Limelight Networks, Inc.
Form 10-Q
May 10, 2013
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-Q

**(Mark One)**

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

**For the quarterly period ended March 31, 2013**

**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** | **20-1677033** |
|---|---|
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |

**222 South Mill Avenue, 8th Floor**

**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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 | x |
| Non-accelerated filer | ¨ (Do not check if a smaller reporting company) | 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 x

The number of shares outstanding of the registrant s common stock as of April 30, 2013: 96,146,449 shares.

**LIMELIGHT NETWORKS, INC.**

**FORM 10-Q**

**Quarterly Period Ended March 31, 2013**

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**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**LIMELIGHT NETWORKS, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(In thousands, except per share data)**

**(Unaudited)**

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 86,163 | $ 108,915 |
| Marketable securities | 34,041 | 19,040 |
| Accounts receivable, net | 27,537 | 26,602 |
| Income taxes receivable | 318 | 471 |
| Deferred income taxes | 71 | 38 |
| Prepaid expenses and other current assets | 11,108 | 12,308 |
| Total current assets | 159,238 | 167,374 |
| Property and equipment, net | 35,339 | 41,251 |
| Marketable securities, less current portion | 11 | 18 |
| Deferred income tax, less current portion | 2,849 | 2,838 |
| Goodwill | 80,458 | 80,278 |
| Other intangible assets, net | 5,713 | 6,387 |
| Other assets | 6,600 | 6,735 |
| Total assets | $ 290,208 | $ 304,881 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 6,108 | $ 6,730 |
| Deferred revenue | 7,107 | 6,892 |
| Capital lease obligations | 1,032 | 1,301 |
| Income taxes payable | 798 | 519 |
| Other current liabilities | 10,722 | 14,866 |
| Total current liabilities | 25,767 | 30,308 |
| Capital lease obligations, less current portion | 664 | 824 |
| Deferred income tax | 423 | 461 |
| Deferred revenue, less current portion | 2,281 | 797 |
| Other long-term liabilities | 5,144 | 5,261 |
| Total liabilities | 34,279 | 37,651 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Convertible preferred stock, $0.001 par value; 7,500 shares authorized; 0 shares issued and outstanding | | |
| | 96 | 98 |

| | | |
|---|---|---|
| Common stock, $0.001 par value; 300,000 shares authorized at March 31, 2013 and December 31, 2012; 96,105 and 98,038 shares issued and outstanding at March 31, 2013 and December 31, 2012, respectively | | |
| Additional paid-in capital | 450,625 | 452,258 |
| Contingent consideration | 33 | 33 |
| Accumulated other comprehensive loss | (2,239) | (709) |
| Accumulated deficit | (192,586) | (184,450) |
| Total stockholders equity | 255,929 | 267,230 |
| Total liabilities and stockholders equity | $ 290,208 | $ 304,881 |

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

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**LIMELIGHT NETWORKS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(In thousands, except per share data)**

**(Unaudited)**

| | For the Three Months Ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| Revenues | $ 45,813 | $ 44,316 |
| Cost of revenue: | | |
| Cost of services (1) | 22,052 | 20,501 |
| Depreciation network | 6,680 | 6,829 |
| Total cost of revenue | 28,732 | 27,330 |
| Gross profit | 17,081 | 16,986 |
| Operating expenses: | | |
| General and administrative | 8,073 | 8,320 |
| Sales and marketing | 10,484 | 11,632 |
| Research and development | 5,741 | 5,166 |
| Depreciation and amortization | 1,450 | 1,398 |
| Total operating expenses | 25,748 | 26,516 |
| Operating loss | (8,667) | (9,530) |
| Other income (expense): | | |
| Interest expense | (27) | (50) |
| Interest income | 70 | 106 |
| Other, net | 568 | (86) |
| Total other income (expense) | 611 | (30) |
| Loss from continuing operations before income taxes | (8,056) | (9,560) |
| Income tax provision | 80 | 137 |
| Loss from continuing operations | (8,136) | (9,697) |
| Discontinued operations: | | |
| Loss from discontinued operations, net of income taxes | | (309) |
| Net loss | $ (8,136) | $ (10,006) |
| Basic net loss per weighted average share: | | |
| Continuing operations | $ (0.08) | $ (0.09) |
| Discontinued operations | | (0.01) |
| Total | $ (0.08) | $ (0.10) |
| Diluted net loss per weighted average share: | | |

