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)

þ **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

o **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	**20-1677033**
(State or other jurisdiction of incorporation or organization)	*(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 þ No o

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 o	Accelerated filer o	Non-accelerated filer þ	Smaller reporting company o
		(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 o No þ

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

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

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

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.

3

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 From 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 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 i 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	For the Three Months Ended March 31, 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	For the Three Months Ended March 31, 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	For the Three Months Ended March 31, 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	For the Three Months Ended March 31, 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

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 o f 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 is 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

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):

		Fair Value Measurements at Reporting Date Using		
Description	Total	Quoted Prices In Active Markets for Identical Assets (Level 1)	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, antici intend, could, estimate, or continue, and similar expressions or variations. These statements are based on the belie 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, 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.

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 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 was 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 ratable 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	Increase (Decrease)	Percent Change
		(in thousands)		
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;