees are recorded as deferred revenue and recognized as revenue ratably over the estimated life of the customer arrangement. The Company also derives revenue from services sold as discrete, non-recurring events or based solely on usage. For these services, the Company recognizes revenue after an enforceable contract has been signed by both parties, the fee is fixed or determinable, the event or usage has occurred and collection is reasonably assured.

The Company has on one occasion entered into a multi-element arrangement. When the Company enters into such arrangements, each element is accounted for separately over its respective service period or at the time of delivery, provided that there is objective evidence of fair value for the separate elements. Objective evidence of fair value includes the price charged for the element when sold separately. If the fair value of each element cannot be objectively determined, the total value of the arrangement is recognized ratably over the entire service period to the extent that all services have begun to be provided, and other revenue recognition criteria has been satisfied.

The multi-element arrangement includes a significant software component. In accounting for such an arrangement the Company applies the provisions of Statement of Position, 97-2, (SOP 97-2) *Software Revenue Recognition*, as amended by SOP 98-9, Modifications of SOP 97-2, *Software Revenue Recognition, With Respect to Certain Transactions*. The Company recognizes software license revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection of the receivable is probable. If a software license contains an undelivered element, the vendor-specific objective evidence (VSOE) of fair value of the undelivered element is deferred and the revenue recognized once the element is delivered. The undelivered elements are primarily software support and professional services. VSOE of fair value of software support and professional services is based upon hourly rates or fixed fees charged when those services are sold separately. If VSOE cannot be established for all elements to be delivered, the Company defers all amounts received under the arrangement and does not begin to recognize revenue until the delivery of the last element of the contract has started. Subsequent to commencement of delivery of the last element, the Company commences revenue recognition. Amounts to be received under the contract are then included in the amortizable base and then recognized as revenue ratably over the remaining term of the arrangement until the Company has delivered all elements and has no additional performance obligations.

The multi-element arrangement provided for consulting services related to the development of a custom CDN solution, the cross-license of certain technologies, including certain components of the Company's CDN software and technology, and post-contract customer support (PCS) for both the custom CDN solution and the software component (the Multi-Element Arrangement). The agreement also contains a commitment by the customer to transmit a certain amount of traffic over the Company's network during a five-year period from commencement of the agreement or be subject to penalty payments.

The Company does not have VSOE of fair value to allocate the fee to the separate elements of the Multi-Element Arrangement as it has not licensed the intellectual property and software components, nor PCS separately. Accordingly the Company will recognize the revenues related to the professional services, license and PCS ratably over the four-year period over which the PCS has been contracted as allowed for by paragraph 12 of SOP 97-2. Because delivery of the license and PCS elements of this arrangement had not occurred at June 30, 2007, revenue on all services provided to this customer during the three months ended June 30, 2007, including the ongoing content delivery services, and the direct incremental costs incurred associated with these revenues, were deferred until such time as delivery occurs and PCS has commenced. Concurrently with the signing of the Multi-Element Arrangement, the Company also extended and amended a content delivery contract entered into originally in 2005. The arrangement for transmitting content is not a required element of the new software and node development project commencing under the Multi-Element Arrangement. The Company will continue to receive payments on a usage basis under the content delivery contract. Given that the services are priced at market rates and subject to regular adjustments and are cancelable with thirty days' notice, the amount of revenue and pricing is considered variable and contingent until

services are delivered. As such, the Company has attributed revenue for the service as one that is contingent and becomes measurable as the services are delivered under the terms of the content delivery contract. Accordingly, the Company will record revenue on a monthly basis in an amount based upon usage. Because the content delivery agreement was amended concurrently with the Multi-Element Arrangement, the Company deferred revenue recognition until commencement of delivery of the last element of the Multi-Element Arrangement, which was determined to be July 27, 2007. For the three-month period ended March 31, 2008 the Company recognized approximately \$1.0 million in revenue and approximately \$21,000 in costs of revenue. The Company did not recognize any revenue or costs of revenue during the three month period ended March 31, 2007. As of March 31, 2008, the Company had remaining deferred revenue related to the multi-element arrangement of \$11.3 million, which is expected to be recognized ratably over the remaining original 44-month period that commenced in July 2007 and had remaining related deferred costs of \$0.2 million.

The Company also sells services through a reseller channel. Assuming all other revenue recognition criteria are met, revenue from reseller arrangements is recognized over the term of the contract, based on the reseller's contracted non-refundable minimum purchase commitments plus amounts sold by the reseller to its customers in excess of the minimum commitments. These excess commitments are recognized as revenue in the period in which the service is provided. The Company records revenue under these agreements on a net or gross basis depending upon the terms of the arrangement in accordance with EITF 99-19 *Recording Revenue Gross as a Principal Versus Net as an Agent*. The Company typically records revenue gross when it has risk of loss, latitude in establishing price, credit risk and is the primary obligor in the arrangement.

Table of Contents

From time to time, the Company enters into contracts to sell services to unrelated companies at or about the same time the Company enters into contracts to purchase products or services from the same companies. If the Company concludes that these contracts were negotiated concurrently, the Company records as revenue only the net cash received from the vendor. For certain non-cash arrangements whereby the Company provides rack space and bandwidth services to several companies in exchange for advertising the Company records barter revenue and expense if the services are objectively measurable. The various types of advertising include radio, Website, print and signage. The Company recorded barter revenue and expense of approximately \$114,000, and \$222,000, for the three months ended March 31, 2008 and 2007, respectively.

The Company may from time to time resell licenses or services of third parties. Revenue for these transactions is recorded when the Company has risk of loss related to the amounts purchased from the third party and the Company adds value to the license or service, such as by providing maintenance or support for such license or service. If these conditions are present, the Company recognizes revenue when all other revenue recognition criteria are satisfied.

Cash and Cash Equivalents

The Company holds its cash and cash equivalents in checking, money market, and investment accounts with a minimum credit rating of A1/P1. The Company considers all highly liquid investments with maturities of three months or less when purchased to be cash equivalents.

Investments in Marketable Securities

The Company accounts for its investments in debt and equity securities under FASB's Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities* and FASB Staff Position, or FSP, SFAS No. 115-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*. Management determines the appropriate classification of such securities at the time of purchase and reevaluates such classification as of each balance sheet date. Realized gains and losses and declines in value judged to be other than temporary are determined based on the specific identification method and is reported in the statements of operations.

The Company has classified its investments in equity and debt securities as available-for-sale. Available-for-sale investments are initially recorded at cost with temporary changes in fair value periodically adjusted through comprehensive income. The Company periodically reviews its investments for other-than-temporary declines in fair value based on the specific identification method and writes down investments to their fair value when an other-than-temporary decline has occurred.

The following is a summary of available-for-sale securities at March 31, 2008 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Government agency bonds	\$ 29,231	\$ 120	\$ (4)	\$ 29,347
Commercial paper	24,586	3	(5)	24,584
Corporate notes and bonds	20,238	254		20,492
Total available-for-sale debt securities	74,055	377	(9)	74,423
Publicly traded common stock	32			32
Total available-for-sale securities	\$ 74,087	\$ 377	\$ (9)	\$ 74,455

At March 31, 2008, the Company evaluated its investment portfolio, and noted unrealized losses of \$9,000 were due to fluctuations in interest rates. Management does not believe any of the unrealized losses represented an other-than-temporary impairment based on its evaluation of available evidence as of March 31, 2008. The Company's intent is to hold these investments to such time as these assets are no longer impaired.

Expected maturities can differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties, and the Company views its available-for-sale securities as available for current operations.

At March 31, 2008, the Company evaluated its investment portfolio in publicly traded common stock to determine if there had been decline in market value that was considered to be other-than-temporary. The Company concluded that \$0.1 million of the decline associated with a publicly traded common stock was other than temporary and recorded an impairment charge in interest income.

Table of Contents

The amortized cost and estimated fair value of the available-for-sale debt securities at March 31, 2008, by maturity, are shown below (in thousands).

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale debt securities				
Due in one year or less	\$ 53,928	\$ 67	\$ (9)	\$ 53,986
Due after one year and through five years	20,127	310		20,437
Due after five years and through ten years				
Due after ten years				
	\$ 74,055	\$ 377	\$ (9)	\$ 74,423

The following is a summary of available-for-sale securities at December 31, 2007 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Government agency bonds	\$ 19,764	\$ 68	\$ (3)	\$ 19,829
Commercial paper	43,916	3	(10)	43,909
Corporate notes and bonds	19,397	141	(3)	19,535
Total available-for-sale debt securities	83,077	212	(16)	83,273
Publicly traded common stock	87			87
Total available-for-sale securities	\$ 83,164	\$ 212	\$ (16)	\$ 83,360

The amortized cost and estimated fair value of the available-for-sale debt securities at December 31, 2007, by maturity, are shown below (in thousands).

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale debt securities				
Due in one year or less	\$ 64,092	\$ 16	\$ (16)	\$ 64,092
Due after one year and through five years	18,985	196		19,181
Due after five years and through ten years				
Due after ten years				
	\$ 83,077	\$ 212	\$ (16)	\$ 83,273

Recently Issued Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS No. 141(R)). SFAS No. 141(R) replaces SFAS No. 141 and, although it retains certain requirements of that guidance, it is broader in scope. SFAS No. 141(R) establishes principles and requirements in the recognition and measurement of the assets

acquired, the liabilities assumed and any non-controlling interests related to a business combination. Among other requirements, direct acquisition costs and acquisition-related restructuring costs must be accounted for separately from the business combination. In addition, SFAS No. 141(R) provides guidance in accounting for step acquisitions, contingent liabilities, goodwill, contingent consideration, and other aspects of business combinations. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Accordingly, the Company will adopt SFAS No. 141(R) on January 1, 2009 and will apply its provisions prospectively. The Company does not believe the adoption of this standard will have a material impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* (SFAS No. 160). SFAS No. 160 requires that ownership interests in subsidiaries held by parties other than the parent be presented separately within equity in the consolidated balance sheet. SFAS No. 160 also requires that the consolidated net income attributable to the parent and to the noncontrolling interests be identified and displayed on the face of the consolidated income statement. Changes in ownership interests, deconsolidation and additional disclosures regarding noncontrolling interests are also addressed in the new guidance. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Accordingly, the Company will adopt SFAS No. 160 on January 1, 2009. As of March 31, 2008, we had no noncontrolling interests recorded in our balance sheet. The Company does not believe the adoption of SFAS No. 160 will have a material impact on its financial position or results of operations.

In February 2008, the FASB issued FASB Staff Position (FSP) No. 157-2 (FSP 157-2). FSP 157-2 delays the effective date of SFAS 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. In February 2008, the FASB also issued FSP No. 157-1 that would exclude leasing transactions accounted for under SFAS No. 13, *Accounting for Leases*, and its related interpretive accounting pronouncements. The Company does not expect the SFAS 157 staff position guidance to have a material impact on its consolidated financial statements.

In March 2008, the FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133* (SFAS No. 161). SFAS No. 161 requires entities that utilize derivative instruments to provide qualitative disclosures about their objectives and strategies for using such instruments, as well as any details of credit-risk-related

Table of Contents

contingent features contained within derivatives. SFAS No. 161 also requires entities to disclose additional information about the amounts and location of derivatives located within the financial statements, how the provisions of SFAS No. 133 has been applied, and the impact that hedges have on an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company currently does not utilize any derivative instruments and/or hedging activities. Since the Company does not have any derivative instruments and/or hedging activities, the Company does not believe that the adoption of this statement will have a material effect on its financial position or results of operations.

3. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets include:

	As of March 31, 2008	As of December 31, 2007
Non-income taxes receivable	\$ 2,389	\$ 2,109
Prepaid royalties and licenses	150	525
Interest receivable	666	506
Employee advances and prepaid recoverable commissions	235	118
Other	1,568	1,211
Total prepaid expenses and other current assets	\$ 5,008	\$ 4,469

4. Property and Equipment

Property and equipment include:

	As of March 31, 2008	As of December 31, 2007
Network equipment	\$ 82,480	\$ 79,676
Computer equipment	1,379	1,573
Furniture and fixtures	419	291
Leasehold improvements	1,761	1,411
Other equipment	308	301
	86,347	83,252
Less: accumulated depreciation	(42,384)	(36,284)
	\$ 43,963	\$ 46,968

5. Other Current Liabilities

Other current liabilities consist of the following (in thousands)

	As of March 31, 2008	As of December 31, 2007
Accrued cost of revenue	\$ 4,513	\$ 3,007

Accrued compensation and benefits	1,621	1,900
Non-income taxes payable	2,792	3,161
Accrued legal fees	3,886	137
Other accrued expenses	1,940	1,107
Total other current liabilities	\$ 14,752	\$ 9,312

6. Litigation

In June 2006, Akamai Technologies, Inc., or Akamai, and the Massachusetts Institute of Technology, or MIT, filed a lawsuit against the Company in the U.S. District Court for the District of Massachusetts alleging that the Company was infringing two patents assigned to MIT and exclusively licensed by MIT to Akamai, U.S. Patent No. 6,553,413 (the 413 patent) and U.S. Patent No. 6,108,703 (the 703 patent). In September 2006, Akamai and MIT expanded their claims to assert infringement of a third, recently issued patent, U.S. Patent No. 7,103,645 (the 645 patent). In February 2008, a jury returned a verdict in this lawsuit, finding that the Company infringed four claims of the 703 patent at issue and rejecting the Company's invalidity defenses for the period April 2005 through December 31, 2007. The jury awarded an aggregate of approximately \$45.5 million which includes lost profits, reasonable royalties and price erosion damages. In addition the jury awarded pre-judgment interest which the Company estimates to be \$2.6 million at December 31, 2007. The Company has recorded the aggregate \$48.1 million as a provision for litigation as of December 31, 2007. A key determinant in our ability to estimate possible future charges is the extent to which we are able to

Table of Contents

determine a correlation between the jury awarded amount to the various elements of the allegations. For the three months ended March 31, 2008, the Company estimated its revenue from alleged infringing methods totaled approximately 54% of its total revenue. Applying the damage metric of approximately 43% to alleged infringing revenue, the Company recorded a potential additional damage liability totaling \$6.9 million, plus additional interest of \$0.2 million for the three month-period ended March 31, 2008.

While the Company will continue to pursue multiple legal recourses available to it which could reduce or even possibly eliminate the related financial exposure in the jury verdict, if the Company is not able to prevail in its efforts, there could be additional charges recorded by the Company in future periods. Akamai is also seeking a permanent injunction to enjoin the Company from further infringement of the 703 patent. Such charges would be dependent in part upon judicial determinations made on the various elements of the matter and the activities of the Company in future periods. The Company, during its financial statement close process, will evaluate if additional accrual amounts are required at each reporting period. The Company would record additional accrual amounts to the extent the Company determines amounts are probable of being paid and are also reasonably estimable. Such amounts could be, but are not limited to, damages associated with post-judgment lost profits, price erosion, and royalties as well as interest related to pre-and-post-judgment amounts.

In December 2007, Level 3 Communications, LLC, or Level 3, filed a lawsuit against the Company in the U.S. District Court for the Eastern District of Virginia alleging that the Company is infringing three patents Level 3 allegedly acquired from Savvis Communications Corp. In addition to monetary relief, including treble damages, interest, fees and costs, the complaint seeks an order permanently enjoining the Company from conducting its business in a manner that infringes the relevant patents. Discovery has begun, and the Court has set a trial date for October 2008. While the Company believes that the claims of infringement asserted against it by Level 3 in the present litigation are without merit and intends to vigorously defend the action, there can be no assurance that this lawsuit ultimately will be resolved in the Company's favor. An adverse ruling could seriously impact the Company's ability to conduct its business and to offer its products and services to its customers. This, in turn, would harm the Company's revenue, market share, reputation, liquidity and overall financial position. The Company is not able at this time to estimate the range of potential loss nor does it believe that a loss is probable. Therefore, there is no provision for this lawsuit in the Company's financial statements.