| | | | | |
|---|---|---|---|---|
| Continuing operations | $ | (0.08) | $ | (0.09) |
| Discontinued operations | | | | (0.01) |
| Total | $ | (0.08) | $ | (0.10) |
| Shares used in per weighted average share calculations: | | | | |
| Basic | | 96,818 | | 104,226 |
| Diluted | | 96,818 | | 104,226 |

(1) Cost of services excludes amortization related to certain intangibles, including existing technologies, customer relationships, trade names and trademarks, which are included in depreciation and amortization

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

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**LIMELIGHT NETWORKS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

**(In thousands, except per share data)**

**(Unaudited)**

| | For the Three Months Ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| Net loss | $ (8,136) | $ (10,006) |
| Other comprehensive income (loss), net of tax: | | |
| Unrealized loss on investments | (55) | (15) |
| Foreign exchange translation | (1,475) | 457 |
| Other comprehensive income (loss), net of tax | (1,530) | 442 |
| Comprehensive loss | $ (9,666) | $ (9,564) |

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

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**LIMELIGHT NETWORKS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands)**

**(Unaudited)**

| | For the Three Months Ended March 31, | |
|---|---|---|
| | **2013** | **2012** |
| **Operating activities** | | |
| Net loss | $ (8,136) | $ (10,006) |
| Loss from discontinued operations | | (309) |
| Net loss from continuing operations | (8,136) | (9,697) |
| Adjustments to reconcile net loss from continuing operations to net cash provided by (used in) operating activities of continuing operations: | | |
| Depreciation and amortization | 8,130 | 8,227 |
| Share-based compensation | 3,350 | 3,951 |
| Deferred income taxes | (171) | (112) |
| Foreign currency remeasurement gain | (861) | (97) |
| Accounts receivable charges | 326 | 426 |
| Accretion of marketable securities | 96 | 99 |
| Non cash increase in cost basis investment | | (374) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (1,260) | 280 |
| Prepaid expenses and other current assets | 1,085 | (361) |
| Income taxes receivable | 141 | (35) |
| Other assets | 106 | (2,130) |
| Accounts payable | (96) | (625) |
| Deferred revenue | 1,698 | 774 |
| Other current liabilities | (1,947) | (1,246) |
| Income taxes payable | 307 | (500) |
| Other long term liabilities | (116) | (508) |
| Net cash provided by (used in) operating activities of continuing operations | 2,652 | (1,928) |
| **Investing activities** | | |
| Purchases of marketable securities | (38,039) | (15,469) |
| Maturities of marketable securities | 22,895 | 7,303 |
| Purchases of property and equipment | (2,603) | (5,680) |
| Proceeds from the sale of discontinued operations | | 5,839 |
| Net cash used in investing activities of continuing operations | (17,747) | (8,007) |
| **Financing activities** | | |
| Payments on capital lease obligations | (429) | (436) |
| Payment of employee tax withholdings related to restricted stock | (1,358) | (259) |
| Cash paid for purchase of common stock | (5,512) | (1,161) |
| Proceeds from exercise of stock options | | 118 |
| Net cash used in financing activities of continuing operations | (7,299) | (1,738) |

| | | |
|---|---|---|
| Effect of exchange rate changes on cash and cash equivalents | (358) | 57 |
| Net decrease in cash and cash equivalents | (22,752) | (11,616) |
| Cash and cash equivalents, beginning of period | 108,915 | 120,349 |
| Cash and cash equivalents, end of period | $ 86,163 | $ 108,733 |
| **Supplement disclosure of cash flow information** | | |
| Cash paid during the period for interest | $ 27 | $ 51 |
| Cash paid during the period for income taxes, net of refunds | $ (194) | $ 790 |
| Property and equipment remaining in accounts payable and other current liabilities | $ 233 | $ 1,439 |
| Contingent consideration common stock issued in connection with acquisition of businesses | $ | $ 109 |

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

**LIMELIGHT NETWORKS, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Nature of Business**

Limelight Networks, Inc. (the Company) operates a globally distributed, high-performance computing platform (its global computing platform) and provides a suite of integrated services including content delivery, web and video content management, mobility, web application acceleration, cloud storage, and related consulting services that enable companies and other organizations to create, manage, and deliver a global digital presence.

The integrated suite of services that the Company offers collectively comprises its Orchestrate Digital Presence Platform (Orchestrate, or the Orchestrate Platform). The Company provides the Orchestrate Platform as Software-as-a-Service (SaaS) and Infrastructure-as-a-Service (IaaS), which other than content delivery services, are referred to collectively as Value Added Services (VAS). The Company offers VAS both collectively as the end-to-end Orchestrate Platform and individually for customers that may not be inclined or able to adopt the entire platform.

The Orchestrate Platform and services help the Company s customers optimize and streamline their online digital presence across web, mobile, social, and large screen channels. The Orchestrate Platform and services provide advanced features which include website content management, personalization and targeting, video publishing, mobile enablement, content delivery, transcoding, and cloud storage, combined with social media integration and reporting analytics. These services are provided through the cloud and leverage the Company s global computing platform, which provides highly available, highly redundant storage, bandwidth, and computing resources, as well as connectivity to last-mile broadband network providers. The Company s professional consulting services team helps organizations access their digital presence requirements and improve their digital presence activities.

The Company derives revenue primarily from the sale of the Orchestrate Platform and its individual components as managed services. The Company also generates revenue through the sale of professional services and other infrastructure services, such as transit and rack space services.

The Company provides its services to customers that it believes view Internet, mobile, and social initiatives as critical to their success, including traditional and emerging media companies operating in the television, music, radio, newspaper, magazine, movie, videogame, software, and social media industries, as well as to enterprises, technology companies, and government entities conducting business online. The Company s offerings enable organizations to remove the complexity of creating, managing, delivering, and optimizing their digital presence by streamlining processes and optimizing business results across all customer interaction channels, which helps them to deliver a high quality online media experience, improve brand awareness, drive revenue, and enhance their customer relationships.

The Company has operated in the Phoenix metropolitan area since 2001 and elsewhere throughout the United States since 2003. The Company began international operations in 2004.

**2. Summary of Significant Accounting Policies**

***Basis of Presentation***

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles, consistent in all material respects with those applied in its financial statements included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2012. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. Such interim financial information is unaudited but reflects all adjustments that in the opinion of management are necessary for the fair presentation of the interim periods presented. All such adjustments are, in the opinion of management, of a normal recurring nature. 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, 2013 or for any future periods. This Quarterly Report on Form 10-Q should be read in conjunction with the Company s audited financial statements and footnotes included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

The condensed consolidated financial statements include accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated. Certain reclassifications have been made to prior year amounts to conform to the current year presentation. The Company has revised the statement of cash flow presentation to reclassify certain remeasurement gains and losses from the Effect of exchange rate changes on cash and cash equivalents line item to the Foreign currency remeasurement gain line item included

in Net cash provided by (used in) operating activities of continuing operations. The amount of this reclassification for the three months ended March 31, 2012 was approximately $97,000.

On September 1, 2011, the Company completed the sale of its EyeWonder LLC and subsidiaries and chors GmbH video and rich media advertising services (EyeWonder and chors) to DG FastChannel, Inc. (now Digital Generation, Inc.) (DG). The sale of EyeWonder and chors met the criteria for discontinued operations during the year ended December 31, 2011. Accordingly, the results of operations related to EyeWonder and chors have been classified as discontinued operations in all periods presented. See further discussion at Note 4.

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***Use of Estimates***

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results and outcomes may differ from those estimates.

***Recent Accounting Standards***

*Recently Adopted Accounting Standard*

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-02, which requires additional disclosures regarding the reporting of reclassifications out of accumulated other comprehensive income (loss). ASU 2013-02 requires an entity to present, either on the face of the statement where net income (loss) is presented, or in the notes, significant amounts reclassified out of accumulated other comprehensive income (loss) by the respective line items of net income (loss), but only if the amount reclassified is required under U.S. generally accepted accounting principles to be reclassified to net income (loss) in its entirety in the same reporting period. This guidance is effective for reporting periods beginning after December 15, 2012. The Company adopted this guidance effective January 1, 2013, and has included the additional disclosures in Note 15.