In August 2007, the Company, certain of its officers and current and former directors, and the firms that served as the lead underwriters in the Company's initial public offering were named as defendants in several purported class action lawsuits filed in the U. S. District Courts for the District of Arizona and the Southern District of New York. All of the New York cases were transferred to Arizona and consolidated into a single action. The plaintiffs' consolidated complaint asserts causes of action under Sections 11, 12, and 15 of the Securities Act of 1933, as amended, on behalf of a purported class of individuals who purchased the Company's common stock in its initial public offering and/or pursuant to its Prospectus. The complaint alleges, among other things, that the Company omitted and/or misstated certain facts concerning the seasonality of its business and the loss of revenue related to certain customers. On March 17, 2008, the Company and the individual defendants moved to dismiss all of the plaintiffs' claims. Although the Company believes that it and the individual defendants have meritorious defenses to the plaintiffs' claims and intends to contest the lawsuits vigorously, an adverse resolution of the lawsuits may have a material adverse effect on the Company's financial position and results of operations in the period in which the lawsuits are resolved. The Company is not able at this time to estimate the range of potential loss nor does it believe that a loss is probable. Therefore, there is no provision for these lawsuits in the Company's financial statements.

In April 2008, Two-Way Media LLC (TWM) filed a lawsuit against the Company and other defendants, including Akamai, AT&T Corp., SBC Internet Services and Southwestern Bell Telephone Company, in the U.S. District Court for the Southern District of Texas, Corpus Christi Division. TWM alleges the Company infringes four patents owned by TWM. TWM seeks both monetary and injunctive relief against the Company. While the Company believes that the claims of infringement asserted against it by TWM in the present litigation are without merit and intends to vigorously defend the action, there can be no assurance that this lawsuit ultimately will be resolved in the Company's favor. An adverse ruling could seriously impact the Company's ability to conduct its business and to offer its products and services to its customers. The Company is not able at this time to estimate the range of potential loss nor does it

believe that a loss is probable. Therefore, there is no provision for these lawsuits in the Company's financial statements.

7. Net Income (Loss) Per Share

The Company follows EITF Issue No. 03-6, *Participating Securities and the Two-Class Method under FASB Statement 128*, which established standards regarding the computation of earnings per share (EPS) by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the company. EITF Issue No. 03-6 requires earnings available to common stockholders for the period, after deduction of preferred stock dividends, to be allocated between the common and preferred shareholders based on their respective rights to receive dividends. Basic net loss per share is then calculated by dividing income allocable to common stockholders (including the reduction for any undeclared, preferred stock dividends assuming current income for the period had been distributed) by the weighted-average number of common shares outstanding, net of shares subject to repurchase by the Company, during the period. EITF Issue No. 03-6 does not require the presentation of basic and diluted net loss per share for securities other than common stock; therefore, the following net loss per share amounts only pertain to the Company's common stock. The Company calculates diluted net loss per share under the if-converted method unless the conversion of the preferred stock is anti-dilutive to basic net loss per share. To the extent preferred stock is anti-dilutive, the Company calculates diluted net loss per share under the two-class method. Potential common shares include restricted common stock and incremental shares of common stock issuable upon the exercise of stock options and warrants using the treasury stock method.

Table of Contents

The following table sets forth the components used in the computation of basic and diluted net loss per share for the periods indicated (in thousands, except per share data):

	For the Three Months Ended March 31,	
	2008	2007
Numerator:		
Net loss	\$ (18,442)	\$ (3,905)
Less: Income allocable to preferred stockholders		
Net loss allocable to common stockholders	\$ (18,442)	\$ (3,905)
Denominator:		
Weighted average common shares	82,623	21,945
Less: Weighted-average unvested common shares subject to repurchase		
Denominator for basic net loss per share	82,623	21,945
Dilutive effect of stock options and shares subject to repurchase		
Dilutive effect of outstanding stock warrants		
Denominator for diluted net loss per share	82,623	21,945
Basic net loss per share	\$ (0.22)	\$ (0.18)
Diluted net loss per share	\$ (0.22)	\$ (0.18)

The following outstanding options, common stock subject to repurchase and common stock warrants were excluded from the computation of diluted net loss per common share for the periods presented because including them would have had an antidilutive effect:

	For the Three Months Ended March 31,	
	2008	2007
Options to purchase common stock and stock subject to repurchase	2,811	6,077
Stock warrants (as converted basis)		

8. Comprehensive Loss

The following table presents the calculation of comprehensive loss and its components (in thousands):

	For the Three Months Ended March 31,	
	2008	2007
Net loss	\$ (18,442)	\$ (3,905)
Other comprehensive loss, net of tax:		
Unrealized gain (loss) on investments	114	(85)
Foreign exchange translation	(156)	

Other comprehensive loss	(42)	(85)
Comprehensive loss	\$ (18,484)	\$ (3,990)

For the periods presented, accumulated other comprehensive loss consisted of (in thousands):

	As of March 31, 2008	As of December 31, 2007
Net unrealized gain (loss) on investments, net of tax	\$ 224	\$ 110
Foreign currency translation	(160)	(4)
Total accumulated other comprehensive loss	\$ 64	\$ 106

Table of Contents**9. Stockholders Equity*****Initial Public Offering (IPO)***

On June 8, 2007, the Company completed an initial public offering of its common stock in which the Company sold and issued 14,900,000 shares of its common stock and selling stockholders sold 3,500,000 shares of the Company's common stock, in each case at a price to the public of \$15.00 per share. The common shares began trading on the NASDAQ Global Market on June 8, 2007. The Company raised a total of \$223.5 million in gross proceeds from the IPO, or approximately \$203.9 million in net proceeds after deducting underwriting discounts and commissions of approximately \$15.6 million and other offering costs of approximately \$4.0 million.

Stock Split

On May 14, 2007, the Company effected a 3-for-2 forward stock split of its outstanding capital stock. All share and per-share data have been restated to reflect this stock split.

Conversion of Preferred Stock

On June 14, 2007, upon the closing of the Company's IPO, all outstanding shares of the Company's Series A and Series B Convertible Preferred Stock automatically converted into 44,940,261 shares of common stock on a 1-for-1 share basis.

10. Share-Based Compensation

The following table summarizes the components of share-based compensation expense included in the Company's condensed consolidated statement of operations for the three month periods ended March 31, 2008 and 2007 in accordance with SFAS No. 123R (in thousands):

	For the Three Months Ended March 31,	
	2008	2007
Share-based compensation expense by type of award:		
Stock options	\$ 3,204	\$ 4,160
Restricted stock	756	911
Total share-based compensation expense	\$ 3,960	\$ 5,071
Effect of share-based compensation expense on income by line:		
Cost of services	\$ 507	\$ 242
General and administrative expense	1,665	3,743
Sales and marketing expense	1,306	235
Research and development expense	482	851
Total cost related to share-based compensation expense	\$ 3,960	\$ 5,071

Unrecognized share-based compensation expense totaled \$55.3 million at March 31, 2008. We expect to amortize \$13.7 million during the remainder of 2008, \$18.4 million in 2009 and the remainder thereafter based upon the scheduled vesting of the options outstanding at that time.

11. Related Party Transactions

The Company leases office space from a company owned by two of the Company's executives. Rent expense for the lease, including reimbursement for telecommunication lines, was approximately \$3,000 for each of the three month periods ended March 31, 2008 and 2007.

The Company sells services to several entities owned, in whole or in part, by several Company executives. Revenue derived from related parties was less than 1% for the three-month periods ended March 31, 2008 and 2007, respectively. Management believes that all of the Company's related party transactions reflected arm's length terms.

12. Concentrations

Edgar Filing: Limelight Networks, Inc. - Form 10-Q

For the three-month periods ended March 31, 2008 and 2007, the Company had one major customer for which revenue exceeded 10% of total revenue. The revenues for the three-month periods ended March 31, 2008 and 2007, for this customer totaled approximately \$4.5 million and \$2.3 million, respectively.

Revenue from non-U.S. sources totaled approximately \$4.2 million and \$3.1 million for the three-month periods ended March 31, 2008 and 2007, respectively.

Table of Contents**13. Income taxes**

We utilize the asset and liability method of accounting for income taxes as set forth in SFAS No. 109, *Accounting for Income taxes*, or SFAS 109. Under the asset and liability method, deferred taxes are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities using tax rates expected to be in effect during the years in which the basis differences reverse. A valuation allowance is recorded when it is more likely than not that some of the deferred tax assets will not be realized.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a two-step process to determine the amount of tax benefit to be recognized. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon external examination. If the tax position is deemed more-likely-than-not to be sustained, the tax position is then assessed to determine the amount of benefit to recognize in the financial statements. The amount of the benefit that may be recognized is the largest amount that has a greater than fifty percent likelihood of being realized upon ultimate settlement.

As of March 31, 2008, the Company has approximately \$604,000 of total unrecognized tax benefits which did not materially change during the first quarter of 2008. This total of unrecognized tax benefits, if recognized, would favorably affect the effective income tax rate. The Company anticipates its unrecognized tax benefits will decrease within twelve months of the reporting date, as a result of settling potential tax liabilities in certain foreign and state jurisdictions.

The Company recognizes interest and penalties related to unrecognized tax benefits in its tax provision. As of March 31, 2008, the Company has recorded a liability of \$167,000 for the payment of interest and penalties, which did not materially change during the first quarter of 2008.

During the three months ended March 31, 2008, the Company performed its assessment of the recoverability of deferred tax assets and determined there was sufficient negative evidence as a result of the Company's cumulative losses to conclude that it was more likely than not that the Company's deferred tax assets would not be realized and accordingly maintained a full valuation allowance. In calculating its effective income tax rate for 2008, no benefit is provided for temporary differences that increase deferred tax assets relating to stock-based compensation.

The Company conducts business in various jurisdictions in the United States and in foreign countries and is subject to examination by tax authorities. As of March 31, 2008 and December 31, 2007, the Company is not under examination. The tax years 2002 through 2006 remain open to examination by U.S. and certain state and foreign taxing jurisdictions.

14. Segment Reporting

The Company operates in one industry segment—content delivery network services. The Company operates in three geographic areas—the United States, Europe and Asia Pacific.

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, establishes standards for reporting information about operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Company's chief operating decision maker is its Chief Executive Officer. The Company's Chief Executive Officer reviews financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance. The Company has one business activity and there are no segment managers who are held accountable for operations, operating results and plans for products or components below the consolidated unit level. Accordingly, the Company reports as a single operating segment.

Revenue by geography is based on the location of the customer from which the revenue is earned. The following table sets forth revenue and long-lived assets by geographic area (in thousands):

**For the
Three Months Ended
March 31,**

	2008	2007
Domestic Revenue	\$ 26,036	\$ 20,259
International Revenue	4,166	3,094
Total Revenue	\$ 30,202	\$ 23,353

Table of Contents

The following table sets forth long-lived assets by geographic area (in thousands).

	As of March 31, 2008	As of December 31, 2007
Domestic long-lived assets	\$ 40,094	\$ 44,158
International long-lived assets	3,869	2,810
Total long-lived assets	\$ 43,963	\$ 46,968

15. Fair Value Measurements

In September 2006, the FASB issued statement No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. The Company has adopted the provisions of SFAS No. 157 as of January 1, 2008, for financial instruments. Although the adoption of SFAS No. 157 did not materially impact its financial condition, results of operations, or cash flow, the Company is now required to provide additional disclosures as part of its financial statements.

SFAS No. 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

As of March 31, 2008, the Company held certain assets that are required to be measured at fair value on a recurring basis. These include commercial paper, corporate notes and bonds, and US Government Agency Bonds which are classified as marketable securities on the Company's condensed consolidated balance sheet. All of these investments are publicly traded and for which market prices are readily available.

The Company's assets measured at fair value on a recurring basis subject to the disclosure requirements of SFAS 157 at March 31, 2008, were as follows (in thousands):

Description	Total	Fair Value Measurements at Reporting Date Using		
		In Active Markets for Identical Assets (Level 1)	Quoted Prices Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Government agency bonds	\$ 29,347	\$ 29,347	\$	\$
Commercial paper	24,584		24,584	
Corporate notes and bonds	20,492	20,492		
Publicly traded common stock	32	32		
Total assets measured at fair value	\$ 74,455	\$ 49,871	\$ 24,584	\$

For the period ended March 31, 2008, realized gains and losses for marketable securities are reported in interest income, unrealized gains and losses for marketable securities are included in other comprehensive income and

expense.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and the related notes thereto included elsewhere in this quarterly report on Form 10-Q and the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2007 included in our annual report on Form 10-K filed with the Securities and Exchange Commission, or SEC, on March 25, 2008. This quarterly report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements include statements as to industry trends and future expectations of ours and other matters that do not relate strictly to historical facts. These statements are often identified by the use of words such as may, will, expect, believe, anticipate, intend, could, estimate, or continue, and similar expressions or variations. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled Risk Factors set forth in Part II, Item 1A of this quarterly report on Form 10-Q and in our other SEC filings. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Overview

We were founded in 2001 as a provider of content delivery network, or CDN, services to deliver digital content over the Internet. We began development of our infrastructure in 2001 and began generating meaningful revenue in 2002. As of March 31, 2008, we had over 1,200 active customers worldwide. We primarily derive income from the sale of services to customers executing contracts with terms of one year or longer, which we refer to as recurring revenue contracts or long-term contracts. These contracts generally commit the customer to a minimum monthly level of usage with additional charges applicable for actual usage above the monthly minimum. Recently however, we have entered into an increasing number of customer contracts that have minimum usage commitments that are based on twelve-month or longer periods. We believe that having a consistent and predictable base level of revenue is important to our financial success. Accordingly, to be successful, we must maintain our base of recurring revenue contracts by eliminating or reducing any customer cancellations or terminations and build on that base by adding new customers and increasing the number of services,

Table of Contents

features and functionalities our existing customers purchase. At the same time, we must ensure that our expenses do not increase faster than, or at the same rate as, our revenues. Accomplishing these goals requires that we compete effectively in the marketplace on the basis of price, quality and the attractiveness of our services and technology.

We primarily derive revenue from the sale of CDN and related services to our customers. These services include delivery of digital media, including video, music, games, software and social media as well as associated services such as storage, data center, transit and consulting services. We primarily generate revenue by charging customers on a per-gigabyte basis or on a variable basis based on peak delivery rate for a fixed period of time, as our services are used. During 2007 we entered into a multi-element arrangement which generates revenue by providing consulting services related to the development of a Custom CDN solution, through the cross-license of certain technologies, including certain components of our CDN software and technology, and post-contract customer support (PCS) for both the custom CDN-solution and the software component. We also derive some business from the sale of custom CDN services. These are generally limited to modifying our network to accommodate non standard content player software or to establish dedicated customer network components that reside both within our network or that operate within our customers' network.

In February 2008, a jury returned a verdict in a patent infringement lawsuit filed by Akamai Technologies, Inc., or Akamai, and the Massachusetts Institute of Technology, or MIT, against us, finding that we infringed four claims of the 703 patent and rejecting our invalidity defenses. The jury awarded Akamai an aggregate of approximately \$45.5 million in lost profits, reasonable royalties and price erosion damages, plus pre-judgment interest estimated to be \$2.6 million that we recorded in 2007. An additional provision of approximately \$7.1 million for potential additional infringement damages and interest was recorded during the three-month period ended March 31, 2008. A final judgment has not yet been entered. We are still pursuing a number of equitable defenses, and we recently filed several motions seeking relief from the Court. Akamai has filed motions for summary judgment on our remaining equitable defenses and for a permanent injunction, which we have or will oppose. We continue to believe that the claims of infringement asserted against us by Akamai and MIT in the present litigation are without merit and that the jury's verdict is incorrect, and we will continue to defend the case vigorously; however, we cannot assure you that this lawsuit ultimately will be resolved in our favor. An adverse judgment or injunction could seriously impact our ability to conduct our business and to offer our products and services to our customers. A permanent injunction could prevent us from operating our CDN to deliver certain types of traffic, which could impact the viability of our business. These adverse outcomes, in turn, would harm our revenue, market share, reputation, liquidity and overall financial position. Whether or not we prevail in this case, we expect that the litigation will continue to be expensive, time consuming and a distraction to our management in operating our business. This lawsuit and other ongoing legal proceedings are described under Legal Proceedings in Part II, Item 1 of this quarterly report on Form 10-Q.

Overview of Operations

Traffic on our network has grown in each of the last three years. This traffic growth is the result of growth in the number of new customers, as well as growth in the traffic delivered to existing customers. Our revenue is generated primarily by charging for traffic delivered. During the quarter ended March 31, 2008, we continued to add new customers. We have seen an increase in the length of our sales cycle, but we continue to see that new customers want the benefits of the unique services that we bring to the market. However, it is not possible to accurately determine the longer term impact associated with the overhang of litigation will have on our ability to effectively compete.

Table of Contents

Historically, we have derived a portion of our revenue from outside of the United States. Our international revenue has grown recently, and we expect this trend to continue as we focus on our strategy of expanding our network and customer base internationally. For the year ended December 31, 2007 revenue derived from customers outside the United States accounted for approximately 13% of our total revenue, of which nearly all was derived from operations in Europe. For the three-month periods ended March 31, 2008 and 2007, respectively, revenue derived from customers outside the United States accounted for approximately 14% and 13% respectively, of our total revenue. For the three-month period ended March 31, 2008, we derived approximately 78% our international revenue from Europe and approximately 22% of our international revenue from Asia Pacific. For the three-month period ended March 31, 2007, our international revenue was derived primarily from Europe. We expect foreign revenue as a percentage of our total revenues to increase as a percentage of revenue in 2008. Our international business is managed as a single geographic segment, and we report our financial results on this basis.

During any given fiscal period, a relatively small number of customers typically account for a significant percentage of our revenue. For example, in 2007, sales to our top 20 customers, in terms of revenue, accounted for approximately 57% of our total revenue. During 2007 one of these top 20 customers, Microsoft, represented approximately 12% of our total revenue for that period. For the three-month period ended March 31, 2008, sales to our top 20 customers, in terms of revenue, accounted for approximately 58% of our total revenue. During the three-month period ended March 31, 2008 we had one customer, Microsoft that accounted for approximately 15% of our revenue during the period. During 2007, we entered into a multi-element arrangement with Microsoft which generates revenue by providing consulting services related to the development of a Custom CDN solution, amortization of prepaid license and amortization of prepaid post-contract customer support (PCS) for both the custom CDN-solution and the software component. Revenue from this multi-element arrangement is being recognized over the term of the software agreement which at March 31, 2008, had 35-months remaining. Our relationship with Microsoft includes a minimum annual traffic commitment which runs through March 2012. We anticipate customer concentration levels will decline compared to prior years as our customer base continues to grow and diversify. In addition to selling to our direct customers, we maintain relationships with a number of resellers that purchase our services and charge a mark-up to their end customers. Revenue generated from sales to direct and reseller customers accounted for approximately 1% for the year ended December 31, 2007. For the three-month period ended March 31, 2008, revenue generated from sales to direct and reseller customers accounted for approximately 1% of our total revenue.

In addition to these revenue-related business trends, our cost of revenue as a percentage of revenue rose for the three month period ended March 31, 2008 compared to the three-month period ended March 31, 2007. This increase is primarily the result of increased cost of depreciation, network operations personnel costs and co-location costs related to the increased investments to build out the capacity of our network. Operating expense has increased in absolute dollars each period as revenue has increased. In 2007, these increases accelerated due primarily to increased stock based compensation, cost of litigation with Akamai and MIT, professional services and other fees associated with becoming a public company, payroll and payroll-related costs, associated with additional general administrative and sales and marketing resources to support our current and future growth. For the period ended March 31, 2008, operating expenses continued to increase primarily due to increased litigation costs and legal fees.

We make our capital investment decisions based upon careful evaluation of a number of variables, such as the amount of traffic we anticipate on our network, the cost of the physical infrastructure required to deliver that traffic, and the forecasted capacity utilization of our network. Our capital expenditures have varied over time, in particular as we purchased servers and other network equipment associated with our network build-out. For example, in 2005, 2006 and 2007, we made capital purchases of \$10.9 million, \$40.4 million and \$26.5 million, respectively. For the three-month period ended March 31, 2008, we made capital investments of \$3.1 million. This was considerably lower than historical levels primarily related to two things. First, continued improvements in the efficiency of our network allowing us to meet traffic growth with less investment and second, during the first quarter of 2008 one large traffic customer shut down its site and we discontinued service to two large customers for non payment of services which allowed us to recoup a significant amount of network capacity to meet future growth needs. We expect to have ongoing capital expenditure requirements, as we continue to invest in and expand our CDN. We currently anticipate

making aggregate capital expenditures of approximately \$11.0 million to \$13.0 million during the remainder of 2008.

We have also generated revenue from certain customers that are entities related to certain of our founders. The aggregate amounts of revenue derived from these related party transactions was less than 1% for the year ended December 31, 2007. For the three-month period ended March 31, 2008, revenue from related parties was less than 1% of our total revenue. We believe that all of our related party transactions reflected arm's length terms.

We are currently engaged in litigation with one of our principal competitors, Akamai Technologies, Inc., or Akamai, and its licensor, the Massachusetts Institute of Technology, or MIT, in which these parties have alleged that we are infringing three of their patents. In February 2008, a jury returned a verdict in this lawsuit, finding that we infringed four claims of the patent at issue and rejecting our invalidity defenses. The jury awarded Akamai an aggregate of approximately \$45.5 million in lost profits, reasonable royalties and price erosion damages, plus pre-judgment interest estimated to be \$2.6 million that we recorded in 2007. A final judgment has not yet been entered. While we will continue to pursue multiple legal recourses available to us which could reduce or

Table of Contents

even possibly eliminate the related financial exposure, if we are not able to prevail in our efforts, there could be additional charges recorded by us in future periods. Such charges would be dependent in part upon judicial determinations made on the various elements of the matter and our activities in future periods. During our financial statement close process, we evaluate if additional accrual amounts are required at each reporting period. We record additional accrual amounts to the extent we determine amounts are probable of being paid and are also reasonably estimable. Such amounts could be, but are not limited to, damages associated with post-judgment lost profits, and royalties as well as interest related to pre-and-post-judgment amounts. A key determinant in our ability to estimate possible future charges is the extent to which we are able to determine a correlation between the jury awarded amount to the various elements of the allegations. During the three months ended March 31, 2008, we estimated our revenue from alleged infringing methods totaled approximately 54% of our total revenue. Applying the damage metric of approximately 43% to alleged infringing revenue we recorded a potential additional damage liability totaling \$6.9 million, plus additional interest of \$0.2 million for the three-month period ended March 31, 2008. Our legal and other expenses associated with this case have been significant to date, including aggregate expenditures of \$3.1 million in 2006 and \$6.8 million in 2007 and \$4.7 million for the three-months ended March 31, 2008 compared to \$0.9 million for the three-months ended March 31, 2007. We include these litigation expenses in general and administrative expenses, as reported in our unaudited consolidated statement of operations. We expect that these expenses will continue to remain significant. A portion of the cash impact of these litigation expenses have been offset through the availability of an escrow fund established in connection with our Series B preferred stock financing. This escrow account was established with an initial balance of approximately \$10.1 million to serve as security for the indemnification obligations of our stockholders tendering shares in that financing. In May 2007, we, the tendering stockholders and the Series B preferred stock investors agreed to distribute \$3.7 million of the escrow account to the tendering stockholders upon the closing of our initial public offering. As of the closing of our initial public offering, approximately \$3.7 million of the escrow was paid to the tendering stockholders. The escrow account has been drawn down as we incur Akamai-related litigation expenses. Cash reimbursed from this escrow account is recorded as additional paid-in capital. At March 31, 2008, the balance outstanding in the escrow was \$1.0 million and we utilized \$1.0 million of the balance during the quarter ended March 31, 2008. We expect to draw the remaining \$1.0 million from this escrow during the three month period ending June 30, 2008.

In December 2007, Level 3 Communications, LLC, or Level 3, filed a lawsuit against us in the U.S. District Court for the Eastern District of Virginia alleging that we are infringing three patents Level 3 allegedly acquired from Savvis Communications Corp. In addition to monetary relief, including treble damages, interest, fees and costs, the complaint seeks an order permanently enjoining us from conducting our business in a manner that infringes the relevant patents. Discovery has begun, and the Court has set a trial date for October 2008. While we believe that the claims of infringement asserted against us by Level 3 in the present litigation are without merit and intend to vigorously defend the action, there can be no assurance that this lawsuit ultimately will be resolved in our favor. An adverse ruling could seriously impact our ability to conduct our business and to offer our products and services to our customers. This, in turn, would harm our revenue, market share, reputation, liquidity and overall financial position.

In August 2007, we, certain of our officers and current and former directors, and the firms that served as the lead underwriters in our initial public offering were named as defendants in several purported class action lawsuits filed in the U. S. District Courts for the District of Arizona and the Southern District of New York. All of the New York cases were transferred to Arizona and consolidated into a single action. The plaintiffs consolidated complaint asserts causes of action under Sections 11, 12, and 15 of the Securities Act of 1933, as amended, on behalf of a purported class of individuals who purchased our common stock in our initial public offering and/or pursuant to our Prospectus. The complaint alleges, among other things, that we omitted and/or misstated certain facts concerning the seasonality of our business and the loss of revenue related to certain customers. On March 17, 2008, we and the individual defendants moved to dismiss all of the plaintiffs claims. Although we believe that we and the individual defendants have meritorious defenses to the plaintiffs claims and intend to contest the lawsuits vigorously, an adverse resolution of the lawsuits may have a material adverse effect on our financial position and results of operations in the period in which the lawsuits are resolved. We are not able at this time to estimate the range of potential loss nor do we believe that a loss is probable. Therefore, there is no provision for these lawsuits in our financial statements.

In April 2008, Two-Way Media LLC (TWM) filed a lawsuit against us and other defendants, including Akamai, AT&T Corp., SBC Internet Services and Southwestern Bell Telephone Company, in the U.S. District Court for the Southern District of Texas, Corpus Christi Division. TWM alleges we infringe four patents owned by TWM. TWM seeks both monetary and injunctive relief against us. While we believe that the claims of infringement asserted against us by TWM in the present litigation are without merit and intend to vigorously defend the action, there can be no assurance that this lawsuit ultimately will be resolved in our favor. An adverse ruling could seriously impact our ability to conduct our business and to offer our products and services to our customers. We are not able at this time to estimate the range of potential loss nor do we believe that a loss is probable. Therefore, there is no provision for these lawsuits in our financial statements.

We were unprofitable for the three-months ended March 31, 2008; the largest negative impact to our profitability was the accrual of \$6.9 million for the potential continuing damages, plus additional interest of \$0.2 million from the jury verdict returned against us regarding the patent infringement lawsuit filed by Akamai Technologies, Inc., litigation costs of \$5.4 million, and \$4.0 million in share-based compensation. The significant increase in litigation cost primarily results from our on-going litigation with Akamai. Going forward, litigation costs will continue to be significant as the company will continue to have costs associated with completion of the initial trial with Akamai and the subsequent appeal as well as the costs associated with the Level 3 and Two-Way Media cases.

Our future results will be affected by many factors identified in the section captioned Risk Factors, in this quarterly report on

Table of Contents

Form 10-Q, including our ability to:

Successfully implement technical changes in our methods to deliver customer traffic to avoid further infringing on Akamai patents;

increase our revenue by adding customers and limiting customer cancellations and terminations, as well as increasing the amount of monthly recurring revenue that we derive from our existing customers;

manage the prices we charge for our services, as well as the costs associated with operating our network in light of increased competition;

successfully manage our litigation with Akamai, Level 3 and Two-Way Media to conclusion;

prevent disruptions to our services and network due to accidents or intentional attacks; and

continued ability to deliver a significant portion of our traffic through settlement free peering relationships which significantly reduce our cost of delivery.

As a result, we cannot assure you that we will achieve our expected financial objectives, including positive net income.

Critical Accounting Policies and Estimates

Our management's discussion and analysis of our financial condition and results of operations are based upon our unaudited condensed consolidated financial statements included elsewhere in this quarterly report on Form 10-Q, which have been prepared by us in accordance with accounting principles generally accepted in the United States for interim periods. These principles require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, cash flow and related disclosure of contingent assets and liabilities. Our estimates include those related to revenue recognition, accounts receivable reserves, income and other taxes, stock-based compensation and equipment and contingent obligations. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. To the extent that there are material differences between these estimates and our actual results, our future financial statements will be affected.

As of March 31, 2008, there have been no material changes to any of the critical accounting policies as described in our annual report on Form 10-K dated March 25, 2008. During the quarter ended March 31, 2008, we began to estimate the potential continuing damages from the jury verdict against us regarding the patent infringement lawsuit filed by Akamai Technologies, Inc.

Table of Contents**Results of Operations****Revenue**

	Three months ended March 31,			
	2008	2007	Increase (Decrease)	Percent Change
		(in thousands)		
Revenue	\$30,202	\$23,353	\$6,849	29%

Revenue increased 29%, or \$6.8 million, to \$30.2 million for the three months ended March 31, 2008 as compared to \$23.4 million for the three months ended March 31, 2007. The increase in revenue for the three months ended March 31, 2008 as compared to the same period in the prior year was primarily attributable to an increase in our recurring CDN service revenue of \$6.6 million. The increase in CDN service revenue was primarily attributable to an increase in the number of customers under recurring revenue contracts, as well as an increase in traffic and additional services sold to new and existing customers. As of March 31, 2008, we had 1,232 active customers under recurring CDN service revenue contracts as compared to 726 as of March 31, 2007. During the year ended December 31, 2007, we deferred \$3.4 million of custom CDN services revenue from one customer as the amounts were part of a multi-element arrangement. Entering into the multi-element arrangement with this customer changed the way we accounted for revenue earned from this customer during 2007. The revenue from the custom CDN services is being recognized ratably over a 44 month period starting in July 2007. As new service and or license fees are billed it is added to the deferred revenue and amortized over the then remaining contract term. As of March 31, 2008, we had \$2.9 million of deferred custom CDN services revenue remaining of which approximately \$0.8 million will be recognized during the remainder of 2008, \$1.0 million in 2009 and the remainder thereafter.

Table of Contents

For the three months ended March 31, 2008 and 2007, approximately 14% and 13%, respectively, of our total revenues were derived from our operations located outside of the United States. For the three months ended March 31, 2008, we derived approximately 78% our international revenue from Europe and approximately 22% of our international revenue from Asia Pacific. For the three months ended March 31, 2007, our international revenue was derived primarily from Europe. No single country outside of the United States accounted for 10% or more of revenues during these periods.