*Recently Issued Accounting Pronouncements*

In March 2013, the FASB issued ASU 2013-05, which permits an entity to release cumulative translation adjustments into net income when a reporting entity (parent) ceases to have a controlling financial interest in a subsidiary or group of assets that is a business within a foreign entity. Accordingly, the cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided, or, if a controlling financial interest is no longer held. The revised standard is effective for the Company for fiscal years beginning after December 15, 2013; however, early adoption is permitted. The Company does not expect adoption of this ASU to significantly impact its consolidated financial statements.

**3. Investments in Marketable Securities**

The following is a summary of marketable securities (designated as available-for-sale) at March 31, 2013 (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Government agency bonds | $ 3,091 | $ 2 | $ | $ 3,093 |
| Certificate of deposit | 2,744 | | | 2,744 |
| Commercial paper | 3,998 | | 2 | 3,996 |
| Corporate notes and bonds | 24,250 | 1 | 43 | 24,208 |
| | 34,083 | 3 | 45 | 34,041 |
| Publicly traded common stock | 12 | | 1 | 11 |
| Total marketable securities | $ 34,095 | $ 3 | $ 46 | $ 34,052 |

At March 31, 2013, the Company evaluated its marketable securities and noted unrealized losses were due to fluctuations in interest rates.

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.

The amortized cost and estimated fair value of marketable securities at March 31, 2013, 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 | $ 16,799 | $ 3 | $ 7 | $ 16,795 |
| Due after one year and through five years | 17,284 | | 38 | 17,246 |
| | $ 34,083 | $ 3 | $ 45 | $ 34,041 |

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The following is a summary of marketable securities (designated as available-for-sale) at December 31, 2012 (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Government agency bonds | $ 6,266 | $ 4 | $ | $ 6,270 |
| Certificate of deposit | 2,741 | | | 2,741 |
| Commercial paper | 500 | | | 500 |
| Corporate notes and bonds | 9,527 | 3 | 1 | 9,529 |
| | 19,034 | 7 | 1 | 19,040 |
| Publicly traded common stock | 12 | 6 | | 18 |
| Total marketable securities | $ 19,046 | $ 13 | $ 1 | $ 19,058 |

The amortized cost and estimated fair value of marketable securities at December 31, 2012, by maturity, are shown below (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Available-for-sale securities | | | | |
| Due in one year or less | $ 18,260 | $ 6 | $ 1 | $ 18,265 |
| Due after one year and through five years | 774 | 1 | | 775 |
| | $ 19,034 | $ 7 | $ 1 | $ 19,040 |

**4. Discontinued Operations**

On September 1, 2011, the Company completed the sale of its EyeWonder and chors rich media advertising services to DG for net proceeds of $61.0 million ($66.0 million gross cash proceeds less $5.0 million held in escrow), plus an estimated $10.9 million receivable from DG pursuant to the purchase agreement dated as of August 30, 2011 by and among the Company, DG and Limelight Networks Germany GmbH.

The $10.9 million receivable from DG was determined by the Company based on estimated future cash payments equal to the excess of certain current assets over certain current liabilities of EyeWonder and chors as of August 30, 2011, as defined in the purchase agreement (the Net Working Capital). The Company estimated the Net Working Capital based on its determination of the current assets and current liabilities in accordance with the relevant provisions of the purchase agreement.

Under the terms of the purchase agreement, $0.7 million excess of cash and cash equivalents and other current assets over current liabilities was immediately payable to the Company with the remaining Net Working Capital payable as the accounts receivable of $9.6 million and income tax receivable of $0.5 million were collected.

The following is a summary of activity related to the receivable from DG for the year ended December 31, 2012 and the three month period ended March 31, 2013 (in thousands):

| | |
|---|---|
| Balance, December 31, 2011 | $ 10,854 |
| Payments received from DG | (7,440) |
| Allowance for doubtful accounts receivable and other receivables adjustments | (2,060) |
| Net Working Capital adjustments | (818) |

| | | |
|---|---|---|
| Balance, December 31, 2012 | $ | 536 |
| Payments received from DG | | |
| Allowance for doubtful accounts receivable and other receivables adjustments | | |
| Net Working Capital adjustments | | |
| Balance, March 31, 2013 | $ | 536 |

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As of March 31, 2013, the Company assessed the collectability of the remaining accounts receivable balance and believes such amount is collectible. The Company expects to continue to pursue collections on all previously reserved amounts and will record recoveries as an adjustment to income (loss) from discontinued operations.

The sale of EyeWonder and chors meets the criteria to be reported as discontinued operations. Accordingly, the operating results of EyeWonder and chors have been reclassified to discontinued operations in the accompanying condensed consolidated statements of operations. The Company includes only revenues and costs directly attributable to the discontinued operations, in determining income (loss) from discontinued operations, and not those attributable to the ongoing entity. Accordingly, no general corporate overhead costs have been allocated to discontinued operations. There were no operating results of discontinued operations for the three months ended March 31, 2013. Operating results of discontinued operations for the three month period ended March 31, 2012, are as follows (in thousands):

| | Three Months Ended March 31, 2012 |
|---|---|
| General and administrative expenses | $ 147 |
| Loss on sale of discontinued operations, net of income taxes | (456) |
| Loss before income taxes | (309) |
| Income tax benefit (expense) | |
| Loss from discontinued operations | $ (309) |
| Loss from discontinued operations per weighted average share: | |
| Basic | $ (0.01) |
| Diluted | $ (0.01) |
| Shares used in per weighted average share calculation for discontinued operations: | |
| Basic and diluted | 104,226 |

**5. Accounts Receivable, net**

Accounts receivable, net include (in thousands):

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| Accounts receivable | $ 23,879 | $ 23,675 |
| Unbilled accounts receivable | 6,997 | 6,997 |
| | 30,876 | 30,672 |
| Less: credit allowance | (600) | (640) |
| Less: allowance for bad debt | (2,739) | (3,430) |
| Total accounts receivable, net | $ 27,537 | $ 26,602 |

**6. Prepaid Expenses and Other Current Assets**

Prepaid expenses and other current assets include (in thousands):

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| Prepaid bandwidth and backbone services | $ 3,100 | $ 3,614 |
| Gaikai sale escrow receivable | 1,237 | 1,237 |
| Non-income taxes receivable (VAT) | 1,131 | 1,739 |
| Receivable from DG (see note 4) | 536 | 536 |
| Employee advances and prepaid recoverable commissions | 440 | 551 |
| Vendor deposits and other | 4,664 | 4,631 |
| Total prepaid expenses and other current assets | $ 11,108 | $ 12,308 |

In May 2010, the Company made a strategic investment in Gaikai Inc., a private cloud-based gaming technology company (Gaikai). In August 2012, Sony Computer Entertainment Inc. acquired Gaikai and the Company recorded a gain on sale of its cost basis investment in Gaikai of $9.4 million. The carrying value of the Gaikai cost basis investment as of the sale date was approximately $2.0 million. The aggregate selling price was $11.4 million consisting of $10.2 million of cash received and $1.2 million held in escrow for a period of up to 15 months to cover any potential indemnification claims. As of March 31, 2013, the Company was not aware of any potential indemnification claims that are expected to reduce the amount received from escrow, and recorded a current receivable of approximately $1.2 million, which is included in prepaid expenses and other current assets in the accompanying condensed consolidated balance sheets as of March 31, 2013 and December 31, 2012.

**7. Goodwill and Other Intangible Assets**

The Company is required to perform an impairment assessment at least annually, and more frequently under certain circumstances. If the Company determines through the impairment process that goodwill has been impaired, the Company will record the impairment charge in the statement of operations. There can be no assurance that future goodwill impairment tests will not result in a charge to earnings.