Cost of Revenue

	Three months ended March 31,			
	2008	2007	Increase (Decrease)	Percent Change
		(in thousands)		
Cost of revenue	\$20,672	\$ 14,497	\$6,175	43%

Cost of revenue includes fees paid to network providers for bandwidth and fees paid to data center operators for co-location of our network equipment. Cost of revenue also includes payroll and related costs, depreciation of network equipment used to deliver our CDN services and equity-related compensation for network operations personnel.

Cost of revenue increased 43%, or \$6.2 million, to \$20.7 million for the three months ended March 31, 2008 as compared to \$14.5 million for the three months ended March 31, 2007. These increases were primarily due to an increase in aggregate bandwidth and co-location fees of \$3.5 million, due to higher traffic levels and increased amounts of deployed network assets, an increase in depreciation expense of network equipment of \$1.3 million, due to increased investment in our network, and an increase in payroll and related employee costs of \$0.8 million, associated with increased staff and an increase in other costs of \$0.3 million. Other costs include costs associated with the build-out of custom CDN solution for a specific customer. During the three months ended March 31, 2008, we recognized \$21,000 of deferred costs associated with revenue related to the Multi-Element Arrangement entered into during the second quarter of 2007. As of March 31, 2008, there was \$0.2 million of deferred costs remaining to be amortized ratably into cost of services over a 44 month period that commenced in July 2007.

Additionally, during the three-month periods ended March 31, 2008 and 2007, cost of revenue includes share-based compensation expense of approximately \$0.5 million and \$0.2 million, respectively, resulting from our application of SFAS No. 123R.

Cost of revenue was composed of the following (in millions):

	For the Three Months Ended March 31,	
	2008	2007
Bandwidth and co-location fees	\$ 11.8	\$ 8.3
Depreciation network	6.0	4.7
Payroll and related employee costs	1.6	0.8
Share-based compensation	0.5	0.2
Royalty expenses	0.4	0.4
Other costs	0.4	0.1
Total cost of revenues	\$ 20.7	\$ 14.5

We have long-term purchase commitments for bandwidth usage and co-location with various tier 1 network providers and data center operators. The minimum commitments related to bandwidth usage and co-location services under agreements currently in effect are approximately: \$21.2 million for the remainder of 2008, \$20.5 million for 2009, \$11.7 million for 2010, \$5.3 million for 2011 and \$0.6 million for 2012 and beyond.

We expect that cost of revenues will increase during the remainder of 2008. We expect to deliver more traffic on our network, which would result in higher expenses associated with the increased traffic; additionally, we anticipate deploying additional network equipment into our network which will increase in depreciation expense related to our network equipment and increase the fixed cost associated with co-location space where equipment is deployed, along with payroll and related costs, as we expect to continue to make investments in our network to service our expanding customer base. The increase in network personnel and the granting of stock options to those new employees will result in additional expense associated with the amortization of share-based compensation.

Table of Contents**General and Administrative**

	Three months ended March 31,			
	2008	2007 (in thousands)	Increase (Decrease)	Percent Change
General and administrative	\$13,082	\$7,637	\$5,445	71%

General and administrative expenses consist primarily of the following components:

payroll, share-based compensation and other related costs, including related expenses for executive, finance, business applications, internal network management, human resources and other administrative personnel; fees for professional services and litigation expenses;

rent and other facility-related expenditures for leased properties;

depreciation of property and equipment we use internally;

the provision for doubtful accounts; and

non-income related taxes.

General and administrative expenses increased 71%, or \$5.5 million, to \$13.1 million for the three months ended March 31, 2008 as compared to \$7.6 million for the three months ended March 31, 2007. The increase in general and administrative expenses for the three months ended March 31, 2008 as compared to the three months ended March 31, 2007 was primarily due to an increase of \$4.5 million in litigation expenses primarily related to our litigation with Akamai and MIT and the class action lawsuits filed against us beginning in August 2007. Our litigation expenses include \$1.0 million which is reimbursable to us from an escrow fund established in connection with our 2006 stock repurchase. The increase is also attributable to an increase of \$2.3 million, in professional fees. Our increase in professional fees is primarily due to \$0.7 million in increased accounting fees and costs associated with being a publicly traded company and an increase of \$1.6 million in general legal and other professional fees. Included in the \$1.6 million is \$0.6 million for legal fees and other costs associated with patents. In addition, we had an increase of \$0.9 million in bad debt expense. These increases were off-set by a decrease in our share-based compensation expense of \$2.0 million, a decrease of \$0.1 million in payroll and related employee costs and a decrease of \$0.1 million in other expenses. Other expenses include such items as rent, utilities, telephone, insurance, travel and travel-related expenses, fees and licenses and property taxes. The decrease in share-based compensation expense is the result of having fully expensed equity grants made to our founders in connection with our Series B preferred stock financing in July 2006.

General and administrative expense was composed of the following (in millions):

	For the Three Months Ended March 31,	
	2008	2007
Litigation expenses	\$ 5.4	\$ 0.9
Professional fees	2.4	0.1
Share-based compensation	1.7	3.7
Bad debt expense	1.2	0.3
Payroll and related employee costs	1.0	1.1
Other expenses	1.4	1.5

Total general and administrative \$ 13.1 \$ 7.6

We expect general and administrative expenses to increase in 2008 in absolute dollars and to decrease as a percentage of revenue. The increase is due to, payroll and related costs attributable to increased hiring, rents and utilities as we expand our facilities, increased costs associated with litigation, as well as increased accounting and legal and other costs associated with public reporting requirements and compliance with the requirements of the Sarbanes-Oxley Act of 2002. We expect that these increases will be off-set by expected lower share-based compensation expense.

Sales and Marketing

	Three months ended March 31,			Percent Change
	2008	2007 (in thousands)	Increase (Decrease)	
Sales and marketing	\$8,142	\$3,018	\$5,124	170%

Sales and marketing expenses consist primarily of payroll and related costs, share-based compensation and commissions for personnel engaged in marketing, sales and service support functions, professional fees (consultants and recruiting fees), travel and travel-related expenses as well as advertising and promotional expenses.

Sales and marketing expenses increased 170%, or \$5.1 million, to \$8.1 million for the three months ended March 31, 2008, as compared to \$3.0 million for the three months ended March 31, 2007. The increase in sales and marketing expenses in the three- month period ended March 31, 2008 as compared to the three-month period ended March 31, 2007 was primarily due to an increase of \$2.6 million in payroll and related employee costs, which were primarily all additional salaries which reflects the investment we made in our sales and marketing organization during the last nine months of 2007. Additional increases were due to an increase of \$1.1 million in share-based compensation expense, an increase of \$0.4 million in travel and travel-related expenses, an increase of \$0.3 million in professional fees, and an increase of \$0.8 million in other expenses. Other expense included such items as rent and property taxes for our Europe and Asia Pacific sales offices, telephone and office supplies.

Table of Contents

Sales and marketing expense was composed of the following (in millions):

	For the Three Months Ended March 31,	
	2008	2007
Payroll and related employee costs	\$ 4.8	\$ 2.2
Share-based compensation	1.3	0.2
Marketing programs	0.4	0.5
Travel and travel-related expenses	0.4	
Professional fees	0.3	
Reseller commissions	0.1	0.1
Other expenses	0.8	
Total sales and marketing	\$ 8.1	\$ 3.0

We anticipate our sales and marketing expense will continue to increase in 2008 in absolute dollars and remain constant as a percentage of revenue. The increase is due to an expected increase in commissions on higher forecasted sales, the increase in payroll and related costs of sales and marketing personnel, increases in share-based compensation expense under SFAS No. 123R and additional expected increases in marketing costs such as advertising.

Research and Development

	Three months ended March 31,			Percent Change
	2008	2007 (in thousands)	Increase (Decrease)	
Research and development	\$ 1,590	\$ 1,285	\$ 305	24%

Research and development expenses consist primarily of payroll and related costs and share-based compensation expense for research and development personnel who design, develop, test and enhance our services, network and software.

Research and development expenses increased 24%, or \$0.3 million, to \$1.6 million for the three months ended March 31, 2008, as compared to \$1.3 million for the three months ended March 31, 2007. The increase in research and development expenses in the three month period ended March 31, 2008 as compared to the three month period ended March 31, 2007 was primarily due to an increase of \$0.4 million in payroll and related employee costs associated with our hiring of additional network and software engineering personnel, an increase of \$0.3 million in other expenses, off-set by a decrease in share-based compensation of \$0.4 million. Other expenses include such items as travel and travel related expenses, consulting, telephone, and office supplies.

Research and development expense was composed of the following (in millions):

	For the Three Months Ended March 31,	
	2008	2007
Payroll and related employee costs	\$ 0.8	\$ 0.4
Share-based compensation	0.5	0.9
Other expenses	0.3	

Total research and development \$ 1.6 \$ 1.3

We anticipate our research and development expense will continue to increase in 2008 in absolute dollars and remain constant as a percentage of revenue due to increased stock-based compensation expense as well as increased payroll and related costs associated with continued hiring of research development personnel and investments in our core technology and refinements to our other service offerings. Additionally, research and development expenses are expected to decrease as a result of lower share-based compensation expense under SFAS No. 123R.

Table of Contents***Provision for Litigation***

	Three months ended March 31,			Percent Change
	2008	2007 (in thousands)	Increase (Decrease)	
Provision for Litigation	\$7,134	\$	\$7,134	N/A

Provision for litigation relates to our accrual for potential additional damages associated with revenue generated during the three month period ended March 31, 2008 from infringing methods associated with the Akamai litigation. On February 29, 2008, a jury returned a verdict in favor of Akamai. For the year ended December 31, 2007, we recognized a provision for litigation in the amount of \$45.5 million plus pre-judgment interest estimated to be \$2.6 million. During the quarter ended March 31, 2008, we began to estimate the potential continuing damages from the jury verdict. For the quarter, we accrued an additional \$6.9 million for potential on-going damages, plus additional interest of \$0.2 million. Additional price erosion damages are possible but we are not able to determine a reasonable basis for estimation at this time.

Interest Expense

	Three months ended March 31,			Percent Change
	2008	2007 (in thousands)	Increase (Decrease)	
Interest expense	\$21	\$573	\$(552)	(96)%

Interest expense includes interest paid on our debt obligations as well as amortization of deferred financing costs.

Interest expense decreased 96%, or \$0.6 million to \$21,000 for the three months ended March 31, 2008, as compared to \$0.6 million for the three months ended March 31, 2007. The \$21,000 represents the amortization of loan fees associated with our unused line of credit. The decrease in interest expense for the three-month period ended March 31, 2008, was the result of our repayment of our outstanding credit facilities on June 14, 2007 from the proceeds from our initial public offering. As of March 31, 2008, we had no outstanding balances due on any of our credit facilities. We do not expect to incur any interest expense on debt during the remainder of 2008.

Interest Income

	Three months ended March 31,			Percent Change
	2008	2007 (in thousands)	Increase (Decrease)	
Interest income	\$1,891	\$ 89	\$1,802	2,025%

Interest income includes interest earned on invested cash balances and marketable securities.

Interest income increased to \$1.9 million for the three months ended March 31, 2008, as compared to \$0.1 million for the three months ended March 31, 2007. The increase in interest income in the three-month period ended March 31, 2008 as compared to the three-month period ended March 31, 2007 was primarily due to an increase in our average cash balance and the investment of the net proceeds from our initial public offering after the repayment of our outstanding credit facilities. In the future, we anticipate interest income to increase, as a result of substantially increased cash, cash equivalent and marketable securities balances.

Other Income

	Three months ended March 31,		
	Increase	Percent	

Edgar Filing: Limelight Networks, Inc. - Form 10-Q

	2008	2007 (in thousands)	(Decrease)	Change
Other income	\$170	\$ -0-	\$170	N/A
Other income primarily consists of foreign exchange gains of approximately \$106,000.				

22

Table of Contents**Income Tax (Benefit) Expense**

	Three months ended March 31,			Percent Change
	2008	2007 (in thousands)	Increase (Decrease)	
Income tax (benefit) expense	\$(183)	\$ 200	\$(383)	(191)%

Based upon our estimated annual effective tax rate and after consideration of discrete tax items in the quarter, our estimated tax benefit for the three months ended March 31, 2008 consisted of federal, foreign and state provisions/(benefits) for income tax. Our effective tax rate was 0.04% and (5.39%) for the three months ended March 31, 2008 and 2007, respectively. Our income tax benefit on our loss before taxes of \$18.6 million was different than our statutory income tax rate due primarily to an increase in our valuation allowance, netted with the tax benefit of an anticipated federal loss carry-back, and a tax benefit associated with a deferred tax asset associated with state net operating losses which had been subject to a valuation allowance. The effective income tax rate is based primarily upon forecasted income or loss for the year, the composition of the income or loss in different countries, and adjustments, if any, for the potential tax consequences, benefits or resolutions for tax audits.

In 2006 (principally in the last six months of the year) and 2007, approximately \$7.6 million and \$10.5 million of share-based compensation expense was not deductible for tax purposes by us, as certain executives and other employees made tax elections which established tax bases in these awards granted at lower than the fair value recognized within the financial statements. This permanent difference was material to our pre-tax net loss of \$18.6 million for the first three months of 2008. The current unvested awards are expected to generate permanent differences of \$1.9 million for the remaining nine months of 2008 and \$2.6 million, and \$0.6 million for 2009 and 2010, respectively, based on the unvested portion of the equity award outstanding at March 31, 2008 and anticipated vesting at the time.

During the three months ended March 31, 2008, we performed our assessment of the recoverability of deferred tax assets and determined there was sufficient negative evidence as a result of our cumulative losses to conclude that it was more likely than not that our deferred tax assets would not be realized and accordingly maintained a full valuation allowance. In calculating our effective income tax rate for 2008, no benefit is provided for temporary differences that increase deferred tax assets relating to stock-based compensation.

Liquidity and Capital Resources

To date, we have financed our operations primarily through the following transactions:

private sales of common and preferred stock and subordinated notes;

an initial public offering of our common stock in June 2007;

borrowing on credit facilities; and

cash generated by operations.

As of March 31, 2008, our cash, cash equivalents and marketable securities classified as current totaled \$194.7 million.

Operating Activities

Net cash used in operating activities was \$0.6 million for the three months ended March 31, 2008, compared to net cash provided by operating activities of \$6.5 million for the three months ended March 31, 2007. The change to cash used in operating activities for the three month period ended March 31, 2008 was primarily due to our net loss of \$18.4 million, changes in working capital in accounts receivable of \$2.3 million and accounts payable of \$4.6 million, offset by non-cash charges for litigation of \$7.1 million, depreciation and amortization of \$6.3 million, stock-based compensation of \$4.0 million and accounts receivable charges of \$1.6 million, and changes in working capital for other current liabilities of \$5.0 million, income taxes receivable of \$0.6 million and other assets of \$0.6 million.

We expect that cash provided by operating activities will not be sufficient to cover new purchases of property and equipment during the remainder of 2008 and fund potential damages associated with patent litigation. The timing and amount of future working capital changes, requirement to secure potential infringement damages and our ability to manage our days sales outstanding will also affect the future amount of cash used in or provided by operating activities.

Investing Activities

Cash provided by investing activities was \$7.0 million for the three months ended March 31, 2008, compared to cash used in investing activities of \$3.1 million for the three months ended March 31, 2007. Cash provided by investing activities was principally comprised of cash generated from the sale of short-term marketable securities off set by the purchase of short-term marketable securities and capital expenditures primarily for computer equipment associated with the build-out and expansion of our CDN.