The changes in the carrying amount of goodwill for the three month period ended March 31, 2013 were as follows (in thousands):

| | |
|---|---|
| Balance, December 31, 2012 | $ 80,278 |
| Foreign currency translation adjustment | 180 |
| Balance, March 31, 2013 | $ 80,458 |

Other intangible assets that are subject to amortization consist of the following (in thousands):

| | March 31, 2013 | | |
|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Existing technologies | $ 8,529 | $ (4,592) | $ 3,937 |
| Customer relationships | 3,412 | (1,636) | 1,776 |
| Total other intangible assets | $ 11,941 | $ (6,228) | $ 5,713 |

| | December 31, 2012 | | |
|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Existing technologies | $ 8,436 | $ (4,035) | $ 4,401 |
| Customer relationships | 3,412 | (1,427) | 1,985 |
| Trade names and trademark | 160 | (159) | 1 |
| Total other intangible assets | $ 12,008 | $ (5,621) | $ 6,387 |

Aggregate expense related to amortization of other intangible assets included in continuing operations was $0.7 million for the three month periods ended March 31, 2013 and 2012. Based on the Company s other intangible assets as of March 31, 2013, aggregate expense related to amortization of other intangible assets is expected to be $2.1 million for the remainder of 2013, and $2.2 million, $1.1 million, and $0.3 million for fiscal years 2014, 2015, and 2016, respectively.

**8. Property and Equipment, net**

Property and equipment, net include (in thousands):

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| Network equipment | $ 168,568 | $ 168,637 |
| Computer equipment | 10,560 | 10,398 |
| Furniture and fixtures | 2,600 | 2,595 |
| Leasehold improvements | 6,702 | 6,684 |
| Other equipment | 551 | 534 |
| | 188,981 | 188,848 |
| Less: accumulated depreciation | (153,642) | (147,597) |
| Total property and equipment, net | $ 35,339 | $ 41,251 |

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**9. Other Assets**

Other assets include (in thousands):

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| Prepaid bandwidth and backbone services | $ 5,435 | $ 5,799 |
| Vendor deposits and other | 812 | 729 |
| Deferred expenses | 353 | 207 |
| Total other assets | $ 6,600 | $ 6,735 |

The Company enters into multi-year arrangements with a telecommunications providers for bandwidth and backbone capacity. The agreements sometimes require the Company to make advanced payments for future services to be received.

**10. Other Current Liabilities**

Other current liabilities consist of the following (in thousands):

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| Accrued compensation and benefits | $ 3,648 | $ 6,703 |
| Accrued cost of revenue | 1,753 | 2,307 |
| Accrued legal fees | 1,508 | 1,591 |
| Indirect taxes payable | 1,084 | 1,029 |
| Customer deposits | 465 | 361 |
| Other accrued expenses | 2,264 | 2,875 |
| Total other current liabilities | $ 10,722 | $ 14,866 |

**11. Other Long-Term Liabilities**

Other long-term liabilities consist of the following (in thousands):

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| Deferred rent | $ 3,426 | $ 3,543 |
| Income taxes payable | 1,718 | 1,718 |
| Total other long-term liabilities | $ 5,144 | $ 5,261 |

**12. Contingencies**

***Akamai Litigation***

In June 2006, Akamai Technologies, Inc. (Akamai), and the Massachusetts Institute of Technology (MIT), filed a lawsuit against the Company in the United States 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, United States Patent No. 6,553,413 (the 413 patent) and United States 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 United States Patent No. 7,103,645 (the 645 patent). Before trial, Akamai waived by stipulation its claims of indirect or induced infringement and proceeded to trial only on the theory of direct infringement. 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

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the Company s invalidity defenses. The jury awarded an aggregate of approximately $45.5 million which includes lost profits, reasonable royalties and price erosion damages for the period April 2005 through December 31, 2007. In addition, the jury awarded prejudgment interest which the Company estimated to be $2.6 million at December 31, 2007. The Company recorded an aggregate $48.1 million as a provision for litigation as of December 31, 2007. During 2008, the Company recorded a potential additional provision of approximately $17.5 million for potential additional infringement damages and interest. The total provision for litigation at December 31, 2008 was $65.6 million.