We expect to have ongoing capital expenditure requirements but at a lower rate than we had in 2007, as we continue to invest in and expand our CDN. We currently anticipate making aggregate capital expenditures of approximately \$11.0 million to \$13.0 million during the remainder of 2008.

Financing Activities

Cash provided by financing activities decreased \$1.6 million to \$0.1 million for the three months ended March 31, 2008, as compared to \$1.7 million for the three months ended March 31, 2007. The decrease is primarily due to borrowings of \$1.5 million on

Table of Contents

our bank line and \$0.3 million in reimbursement of litigation expenses from our escrow account, off set by payments made on capital lease obligations of \$0.2 million in the three months ended March 31, 2007.

At March 31, 2008 we had no outstanding balance on any of our credit facilities and we had an unused line of credit of up to \$5.0 million dollars. Under the terms of the line of credit, we can borrow up to 50% of the cash balances we hold at the bank, up to a maximum of \$5.0 million dollars. We do not anticipate having to utilize the line of credit for the remainder of 2008.

In connection with our Series B preferred stock financing in July 2006, an escrow account was established with an initial balance of approximately \$10.1 million to serve as security for the indemnification obligations of our stockholders tendering shares in that financing and to fund 50% of the ongoing monthly expenses associated with the Akamai litigation. In May 2007, we, the tendering stockholders and the Series B preferred stock investors agreed to distribute \$3.7 million of the escrow account to the tendering stockholders upon the closing of our initial public offering. During the three-month period ended March 31, 2008, we did not receive any reimbursements from this escrow. At March 31, 2008, the balance outstanding in the escrow was \$1.0 million. We expect to draw the \$1.0 million from this escrow during the three-month period ending June 30, 2008.

Changes in cash, cash equivalents and marketable securities are dependent upon changes in, among other things, working capital items such as deferred revenues, accounts payable, accounts receivable and various accrued expenses, as well as changes in our capital and financial structure due to debt repurchases and issuances, stock option exercises, sales of equity investments and similar events.

At March 31, 2008, we had accrued \$55.3 million associated with potential damages and interest owed to Akamai associated with the ongoing patent infringement litigation. During 2008, we may be required to issue an appeal bond to the court to securitize the potential damage award. Such a bond will require that we pledge a certain amount of our cash reserves as collateral. At this time we are unable to determine if an appeal bond would be required or the amount of such an appeal bond. The trial date for the action is set for October 2008. In the event of a negative outcome at trial there could be additional demands put on our cash reserves to satisfy any potential award associated with that case. It is impossible to determine the amount, if any, of any award and the associated appeal bond requirement.

We believe that our existing cash and cash equivalents will be sufficient to meet our anticipated cash needs for at least the next 12 months. If the assumptions underlying our business plan regarding future revenue and expenses and cost of ongoing litigation change, or if unexpected opportunities or needs arise, we may seek to raise additional cash by selling equity or debt securities. If additional funds are raised through the issuance of equity or debt securities, these securities could have rights, preferences and privileges senior to those accruing to holders of common stock, and the terms of such debt could impose restrictions on our operations. The sale of additional equity or convertible debt securities would also result in additional dilution to our stockholders. In the event that additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us or at all. If we are unable to raise additional capital when desired, our business, operating results and financial condition could be harmed.

Contractual Obligations, Contingent Liabilities and Commercial Commitments

In the normal course of business, we make certain long-term commitments for operating leases, primarily office facilities, bandwidth and computer rack space. These leases expire on various dates ranging from 2008 to 2013. We expect that the growth of our business will require us to continue to add to and increase our long-term commitments in 2008 and beyond. As a result of our growth strategies, we believe that our liquidity and capital resources requirements will grow in absolute dollars but will be generally consistent with that of historical periods on an annual basis as a percentage of net revenue.

The following table presents our contractual obligations and commercial commitments, as of March 31, 2008 over the next five years and thereafter (in thousands):

		Payments Due by Period			More than 5 years
		Less than 1 year	1-3 years	3-5 years	
Contractual Obligations as of March 31, 2008	Total				

Edgar Filing: Limelight Networks, Inc. - Form 10-Q

Operating Leases					
Bandwidth leases	\$ 30,813	\$ 13,467	\$ 12,852	\$ 4,473	\$ 21
Rack space leases	28,513	13,349	15,164		
Real estate leases	2,931	1,242	1,628	61	
Total operating leases	62,257	28,058	29,644	4,534	21
Capital leases					
Bank debt					
Interest on bank debt					
Total commitments	\$ 62,257	\$ 28,058	\$ 29,644	\$ 4,534	\$ 21

Off Balance Sheet Arrangements

We do not have, and have never had, any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Table of Contents

Use of Non-GAAP Financial Measures

To evaluate our business, we consider and use Non-GAAP net income and EBITDA adjusted for share-based compensation and litigation and damage costs as a supplemental measure of operating performance. We consider Non-GAAP net income to be an important indicator of overall business performance because it allows us to illustrate the impact of the effects of share-based compensation, litigation expenses and provision for litigation. We define EBITDA as GAAP net income before interest income, interest expense, other income and expense, provision for income taxes, depreciation and amortization. We define EBITDA adjusted for share-based compensation and litigation and damage costs as EBITDA plus expenses that we do not consider reflective of our ongoing operations. We use EBITDA adjusted for share-based compensation and litigation and damage costs as a supplemental measure to review and assess operating performance. We also believe use of EBITDA adjusted for share-based compensation and litigation and damage costs facilitates investors' use of operating performance comparisons from period to period.

The terms Non-GAAP net income, EBITDA and EBITDA adjusted for share-based compensation and litigation and damage costs are not defined under U.S. generally accepted accounting principles, or U.S. GAAP, and are not measures of operating income, operating performance or liquidity presented in accordance with U.S. GAAP. Our Non-GAAP net income, EBITDA and EBITDA adjusted for share-based compensation and litigation and damage costs have limitations as analytical tools, and when assessing our operating performance, Non-GAAP net income, EBITDA and EBITDA adjusted for share-based compensation and litigation and damage costs should not be considered in isolation, or as a substitute for net income (loss) or other consolidated income statement data prepared in accordance with U.S. GAAP. Some of these limitations include, but are not limited to:

- EBITDA and EBITDA adjusted for share-based compensation and litigation and damage costs do not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments;

- they do not reflect changes in, or cash requirements for, our working capital needs;

- they do not reflect the cash requirements necessary for litigation costs and damages accruals;

- they do not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debt;

- they do not reflect income taxes or the cash requirements for any tax payments;

- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will be replaced sometime in the future, and EBITDA and EBITDA adjusted for share-based compensation and litigation and damage costs do not reflect any cash requirements for such replacements;

- while share-based compensation is a component of operating expense, the impact on our financial statements compared to other companies can vary significantly due to such factors as the assumed life of the options and the assumed volatility of our common stock; and

- other companies may calculate EBITDA and EBITDA adjusted for share-based compensation and litigation and damage costs differently than we do, limiting their usefulness as comparative measures.

We compensate for these limitations by relying primarily on our GAAP results and using Non-GAAP Net Income and EBITDA adjusted for share-based compensation and litigation and damage costs only as supplemental support for management's analysis of business performance. Non-GAAP Net Income, EBITDA and EBITDA adjusted for share-based compensation and litigation and damage costs are calculated as follows for the periods presented in thousands:

Reconciliation of Non-GAAP Financial Measures

In accordance with the requirements of Regulation G issued by the Securities and Exchange Commission, the Company is presenting the most directly comparable GAAP financial measures and reconciling the non-GAAP

financial metrics to the comparable GAAP measures.

Table of Contents

Reconciliation of GAAP Net Income (Loss) to Non-GAAP Net Income (Loss)
(In thousands)
(Unaudited)

	Three Months Ended	
	March	March 31,
	31,	2007
	2008	2007
GAAP net loss	\$ (18,442)	\$ (3,905)
Provision for potential litigation damages	7,134	
Share-based compensation	3,960	5,071
Litigation defense expenses	5,366	885
Non-GAAP net (loss) income	\$ (1,982)	\$ 2,051

Reconciliation of GAAP Net Income (Loss) to EBITDA to EBITDA
Adjusted for Share-Based Compensation and Litigation and Damage Costs
(In thousands)
(Unaudited)

	Three Months Ended	
	March	March 31,
	31,	2007
	2008	2007
GAAP net loss	\$ (18,442)	\$ (3,905)
Add: depreciation and amortization	6,260	4,825
Add: interest expense	21	573
Less: interest and other income	(2,062)	(89)
Plus income tax expense (benefit)	(183)	200
EBITDA	\$ (14,406)	\$ 1,604
Add: provision for litigation	7,134	
Add: share-based compensation	3,960	5,071
Add: litigation defense expenses	5,366	885
EBITDA adjusted for share-based compensation, litigation and damage costs	\$ 2,054	\$ 7,560

Item 3. Quantitative and Qualitative Disclosures About Market Risk**Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to our debt and investment portfolio. In our investment portfolio, we do not use derivative financial instruments. Our investments are primarily with our commercial and investment banks and, by policy, we limit the amount of risk by investing primarily in money market funds, United States Treasury obligations, high-quality corporate and municipal obligations and certificates of deposit. We do not believe that a 10% change in interest rates would have a significant impact on our interest income, operating results or liquidity.

Foreign Currency Risk

Substantially all of our customer agreements are denominated in U.S. dollars, and therefore our revenue is not subject to foreign currency risk. Because we have operations in Europe and Asia, however, we may be exposed to fluctuations in foreign exchange rates with respect to certain operating expenses and cash flows. Additionally, we may continue to expand our operations globally and sell to customers in foreign locations, potentially with customer agreements denominated in foreign currencies, which may increase our exposure to foreign exchange fluctuations. At this time, we do not have any foreign hedge contracts because exchange rate fluctuations have had little or no impact on our operating results and cash flows.

Inflation Risk

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

Item 4. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

We are responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in SEC Rule 13a-15(e). We maintain disclosure controls and procedures, as such term is defined in SEC Rule 13a-15(e), that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and

Table of Contents

operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of March 31, 2008. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There has been no change in our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the period covered by this Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting. Commencing with our year ending December 31, 2008, we must perform system and process evaluations and testing of our internal controls over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal controls over financial reporting, as required under Section 404 of the Sarbanes-Oxley Act. See the Risk Factor entitled *If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements could be impaired, which could adversely affect our operating results, our ability to operate our business and investors view of us* in this quarterly report on Form 10-Q.

PART II. OTHER INFORMATION**Item 1. Legal Proceedings**

We are involved in litigation with Akamai Technologies, Inc. and the Massachusetts Institute of Technology relating to a claim of patent infringement. The action was filed in June 2006 in the U.S. District Court for the District of Massachusetts. The trial date was set for February 2008 with respect to four claims in U.S. Patent No. 6,108,703 (the 703 patent). In February 2008, a jury returned a verdict in this lawsuit, finding that we infringed four claims of the 703 patent at issue and rejecting our invalidity defenses for the period April 2005 through December 31, 2007. The jury awarded an aggregate of approximately \$45.5 million which includes lost profits, reasonable royalties and price erosion damages. In addition the jury awarded pre-judgment interest which we estimated to be \$2.6 million at December 31, 2007. We have recorded the aggregate \$48.1 million as a provision for litigation as of December 31, 2007. An additional provision of approximately \$7.1 million for potential additional infringement damages and interest was recorded during the three month period ended March 31, 2008. A final judgment has not yet been entered. We are still pursuing a number of equitable defenses, and we recently filed several motions seeking relief from the Court, including motions for a new trial and for judgment in our favor as a matter of law. Akamai has filed motions for summary judgment on our remaining equitable defenses and for a permanent injunction, which we have opposed. We continue to believe that the claims of infringement asserted against us by Akamai and MIT in the present litigation are without merit and that the jury's verdict is incorrect, and we will continue to defend the case vigorously. Regardless of the outcome on the pending motions in the trial court, it is likely that appeals by Akamai, us or both will follow. We cannot assure you, however, that this lawsuit ultimately will be resolved in our favor. An adverse judgment or injunction could seriously impact our ability to conduct our business and to offer our products and services to our customers. A permanent injunction could prevent us from operating our CDN to deliver certain types of traffic, which could impact the viability of our business. These adverse outcomes, in turn, would harm our revenue, market share, reputation, liquidity and overall financial position. Whether or not we prevail in this case, we expect that the litigation will continue to be expensive, time consuming and a distraction to our management in operating our business.

Beginning in August 2007, we, certain of our officers and directors, and the firms that served as the lead underwriters in our initial public offering were named as defendants in several purported class action lawsuits. These lawsuits have been consolidated into a single lawsuit in U.S. District Court for the District of Arizona. The consolidated complaint assert causes of action under Sections 11, 12 and 15 of the Securities Act of 1933, as amended, on behalf of a professed class consisting of all those who were allegedly damaged as a result of acquiring our common stock in our initial public offering (IPO) between June 8, 2007 and August 8, 2007. The complaint alleges, among other things, that we omitted and/or misstated certain facts concerning the seasonality of our business and that the loss of revenue with respect to certain customers. On March 17, 2008, we and the individual defendants

moved to dismiss all of the plaintiffs' claims. Although we believe that we and the individual defendants have meritorious defenses to the claims made in the complaint and we intend to contest the lawsuits vigorously, an adverse resolution of the lawsuits may have a material adverse effect on our financial position and results of operations in the period in which the lawsuits are resolved. We are not able at this time to estimate the range of potential loss nor do we believe that a loss is probable. Therefore, we have made no provision for this lawsuit in our financial statements.

In December 2007, Level 3 Communications, LLC, or Level 3, filed a lawsuit against us in the U.S. District Court for the Eastern District of Virginia alleging that we are infringing three patents Level 3 allegedly acquired from Savvis Communications Corp. In addition to monetary relief, including treble damages, interest, fees and costs, the complaint seeks an order permanently enjoining us from conducting our business in a manner that infringes the relevant patents. Discovery has begun, and the Court has set a trial date for October 2008. While we believe that the claims of infringement asserted against us by Level 3 in the present litigation are without merit and intend to vigorously defend the action, there can be no assurance that this lawsuit ultimately will be resolved in our favor. An adverse ruling could seriously impact our ability to conduct our business and to offer our products and services to our customers. This, in turn, would harm our revenue, market share, reputation, liquidity and overall financial position. We are not able at this time to

Table of Contents

estimate the range of potential loss nor do we believe that a loss is probable. Therefore, we have made no provision for this lawsuit in our financial statements.

In April 2008, Two-Way Media LLC (TWM) filed a lawsuit against us and other defendants, including Akamai, AT&T Corp., SBC Internet Services and Southwestern Bell Telephone Company, in the U.S. District Court for the Southern District of Texas, Corpus Christi Division. TWM alleges we infringe four patents owned by TWM. TWM seeks both monetary and injunctive relief against us. While we believe that the claims of infringement asserted against us by TWM in the present litigation are without merit and intend to vigorously defend the action, there can be no assurance that this lawsuit ultimately will be resolved in our favor. An adverse ruling could seriously impact our ability to conduct our business and to offer our products and services to our customers. This, in turn, would harm our revenue, market share, reputation, liquidity and overall financial position. We are not able at this time to estimate the range of potential loss nor do we believe that a loss is probable. Therefore, we have made no provision for this lawsuit in our financial statements.

From time to time, we also may become involved in legal proceedings arising in the ordinary course of our business.

Item 1A. Risk Factors

Investments in the equity securities of publicly traded companies involve significant risks. Our business, prospects, financial condition or operating results could be materially adversely affected by any of these risks, as well as other risks not currently known to us or that we currently consider immaterial. The trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment. In assessing the risks described below, you should also refer to the information contained in this report on Form 10-Q, including our unaudited condensed consolidated financial statements and the related notes, before deciding to purchase any shares of our common stock.

Risks Related to Our Business

A jury has determined that we are infringing a competitor's patent, and an injunction may be entered against us that could force us to cease providing our CDN services.

In February 2008, a jury returned a verdict in a patent infringement lawsuit filed by Akamai Technologies, Inc., or Akamai, and the Massachusetts Institute of Technology, or MIT, against us, finding that we infringed four claims of the patent at issue and rejecting our invalidity defenses. The jury awarded Akamai an aggregate of approximately \$45.5 million in lost profits, reasonable royalties and price erosion damages, plus pre-judgment interest estimated to be \$2.6 million that we have recorded in 2007. An additional provision of approximately \$7.1 million for potential additional infringement damages and interest was recorded during the three-month period ended March 31, 2008. Additional accruals for future periods are expected. A final judgment has not yet been entered. We are still pursuing a number of equitable defenses, and we recently filed several motions seeking relief from the Court. Akamai has filed motions for summary judgment on our remaining equitable defenses and for a permanent injunction which we have opposed. We continue to believe that the claims of infringement asserted against us by Akamai and MIT in the present litigation are without merit and that the jury's verdict is incorrect, and we will continue to defend the case vigorously; however, we cannot assure you that this lawsuit ultimately will be resolved in our favor. An adverse judgment or injunction could seriously impact our ability to conduct our business and to offer our products and services to our customers. A permanent injunction could prevent us from operating our CDN to deliver certain types of traffic, which could impact the viability of our business. These adverse outcomes, in turn, would harm our revenue, market share, reputation, liquidity and overall financial position. Whether or not we prevail in this case, we expect that the litigation will continue to be expensive, time consuming and a distraction to our management in operating our business. This lawsuit and other ongoing legal proceedings are described under **Legal Proceedings** in Part II, Item 1 of this quarterly report on Form 10-Q.

We may need to defend our intellectual property and processes against patent or copyright infringement claims, which would cause us to incur substantial costs and threaten our ability to do business.

Companies, organizations or individuals, including our competitors, may hold or obtain patents or other proprietary rights that would prevent, limit or interfere with our ability to make, use or sell our services or develop new services, which could make it more difficult for us to operate our business. From time to time, we may receive inquiries from

holders of patents inquiring whether we infringe their proprietary rights. Companies holding Internet-related patents or other intellectual property rights are increasingly bringing suits alleging infringement of such rights or otherwise asserting their rights and seeking licenses. For example, in June 2006, we were sued by Akamai and MIT alleging we infringed patents licensed to Akamai, and in February 2008 a jury returned a verdict in this case, finding that we infringed four claims of the patent at issue and rejecting our invalidity defenses. The jury awarded Akamai an aggregate of approximately \$45.5 million in lost profits, reasonable royalties and price erosion damages, plus pre-judgment interest estimated to be \$2.6 million that we have recorded in 2007. An additional provision of approximately \$7.1 million for potential additional infringement damages and interest was recorded during the three-month period ended March 31, 2008 and additional accruals for future periods are expected. Although a final judgment has not yet been entered, an adverse judgment or injunction could seriously impact our ability to conduct our business and to offer our products and services to our customers. A permanent injunction could prevent us from operating our CDN to deliver certain types of traffic, which could impact the viability of our business. In addition, in December 2007, Level 3 Communications, or Level 3, filed a lawsuit against us alleging that we are infringing three patents Level 3 allegedly acquired from Savvis Communications Corp. In addition to monetary relief, including treble damages, interest, fees and costs, the complaint seeks an order permanently enjoining us from conducting our business in a manner that infringes

Table of Contents

the relevant patents. Further, in April 2008, Two-Way Media LLC, or TWM, filed a lawsuit against us and several other defendants alleging that we are infringing four patents owned by TWM. TWM is seeking monetary damages and injunctive relief. Any litigation or claims, whether or not valid, could result in substantial costs and diversion of resources. See *Legal Proceeding* in Part II, Item 1 of this quarterly report on Form 10-Q. In addition, if we are determined to have infringed upon a third party's intellectual property rights, we may be required to do one or more of the following:

cease selling, incorporating or using products or services that incorporate the challenged intellectual property;

pay substantial damages;

obtain a license from the holder of the infringed intellectual property right, which license may or may not be available on reasonable terms or at all; or

redesign products or services.

If we are forced to take any of these actions, our business may be seriously harmed. In the event of a successful claim of infringement against us and our failure or inability to obtain a license to the infringed technology, our business and operating results could be harmed.

The expense of defending these lawsuits and other lawsuits to which we may be a party (see discussion in *Legal Proceedings* in Part II, Item 1 of the quarterly report on Form 10Q), particularly fees paid to our lawyers and expert consultants, has been and will continue to be significant and will continue to adversely affect our operating results during the pendency of the lawsuits.

Our limited operating history makes evaluating our business and future prospects difficult, and may increase the risk of your investment.

Our company has only been in existence since 2001. A significant amount of our growth, in terms of employees, operations and revenue, has occurred since 2004. For example, our revenue has grown from \$5.0 million in 2003 to \$65.2 million in 2006 and to \$103.1 million in 2007. For the three-month period ended March 31, 2008 our revenue was \$30.2 million. As a consequence, we have a limited operating history which makes it difficult to evaluate our business and our future prospects. We have encountered and will continue to encounter risks and difficulties frequently experienced by growing companies in rapidly changing industries, such as the risks described in this quarterly report on Form 10-Q. If we do not address these risks successfully, our business will be harmed.

If we fail to manage future growth effectively, we may not be able to market and sell our services successfully.

We have recently expanded our operations significantly, increasing our total number of employees from 29 at December 31, 2004 to 244 at March 31, 2008, and we anticipate that further significant expansion will be required. Our future operating results depend to a large extent on our ability to manage this expansion and growth successfully. Risks that we face in undertaking this expansion include: training new sales personnel to become productive and generate revenue; forecasting revenue; controlling expenses and investments in anticipation of expanded operations; implementing and enhancing our content delivery network, or CDN, and administrative infrastructure, systems and processes; addressing new markets; and expanding international operations. A failure to manage our growth effectively could materially and adversely affect our ability to market and sell our products and services.

We currently face competition from established competitors and may face competition from others in the future.

We compete in markets that are intensely competitive, rapidly changing and characterized by constantly declining prices and vendors offering a wide range of content delivery solutions. We have experienced and expect to continue to experience increased competition, and particularly aggressive price competition. Many of our current competitors, as well as a number of our potential competitors, have longer operating histories, greater name recognition, broader customer relationships and industry alliances and substantially greater financial, technical and marketing resources than we do. As a consequence of the competitive dynamics in our market we have experienced reductions in our prices, which in turn adversely affect our revenue, gross margin and operating results.

Our primary competitors include content delivery service providers such as Akamai, Level 3 Communications and Internap Network Services Corporation, which acquired VitalStream. Also, as a result of the growth of the content

delivery market, a number of companies are currently attempting to enter our market, either directly or indirectly, some of which may become significant competitors in the future. Our competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements. Given the relative ease by which customers typically can switch among CDN providers, differentiated offerings or pricing by competitors could lead to a rapid loss of customers. Some of our current or potential competitors may bundle their offerings with other services, software or hardware in a manner that may discourage content providers from purchasing the services that we offer. In addition, as we expand internationally, we face different market characteristics and competition with local content delivery service providers, many of which are very well positioned within their local markets. Increased competition could result in price reductions and revenue shortfalls, loss of customers and loss of market share, which could harm our business, financial condition and results of operations.

We may lose customers if they elect to develop content delivery solutions internally.

Table of Contents

Our customers and potential customers may decide to develop their own content delivery solutions rather than outsource these solutions to CDN services providers like us. This is particularly true as our customers increase their operations and begin expending greater resources on delivering their content using third-party solutions. For example, in 2006, one customer within our top 10 customers, MySpace.com, which was contracted through a reseller of our services, CDN Consulting, accounted for approximately 21% of our total revenue for that period. At the end of 2006, MySpace became a direct customer of ours. During 2007, sales to the MySpace.com were approximately 3% of our total revenue. For the year ended December 31, 2007, sales to the reseller CDN Consulting were less than 1% of revenue after this change. For the three-month period ended March 31, 2008, revenue from MySpace.com was approximately 2% of our total revenue and revenue from CDN Consulting was less than 1% of our total revenue. If we fail to offer CDN services that are competitive to in-sourced solutions, we may lose additional customers or fail to attract customers that may consider pursuing this in-sourced approach, and our business and financial results would suffer.

We may lose customers if they are unable to build business models that effectively monetize delivery of their content.

Our customers may not be successful in selling advertising or otherwise monetizing the content we delivery on their behalf and consequently may not be successful in creating a profitable business model. This may result in some of our customers discontinuing their internet or web-based business operations and discontinuing use of our services and products. For example, during the three-month period ended March 31, 2008, a significant customer discontinued its website business and ceased using our CDN services. We expect further customers may similarly discontinue operations. Further loss of customers may adversely affect our financial results.

Rapidly evolving technologies or new business models could cause demand for our CDN services to decline or could cause these services to become obsolete.

Customers or third parties may develop technological or business model innovations that address content delivery requirements in a manner that is, or is perceived to be, equivalent or superior to our CDN services. If competitors introduce new products or services that compete with or surpass the quality or the price/performance of our services, we may be unable to renew our agreements with existing customers or attract new customers at the prices and levels that allow us to generate attractive rates of return on our investment. For example, one or more third parties might develop improvements to current peer-to-peer technology, which is a technology that relies upon the computing power and bandwidth of its participants, such that this technological approach is better able to deliver content in a way that is competitive to our CDN services, or even that makes CDN services obsolete. We may not anticipate such developments and may be unable to adequately compete with these potential solutions. In addition, our customers business models may change in ways that we do not anticipate and these changes could reduce or eliminate our customers' needs for CDN services. If this occurred, we could lose customers or potential customers, and our business and financial results would suffer. As a result of these or similar potential developments, in the future it is possible that competitive dynamics in our market may require us to reduce our prices, which could harm our revenue, gross margin and operating results.

If we are unable to sell our services at acceptable prices relative to our costs, our revenue and gross margins will decrease, and our business and financial results will suffer.

Prices for content delivery services have fallen in recent years and are likely to fall further in the future. We have invested significant amounts in purchasing capital equipment to increase the capacity of our content delivery services. For example, in 2006 we invested \$40.6 million in capital expenditures and \$22.7 million in capital expenditures during 2007, primarily for computer equipment associated with the build-out and expansion of our CDN. For the three-month period ended March 31, 2008, we invested \$2.4 million. Our investments in our infrastructure are based upon our assumptions regarding future demand and also prices that we will be able to charge for our services. These assumptions may prove to be wrong. If the price that we are able to charge customers to deliver their content falls to a greater extent than we anticipate, if we over-estimate future demand for our services or if our costs to deliver our services do not fall commensurate with any future price declines, we may not be able to achieve acceptable rates of return on our infrastructure investments and our gross profit and results of operations may suffer dramatically.

In addition, during 2008 and beyond, we expect to increase our expenses, in absolute dollars, in substantially all areas of our business, including sales and marketing, general and administrative, and research and development. During 2008 and 2009, as we further expand our CDN, and we begin to refresh our network equipment, we also expect our capital expenditures to be generally consistent with the high level of expenditures we made in this area in 2006 and 2007. As a consequence, we are dependent on significant future growth in demand for our services to provide the necessary gross profit to pay these additional expenses. If we fail to generate significant additional demand for our services, our results of operations will suffer and we may fail to achieve planned or expected financial results. There are numerous factors that could, alone or in combination with other factors, impede our ability to increase revenue, moderate expenses or maintain gross margins, including:

- failure to increase sales of our core services;

- significant increases in bandwidth and rack space costs or other operating expenses;

- inability to maintain our prices relative to our costs;

- failure of our current and planned services and software to operate as expected;

- loss of any significant customers or loss of existing customers at a rate greater than our

Table of Contents

increase in new customers or our sales to existing customers;

failure to increase sales of our services to current customers as a result of their ability to reduce their monthly usage of our services to their minimum monthly contractual commitment;

failure of a significant number of customers to pay our fees on a timely basis or at all or failure to continue to purchase our services in accordance with their contractual commitments; and

inability to attract high-quality customers to purchase and implement our current and planned services.

If we are unable to develop new services and enhancements to existing services or fail to predict and respond to emerging technological trends and customers' changing needs, our operating results may suffer.

The market for our CDN services is characterized by rapidly changing technology, evolving industry standards and new product and service introductions. Our operating results depend on our ability to develop and introduce new services into existing and emerging markets. The process of developing new technologies is complex and uncertain. We must commit significant resources to developing new services or enhancements to our existing services before knowing whether our investments will result in services the market will accept. For example, during 2007 we introduced our Geo-Compliance paid service option, and we do not yet know whether our customers will adopt this offering in sufficient numbers to justify our development costs. Furthermore, we may not execute successfully our technology initiatives because of errors in planning or timing, technical hurdles that we fail to overcome in a timely fashion, misunderstandings about market demand or a lack of appropriate resources. Failures in execution or market acceptance of new services we introduce could result in competitors providing those solutions before we do, which could lead to loss of market share, revenue and earnings.

We depend on a limited number of customers for a substantial portion of our revenue in any fiscal period, and the loss of, or a significant shortfall in demand from, these customers could significantly harm our results of operations.

During any given fiscal period, a relatively small number of customers typically account for a significant percentage of our revenue. For example, in 2007, sales to our top 10 customers, in terms of revenue, accounted for approximately 45% of our total revenue. For the three month period ended March 31, 2008, sales to our top 10 customers, in terms of revenue, accounted for approximately 45% of our total revenue. During 2007 one of these top 10 customers, Microsoft, represented approximately 12% of our total revenue for that period. For the three-month period ended March 31, 2008, one of these top 10 customers, Microsoft, represented approximately 15% of our total revenue for that period. In the past, the customers that comprised our top 10 customers have continually changed, and we also have experienced significant fluctuations in our individual customers' usage of our services. As a consequence, we may not be able to adjust our expenses in the short term to address the unanticipated loss of a large customer during any particular period. As such, we may experience significant, unanticipated fluctuations in our operating results which may cause us to not meet our expectations or those of stock market analysts, which could cause our stock price to decline.

If we are unable to attract new customers or to retain our existing customers, our revenue could be lower than expected and our operating results may suffer.

In addition to adding new customers, to increase our revenue, we must sell additional services to existing customers and encourage existing customers to increase their usage levels. If our existing and prospective customers do not perceive our services to be of sufficiently high value and quality, we may not be able to retain our current customers or attract new customers. We sell our services pursuant to service agreements that are generally one year in length. Our customers have no obligation to renew their contracts for our services after the expiration of their initial commitment period, and these service agreements may not be renewed at the same or higher level of service, if at all. Moreover, under some circumstances, some of our customers have the right to cancel their service agreements prior to the expiration of the terms of their agreements. Because of our limited operating history, we have limited historical data with respect to rates of customer service agreement renewals. This fact, in addition to the changing competitive landscape in our market, means that we cannot accurately predict future customer renewal rates. Our customers

renewal rates may decline or fluctuate as a result of a number of factors, including:

their satisfaction or dissatisfaction with our services;

the prices of our services;

the prices of services offered by our competitors;

Discontinuation by our customers of their internet or web-based content distribution business;

mergers and acquisitions affecting our customer base; and

reductions in our customers' spending levels.

If our customers do not renew their service agreements with us or if they renew on less favorable terms, our revenue may decline and our business will suffer. Similarly, our customer agreements often provide for minimum commitments that are often significantly

Table of Contents

below our customers' historical usage levels. Consequently, even if we have agreements with our customers to use our services, these customers could significantly curtail their usage without incurring any penalties under our agreements. In this event, our revenue would be lower than expected and our operating results could suffer.

It also is an important component of our growth strategy to market our CDN services to industries, such as enterprise and the government. As an organization, we do not have significant experience in selling our services into these markets. We have only recently begun a number of these initiatives, and our ability to successfully sell our services into these markets to a meaningful extent remains unproven. If we are unsuccessful in such efforts, our business, financial condition and results of operations could suffer.

Our results of operations may fluctuate in the future. As a result, we may fail to meet or exceed the expectations of securities analysts or investors, which could cause our stock price to decline.

Our results of operations may fluctuate as a result of a variety of factors, many of which are outside of our control. If our results of operations fall below the expectations of securities analysts or investors, the price of our common stock could decline substantially. Fluctuations in our results of operations may be due to a number of factors, including:

our ability to increase sales to existing customers and attract new customers to our CDN services;

the addition or loss of large customers, or significant variation in their use of our CDN services;

costs associated with current or future intellectual property lawsuits and other lawsuits;

service outages or security breaches;

the amount and timing of operating costs and capital expenditures related to the maintenance and expansion of our business, operations and infrastructure;

the timing and success of new product and service introductions by us or our competitors;

the occurrence of significant events in a particular period that result in an increase in the use of our CDN services, such as a major media event or a customer's online release of a new or updated video game;

changes in our pricing policies or those of our competitors;

the timing of recognizing revenue;

share-based compensation expenses associated with attracting and retaining key personnel;

limitations of the capacity of our content delivery network and related systems;

the timing of costs related to the development or acquisition of technologies, services or businesses;

general economic, industry and market conditions and those conditions specific to Internet usage and online businesses;

limitations on usage imposed by our customers in order to limit their online expenses; and

geopolitical events such as war, threat of war or terrorist actions.

We believe that our revenue and results of operations may vary significantly in the future and that period-to-period comparisons of our operating results may not be meaningful. You should not rely on the results of one period as an indication of future performance.

After being profitable in 2004 and 2005, we were unprofitable in 2006 and 2007 primarily due in part to increased stock-based compensation expense and litigation costs, which could affect our ability to achieve and maintain profitability in the future.

Our adoption of SFAS 123R in 2006 substantially increased the amount of share-based compensation expense we record and has had a significant impact on our results of operations. After being profitable in 2004 and 2005, we were unprofitable in 2006 and 2007; and for the three-month period ended March 31, 2008; partially due to an increase in our share-based compensation expense, which increased from \$0.1 million in 2005 to \$9.2 million in 2006 and further increased to \$18.9 million in 2007. For the three month period ended March 31, 2008 our share-based compensation expense was \$4.0 million. This significant increase in share-based compensation expense reflects an increase in the level of option and restricted stock grants coupled with a significant increase in the fair market value per share at the date of grant. Our unrecognized share-based compensation expense totaled \$55.3 million at March 31, 2008, of which we expect to amortize \$13.7 million during the remainder of 2008, \$18.4 million in 2009 and the remainder thereafter based upon the scheduled vesting of the options outstanding at that time. We further expect our share-based compensation expense to increase in 2008 and potentially to increase thereafter as we grant additional options or restricted stock awards. The increased share-based compensation expense could adversely affect our ability to achieve and maintain profitability in the future. In 2006, we were sued by Akamai and MIT alleging infringement of certain patents. We have incurred, and will continue to incur, significant costs associated with litigation. These costs were \$6.8 million and \$3.2 million in 2007 and 2006, respectively. For the three month period

Table of Contents

ended March 31, 2008 we incurred \$5.4 million in litigation costs. We expect these costs will continue to increase during the remainder of 2008.

We generate our revenue almost entirely from the sale of CDN services, and the failure of the market for these services to expand as we expect or the reduction in spending on those services by our current or potential customers would seriously harm our business.

While we offer our customers a number of services associated with our CDN, we generated nearly 100% of our revenue in 2007 and for the three months ended March 31, 2008, from charging our customers for the content delivered on their behalf through our CDN. As we do not currently have other meaningful sources of revenue, we are subject to an elevated risk of reduced demand for these services. Furthermore, if the market for delivery of rich media content in particular does not continue to grow as we expect or grows more slowly, then we may fail to achieve a return on the significant investment we are making to prepare for this growth. Our success, therefore, depends on the continued and increasing reliance on the Internet for delivery of media content and our ability to cost-effectively deliver these services. Factors that may have a general tendency to limit or reduce the number of users relying on the Internet for media content or the number of providers making this content available online include a general decline in Internet usage, litigation involving our customers and third-party restrictions on online content, including copyright restrictions, digital rights management and restrictions in certain geographic regions, as well as a significant increase in the quality or fidelity of offline media content beyond that available online to the point where users prefer the offline experience. The influence of any of these factors may cause our current or potential customers to reduce their spending on CDN services, which would seriously harm our operating results and financial condition.

Many of our significant current and potential customers are pursuing emerging or unproven business models which, if unsuccessful, could lead to a substantial decline in demand for our CDN services.

Because the proliferation of broadband Internet connections and the subsequent monetization of content libraries for distribution to Internet users are relatively recent phenomena, many of our customers' business models that center on the delivery of rich media and other content to users remain unproven. For example, social media companies have been among our top recent customers and are pursuing emerging strategies for monetizing the user content and traffic on their web sites. Our customers will not continue to purchase our CDN services if their investment in providing access to the media stored on or deliverable through our CDN does not generate a sufficient return on their investment. A reduction in spending on CDN services by our current or potential customers would seriously harm our operating results and financial condition.

Our business will be adversely affected if we are unable to protect our intellectual property rights from unauthorized use or infringement by third parties.

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. These legal protections afford only limited protection, and we have only one currently issued patent. Monitoring infringement of our intellectual property rights is difficult, and we cannot be certain that the steps we have taken will prevent unauthorized use of our intellectual property rights. We have applied for patent protection in a number of foreign countries, but the laws in these jurisdictions may not protect our proprietary rights as fully as in the United States. Furthermore, we cannot be certain that any pending or future patent applications will be granted, that any future patent will not be challenged, invalidated or circumvented, or that rights granted under any patent that may be issued will provide competitive advantages to us.

Any unplanned interruption in the functioning of our network or services could lead to significant costs and disruptions that could reduce our revenue and harm our business, financial results and reputation.

Our business is dependent on providing our customers with fast, efficient and reliable distribution of application and content delivery services over the Internet. Many of our customers depend primarily or exclusively on our services to operate their businesses. Consequently, any disruption of our services could have a material impact on our customers' businesses. Our network or services could be disrupted by numerous events, including natural disasters, failure or refusal of our third-party network providers to provide the necessary capacity, failure of our software or CDN delivery infrastructure and power losses. In addition, we deploy our servers in approximately 62 third-party co-location facilities, and these third-party co-location providers could experience system outages or other disruptions that could constrain our ability to deliver our services. We may also experience disruptions caused by software viruses

or other attacks by unauthorized users.

While we have not experienced any significant, unplanned disruption of our services to date, our CDN may fail in the future. Despite our significant infrastructure investments, we may have insufficient communications and server capacity to address these or other disruptions, which could result in interruptions in our services. Any widespread interruption of the functioning of our CDN and related services for any reason would reduce our revenue and could harm our business and financial results. If such a widespread interruption occurred or if we failed to deliver content to users as expected during a high-profile media event, game release or other well-publicized circumstance, our reputation could be damaged severely. Moreover, any disruptions could undermine confidence in our services and cause us to lose customers or make it more difficult to attract new ones, either of which could harm our business and results of operations.

Table of Contents

We may have difficulty scaling and adapting our existing architecture to accommodate increased traffic and technology advances or changing business requirements, which could lead to the loss of customers and cause us to incur unexpected expenses to make network improvements.

Our CDN services are highly complex and are designed to be deployed in and across numerous large and complex networks. Our network infrastructure has to perform well and be reliable for us to be successful. The greater the user traffic and the greater the complexity of our products and services, the more resources we will need to invest in additional infrastructure and support. We have spent and expect to continue to spend substantial amounts on the purchase and lease of equipment and data centers and the upgrade of our technology and network infrastructure to handle increased traffic over our network and to roll out new products and services. This expansion is expensive and complex and could result in inefficiencies, operational failures or defects in our network and related software. If we do not expand successfully, or if we experience inefficiencies and operational failures, the quality of our products and services and user experience could decline. From time to time, we have needed to correct errors and defects in our software or in other aspects of our CDN. In the future, there may be additional errors and defects that may harm our ability to deliver our services, including errors and defects originating with third party networks or software on which we rely. These occurrences could damage our reputation and lead us to lose current and potential customers. We must continuously upgrade our infrastructure in order to keep pace with our customers' evolving demands. Cost increases or the failure to accommodate increased traffic or these evolving business demands without disruption could harm our operating results and financial condition.

Our operations are dependent in part upon communications capacity provided by third-party telecommunications providers. A material disruption of the communications capacity we have leased could harm our results of operations, reputation and customer relations.

We lease private line capacity for our backbone from a third party provider, Global Crossing Ltd. Our contracts for private line capacity with Global Crossing generally have terms of three years. The communications capacity we have leased may become unavailable for a variety of reasons, such as physical interruption, technical difficulties, contractual disputes, or the financial health of our third party provider. As it would be time consuming and expensive to identify and obtain alternative third-party connectivity, we are dependent on Global Crossing in the near term. Additionally, as we grow, we anticipate requiring greater private line capacity than we currently have in place. If we are unable to obtain such capacity on terms commercially acceptable to us or at all, our business and financial results would suffer. We may not be able to deploy on a timely basis enough network capacity to meet the needs of our customer base or effectively manage demand for our services.

Our business depends on continued and unimpeded access to third-party controlled end-user access networks.

Our content delivery services depend on our ability to access certain end-user access networks in order to complete the delivery of rich media and other online content to end-users. Some operators of these networks may take measures, such as the deployment of a variety of filters, that could degrade, disrupt or increase the cost of our or our customers' access to certain of these end-user access networks by restricting or prohibiting the use of their networks to support or facilitate our services, or by charging increased fees to us, our customers or end-users in connection with our services. This or other types of interference could result in a loss of existing customers, increased costs and impairment of our ability to attract new customers, thereby harming our revenue and growth.

In addition, the performance of our infrastructure depends in part on the direct connection of our CDN to a large number of end-user access networks, known as peering, which we achieve through mutually beneficial cooperation with these networks. If in the future a significant percentage of these network operators elected to no longer peer with our CDN, the performance of our infrastructure could be diminished and our business could suffer.

If our ability to deliver media files in popular proprietary content formats was restricted or became cost-prohibitive, demand for our content delivery services could decline, we could lose customers and our financial results could suffer.

Our business depends on our ability to deliver media content in all major formats. If our legal right or technical ability to store and deliver content in one or more popular proprietary content formats, such as Adobe Flash or Windows Media, was limited, our ability to serve our customers in these formats would be impaired and the demand for our content delivery services would decline by customers using these formats. Owners of proprietary content formats

may be able to block, restrict or impose fees or other costs on our use of such formats, which could lead to additional expenses for us and for our customers, or which could prevent our delivery of this type of content altogether. Such interference could result in a loss of existing customers, increased costs and impairment of our ability to attract new customers, which would harm our revenue, operating results and growth.

If we are unable to retain our key employees and hire qualified sales and technical personnel, our ability to compete could be harmed.

Our future success depends upon the continued services of our executive officers and other key technology, sales, marketing and support personnel who have critical industry experience and relationships that they rely on in implementing our business plan. In particular, we are dependent on the services of our Chief Executive Officer, Jeffrey W. Lunsford and also our Chief Technical Officer, Nathan F. Raciborski. Neither of these officers nor any of our other key employees is bound by an employment agreement for any specific term. In addition, we do not have key person life insurance policies covering any of our officers or other key employees, and we therefore have no way of mitigating our financial loss were we to lose their services. There is increasing competition for talented individuals with the specialized knowledge to deliver content delivery services and this competition affects both our ability to

Table of Contents

retain key employees and hire new ones. The loss of the services of any of our key employees could disrupt our operations, delay the development and introduction of our services, and negatively impact our ability to sell our services.

Our senior management team has limited experience working together as a group, and may not be able to manage our business effectively.

Four members of our senior management team, our President and Chief Executive Officer, Jeffrey W. Lunsford, our Chief Financial Officer, Matthew Hale, our Senior Vice President of Worldwide Sales, Marketing and Services, David M. Hatfield, and our Senior Vice President and Chief Legal Officer, Philip C. Maynard, have been hired since November 2006. As a result, our senior management team has limited experience working together as a group. This lack of shared experience could harm our senior management team's ability to quickly and efficiently respond to problems and effectively manage our business.

We face risks associated with international operations that could harm our business.

We have operations and personnel in the United States, Japan and the United Kingdom, and we currently maintain network equipment in Australia, Canada, France, Germany, Hong Kong, Singapore, Ireland, Japan, the Netherlands and the United Kingdom. As part of our growth strategy, we intend to expand our sales and support organizations internationally, as well as to further expand our international network infrastructure. We have limited experience in providing our services internationally and such expansion could require us to make significant expenditures, including the hiring of local employees, in advance of generating any revenue. As a consequence, we may fail to achieve profitable operations that will compensate our investment in international locations. We are subject to a number of risks associated with international business activities that may increase our costs, lengthen our sales cycle and require significant management attention.

These risks include:

increased expenses associated with sales and marketing, deploying services and maintaining our infrastructure in foreign countries;

competition from local content delivery service providers, many of which are very well positioned within their local markets;

unexpected changes in regulatory requirements resulting in unanticipated costs and delays;

interpretations of laws or regulations that would subject us to regulatory supervision or, in the alternative, require us to exit a country, which could have a negative impact on the quality of our services or our results of operations;

longer accounts receivable payment cycles and difficulties in collecting accounts receivable;

corporate and personal liability for violations of local laws and regulations;

currency exchange rate fluctuations; and

potentially adverse tax consequences.

Internet-related and other laws relating to taxation issues, privacy and consumer protection and liability for content distributed over our network, could harm our business.

Laws and regulations that apply to communications and commerce conducted over the Internet are becoming more prevalent, both in the United States and internationally, and may impose additional burdens on companies conducting business online or providing Internet-related services such as ours. Increased regulation could negatively affect our business directly, as well as the businesses of our customers, which could reduce their demand for our services. For example, tax authorities abroad may impose taxes on the Internet-related revenue we generate based on where our internationally deployed servers are located. In addition, domestic and international taxation laws are subject to

change. Our services, or the businesses of our customers, may become subject to increased taxation, which could harm our financial results either directly or by forcing our customers to scale back their operations and use of our services in order to maintain their operations. In addition, the laws relating to the liability of private network operators for information carried on or disseminated through their networks are unsettled, both in the United States and abroad. Network operators have been sued in the past, sometimes successfully, based on the content of material disseminated through their networks. We may become subject to legal claims such as defamation, invasion of privacy and copyright infringement in connection with content stored on or distributed through our network. In addition, our reputation could suffer as a result of our perceived association with the type of content that some of our customers deliver. If we need to take costly measures to reduce our exposure to these risks, or are required to defend ourselves against such claims, our financial results could be negatively affected.

If we are required to seek additional funding, such funding may not be available on acceptable terms or at all.

We may need to obtain additional funding due to a number of factors beyond our control, including a shortfall in revenue, increased expenses, final adverse judgments in litigation matters, increase investment in capital equipment or the acquisition of significant businesses or technologies. We believe that our cash, plus cash from operations will be sufficient to fund our operations

Table of Contents

\

and proposed capital expenditures for at least the next 12 months. However, we may need funding before such time. If we do need to obtain funding, it may not be available on commercially reasonable terms or at all. If we are unable to obtain sufficient funding, our business would be harmed. Even if we were able to find outside funding sources, we might be required to issue securities in a transaction that could be highly dilutive to our investors or we may be required to issue securities with greater rights than the securities we have outstanding today. We might also be required to take other actions that could lessen the value of our common stock, including borrowing money on terms that are not favorable to us. If we are unable to generate or raise capital that is sufficient to fund our operations, we may be required to curtail operations, reduce our capabilities or cease operations in certain jurisdictions or completely. Further, the availability of our current cash will be adversely affected if we are required to provide security for the recent jury verdict in the Akamai trial in connection with an appeal or a stay of injunction, should an appeal of a final judgment in favor of Akamai be required or an injunction and stay thereof be issued.

Our business requires the continued development of effective business support systems to support our customer growth and related services.

The growth of our business depends on our ability to continue to develop effective business support systems. This is a complicated undertaking requiring significant resources and expertise. Business support systems are needed for:

- implementing customer orders for services;

- delivering these services; and

- timely billing for these services.

Because our business plan provides for continued growth in the number of customers that we serve and services offered, there is a need to continue to develop our business support systems on a schedule sufficient to meet proposed service rollout dates. The failure to continue to develop effective business support systems could harm our ability to implement our business plans and meet our financial goals and objectives.

If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements could be impaired, which could adversely affect our operating results, our ability to operate our business and investors' views of us.

We must ensure that we have adequate internal financial and accounting controls and procedures in place so that we can produce accurate financial statements on a timely basis. We are required to spend considerable effort on establishing and maintaining our internal controls, which is costly and time-consuming and needs to be re-evaluated frequently. We have very limited experience in designing and testing our internal controls. For example, during the third quarter of 2007, we discovered material weaknesses in our system of internal controls over our revenue recognition and stock-based compensation processes that required us to restate our previously reported consolidated financial statements for the three-and nine-months ended September 30, 2006, the three-months and year ended December 31, 2006, the three-months ended March 31, 2007, and the three-and-six months ended June 30, 2007. We are in the process of documenting, reviewing and, where appropriate, improving our internal controls and procedures. As a newly public company we will be required to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, which will require annual management assessments of the effectiveness of our internal control over financial reporting. In addition, we will be required to file a report by our independent registered public accounting firm addressing these assessments beginning with our Annual Report on Form 10-K for the year ended December 31, 2008. Both we and our independent auditors will be testing our internal controls in anticipation of being subject to Section 404 requirements and, as part of that documentation and testing, may identify areas for further attention and improvement. Implementing any appropriate changes to our internal controls may entail substantial costs to modify our existing financial and accounting systems, take a significant period of time to complete, and distract our officers, directors and employees from the operation of our business. These changes may not, however, be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or a consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and could materially

impair our ability to operate our business. In addition, investors' perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements may seriously affect our stock price.

Changes in financial accounting standards or practices may cause adverse, unexpected financial reporting fluctuations and affect our reported results of operations.

A change in accounting standards or practices can have a significant effect on our operating results and may affect our reporting of transactions completed before the change is effective. New accounting pronouncements and varying interpretations of existing accounting pronouncements have occurred and may occur in the future. Changes to existing rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business. For example, our recent adoption of SFAS 123R in 2006 has increased the amount of stock-based compensation expense we record. This, in turn, has impacted our results of operations for the periods since this adoption and has made it more difficult to evaluate our recent financial results relative to prior periods.

We have incurred, and will continue to incur significantly increased costs as a result of operating as a public company, and our management is required to devote substantial time to compliance initiatives.

As a newly public company, we have incurred, and will continue to incur, significant accounting and other expenses that we did

Table of Contents

not incur as a private company. These expenses include increased accounting, legal and other professional fees, insurance premiums, investor relations costs, and costs associated with compensating our independent directors. In addition, the Sarbanes-Oxley Act of 2002, as well as rules subsequently implemented by the Securities and Exchange Commission and the Nasdaq Global Market, impose additional requirements on public companies, including requiring changes in corporate governance practices. For example, the listing requirements of the Nasdaq Global Market require that we satisfy certain corporate governance requirements relating to independent directors, audit committees, distribution of annual and interim reports, stockholder meetings, stockholder approvals, solicitation of proxies, conflicts of interest, stockholder voting rights and codes of conduct. Our management and other personnel need to devote a substantial amount of time to these compliance initiatives. Moreover, these rules and regulations have increased our legal and financial compliance costs and make some activities more time-consuming and costly. For example, these rules and regulations make it more difficult and more expensive for us to obtain director and officer liability insurance. These rules and regulations could also make it more difficult for us to identify and retain qualified persons to serve on our board of directors, our board committees or as executive officers.

Failure to effectively expand our sales and marketing capabilities could harm our ability to increase our customer base and achieve broader market acceptance of our services.

Increasing our customer base and achieving broader market acceptance of our services will depend to a significant extent on our ability to expand our sales and marketing operations. Historically, we have concentrated our sales force at our headquarters in Tempe, Arizona. However, we have recently begun building a field sales force to augment our sales efforts and to bring our sales personnel closer to our current and potential customers. Developing such a field sales force will be expensive and we have limited knowledge in developing and operating a widely dispersed sales force. As a result, we may not be successful in developing an effective sales force, which could cause our results of operations to suffer.

We believe that there is significant competition for direct sales personnel with the sales skills and technical knowledge that we require. Our ability to achieve significant growth in revenue in the future will depend, in large part, on our success in recruiting, training and retaining sufficient numbers of direct sales personnel. We have expanded our sales and marketing personnel from a total of 13 at December 31, 2004 to 121 at December 31, 2007. As of March 31, 2008, we had 124 sales and marketing personnel. New hires require significant training and, in most cases, take a significant period of time before they achieve full productivity. Our recent hires and planned hires may not become as productive as we would like, and we may be unable to hire or retain sufficient numbers of qualified individuals in the future in the markets where we do business. Our business will be seriously harmed if these expansion efforts do not generate a corresponding significant increase in revenue.

If the estimates we make, and the assumptions on which we rely, in preparing our financial statements prove inaccurate, our actual results may be adversely affected.

Our financial statements have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments about, among other things, taxes, revenue recognition, share-based compensation costs, contingent obligations and doubtful accounts. These estimates and judgments affect the reported amounts of our assets, liabilities, revenue and expenses, the amounts of charges accrued by us, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances and at the time they are made. If our estimates or the assumptions underlying them are not correct, we may need to accrue additional charges that could adversely affect our results of operations, investors may lose confidence in our ability to manage our business and our stock price could decline.

As part of our business strategy, we may acquire businesses or technologies and may have difficulty integrating these operations.

We may seek to acquire businesses or technologies that are complementary to our business. Acquisitions involve a number of risks to our business, including the difficulty of integrating the operations and personnel of the acquired companies, the potential disruption of our ongoing business, the potential distraction of management, expenses related to the acquisition and potential unknown liabilities associated with acquired businesses. Any inability to integrate operations or personnel in an efficient and timely manner could harm our results of operations. We do not have prior

experience as a company in this complex process of acquiring and integrating businesses. If we are not successful in completing acquisitions that we may pursue in the future, we may be required to reevaluate our business strategy, and we may incur substantial expenses and devote significant management time and resources without a productive result. In addition, future acquisitions will require the use of our available cash or dilutive issuances of securities. Future acquisitions or attempted acquisitions could also harm our ability to achieve profitability. We may also experience significant turnover from the acquired operations or from our current operations as we integrate businesses.

Table of Contents

Risks Related to Ownership of Our Common Stock

The trading price of our common stock has been, and is likely to continue to be, volatile.

The trading prices of our common stock and the securities of technology companies generally have been highly volatile. Factors affecting the trading price of our common stock will include:

variations in our operating results;
announcements of technological innovations, new services or service enhancements, strategic alliances or significant agreements by us or by our competitors;

commencement or resolution of, or our involvement in, litigation, particularly our current litigation with Akamai and MIT, Level 3 Communications, Two-Way Media LLC and the Limelight Networks Inc. Securities Litigation matter;

recruitment or departure of key personnel;

changes in the estimates of our operating results or changes in recommendations by any securities analysts that elect to follow our common stock;

developments or disputes concerning our intellectual property or other proprietary rights;

the gain or loss of significant customers;

market conditions in our industry, the industries of our customers and the economy as a whole; and

adoption or modification of regulations, policies, procedures or programs applicable to our business.

In addition, if the market for technology stocks or the stock market in general experiences loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, operating results or financial condition. The trading price of our common stock might also decline in reaction to events that affect other companies in our industry even if these events do not directly affect us.

We are currently subject to a securities class action lawsuit, the unfavorable outcome of which might have a material adverse effect on our financial condition, results of operations and cash flows.

A putative class action lawsuit has been filed against us, certain of our officers and directors, and the lead underwriters of our recent initial public offering, alleging, among other things, securities laws violations. While we intend to vigorously contest this lawsuit and any similar lawsuits filed against us in the future, we cannot determine the outcome or resolution of these claims or when they might be resolved. In addition to the expense and burden incurred in defending this litigation and any damages that we may suffer, our management's efforts and attention may be diverted from the ordinary business operations in order to address these claims. If the final resolution of this litigation is unfavorable to us, our financial condition, results of operations and cash flows may be materially adversely affected if our existing insurance coverage is unavailable or inadequate to resolve the matter.

If securities or industry analysts do not publish research or reports about our business or if they issue an adverse or misleading opinion regarding our stock, our stock price and trading volume could decline.

The trading market for our common stock will be influenced by the research and reports that industry or securities analysts publish about us or our business. If any of the analysts who cover us issue an adverse or misleading opinion regarding our stock, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

Insiders have substantial control over us and will be able to influence corporate matters.

As of March 31, 2008, our directors and executive officers and their affiliates beneficially owned, in the aggregate, approximately 58% of our outstanding common stock, including approximately 37% beneficially owned by investment entities affiliated with Goldman, Sachs & Co. As a result, these stockholders will be able to exercise

significant influence over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, such as a merger or other sale of our company or its assets. This concentration of ownership could limit other stockholders' ability to influence corporate matters and may have the effect of delaying or preventing a third party from acquiring control over us.

Anti-takeover provisions in our charter documents and Delaware law could discourage, delay or prevent a change in control of our company and may affect the trading price of our common stock.

We are a Delaware corporation and the anti-takeover provisions of the Delaware General Corporation Law may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the person becomes an interested stockholder, even if a change in control would be beneficial to our existing stockholders. In addition, our certificate of incorporation and bylaws may discourage, delay or prevent a change in our management or control over us that stockholders may consider favorable. Our certificate of incorporation and bylaws:

- authorize the issuance of blank check preferred stock that could be issued by our board of directors to thwart a takeover attempt;

- provide for a classified board of directors, as a result of which the successors to the directors whose terms have expired will be elected to serve from the time of election and qualification until the third annual meeting following their election;

Table of Contents

require that directors only be removed from office for cause and only upon a majority stockholder vote;

provide that vacancies on the board of directors, including newly created directorships, may be filled only by a majority vote of directors then in office;

limit who may call special meetings of stockholders;

prohibit stockholder action by written consent, requiring all actions to be taken at a meeting of the stockholders; and

require supermajority stockholder voting to effect certain amendments to our certificate of incorporation and bylaws.

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

(a) Not applicable

(b) On June 7, 2007, our registration statement on Form S-1 (No. 333-141516) was declared effective in connection with our initial public offering, pursuant to which we registered an aggregate of 18,400,000 shares of our common stock, of which we sold 14,900,000 shares and certain selling stockholders sold 3,500,000 shares, including shares subject to the underwriters' over-allotment option, at a price to the public of \$15.00 per share. The offering closed on June 13, 2007, and, as a result, we received net proceeds of approximately \$203.9 million (after underwriters' discounts and commissions of approximately \$15.6 million and additional offering-related costs of approximately \$4.0 million), and the selling stockholders received net proceeds of approximately \$48.8 million (after underwriters' discounts and commissions of approximately \$3.7 million). The managing underwriters of the offering were Goldman, Sachs & Co., Morgan Stanley & Co. Incorporated, Jefferies & Company, Inc., Piper Jaffray & Co. and Friedman, Billings, Ramsey & Co., Inc.

In June 2007, we used \$23.8 million of the net proceeds to repay the outstanding balance of our credit facility with Silicon Valley Bank. We expect to use the remaining net proceeds for capital expenditures, working capital and other general corporate purposes. For the three month period ended March 31, 2008, we made capital expenditures of \$3.1 million and expect total expenditures for the full year 2008 to be between \$12.0 million and \$14.0 million. We may also use a portion of our net proceeds to fund acquisitions of complementary businesses, products or technologies. However, we do not have agreements or commitments for any specific acquisitions at this time. Pending the uses described above, we intend to invest the net proceeds in a variety of short-term, interest-bearing, investment grade securities. There has been no material change in the planned use of proceeds from our initial public offering from that described in the final prospectus dated June 7, 2007 filed by us with the SEC pursuant to Rule 424(b).

ITEM 3. DEFAULT UPON SENIOR SECURITIES

Not applicable

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

None

ITEM 5. OTHER INFORMATION

Not applicable

ITEM 6. EXHIBITS

Exhibit Number	Exhibit Description	Incorporated by Reference			Filing Date	Provided Herewith
		Form	File No.	Exhibit		
3.02	Amended Restated Certificate of Incorporation of Limelight Networks, Inc.	S-1	333-141516	3.2	5/21/07	
3.04		S-1	333-141516	3.4	3/22/07	

Amended and Restated Bylaws of
Limelight Networks, Inc.

31.01	Certification of Principal Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(a).	X
31.02	Certification of Principal Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(a).	X
32.01	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).*	X
32.02	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).*	X

* This certification is not deemed filed for purposes of Section 18 of the Securities Exchange Act, or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that Limelight Networks, Inc. specifically incorporates it by reference.

Table of Contents

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.

LIMELIGHT NETWORKS, INC.

Date: May 14, 2008

By: /s/ Matthew Hale
Matthew Hale
Chief Financial Officer
(Principal Financial Officer)

40

Table of Contents**EXHIBIT INDEX**

Exhibit Number	Exhibit Description	Incorporated by Reference			Filing Date	Provided Herewith
		Form	File No.	Exhibit		
3.02	Amended Restated Certificate of Incorporation of Limelight Networks, Inc.	S-1	333-141516	3.2	5/21/07	
3.04	Amended and Restated Bylaws of Limelight Networks, Inc.	S-1	333-141516	3.4	3/22/07	
31.01	Certification of Principal Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(a).					X
31.02	Certification of Principal Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(a).					X
32.01	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).*					X
32.02	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).*					X

* This certification is not deemed filed for purposes of Section 18 of the Securities Exchange Act, or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities

Act of 1933 or
the Securities
Exchange Act
of 1934, except
to the extent that
Limelight
Networks, Inc.
specifically
incorporates it
by reference.