On July 1, 2008, the court denied the Company s Motions for Judgment as a Matter of Law (JMOL), Obviousness, and a New Trial. The court also denied Akamai s Motion for Permanent Injunction as premature and its Motions for Summary Judgment regarding the Company s equitable defenses. The court conducted a bench trial in November 2008 regarding the Company s equitable defenses. The Company also filed a motion for reconsideration of the court s earlier denial of the Company s motion for JMOL. The Company s motion for JMOL was based largely upon a clarification in the standard for a finding of joint infringement articulated by the Federal Circuit in the case of *Muniauction, Inc. v. Thomson Corp.*, released after the court denied the Company s initial motion for JMOL. On April 24, 2009, the court issued its order and memorandum setting aside the adverse jury verdict and ruling that the Company did not infringe Akamai s 703 patent and that the Company was entitled to JMOL. Based upon the court s April 24, 2009 order, the Company reversed the $65.6 million provision for litigation previously recorded for this lawsuit as the Company no longer believed that payment of any amounts represented by the litigation provision was probable. The court entered final judgment in favor of the Company on May 22, 2009, and Akamai filed its notice of appeal of the court s decision on May 26, 2009. On December 20, 2010, the Court of Appeals for the Federal Circuit issued its opinion affirming the trial court s entry of judgment in the Company s favor. On February 18, 2011, Akamai filed a motion with the Court of Appeals for the Federal Circuit seeking a rehearing and rehearing *en banc*. On April 21, 2011, the Court of Appeals for the Federal Circuit issued an order denying the petition for rehearing, granting the petition for rehearing *en banc*, vacating the December 20, 2010 opinion affirming the trial court s entry of judgment in the Company s favor, and reinstated the appeal.

On August 31, 2012, the Court of Appeals for the Federal Circuit issued its opinion in the case. The Court of Appeals stated that the trial court correctly determined that the Company did not directly infringe Akamai s 703 patent and upheld the trial court s decision to vacate the original jury s damages award. The Court of Appeals also held that the Company did not infringe Akamai s 413 or 645 patents. A slim majority in this three-way divided opinion also announced a revised legal theory of induced infringement, remanded the case to the trial court, and gave Akamai an opportunity for a new trial to attempt to prove that the Company induced its customers to infringe Akamai s patent under the Court of Appeals new legal standard. On December 28, 2012, the Company filed a petition for writ of certiorari to the United States Supreme Court to appeal this sharply divided Court of Appeals decision and sought to stay any proceedings at the trial court until the Supreme Court rules on that petition. Akamai then filed a cross petition for consideration of the Court of Appeals standard for direct infringement followed by an opposition to the Company s petition. The Company believes that the Court of Appeal s new induced infringement standard runs counter to the Patent Act and Supreme Court precedent, and it should be overturned by the Supreme Court. Additionally, just as the Company has successfully shown that it does not directly infringe Akamai s patent, the Company firmly believes that it ultimately would be successful in showing that it does not infringe Akamai s patent under the Court of Appeals majority s new induced infringement theory, and it will continue to vigorously defend against the allegation. The Company is not able at this time to estimate the range of a potential loss. In light of the status of the litigation, the Company believes there is a reasonable possibility that it has incurred a loss related to the Akamai litigation and believes a loss is not probable, and; therefore, no provision for this lawsuit is recorded in the consolidated financial statements.

Legal and other expenses associated with this case have been significant. The Company includes these litigation expenses in general and administrative expenses as incurred, as reported in its consolidated statement of operations.

***Other Litigation***

The Company is subject to various other legal proceedings and claims, either asserted or unasserted, arising in the ordinary course of business. While the outcome of these claims cannot be predicted with certainty, management does not believe the outcome of any of these matters will have a material adverse effect on the Company s business, financial position, results of operations, or cash flows. Litigation relating to the content delivery services industry is not uncommon, and the Company is, and from time to time has been, subject to such litigation. No assurances can be given with respect to the extent or outcome of any such litigation in the future.

***Other Matters***

The Company is subject to indirect taxation in various states and foreign jurisdictions. 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 the Company conducting business online or providing Internet-related services. Increased regulation could negatively affect the Company s business directly, as well as the businesses of its customers, which could reduce their demand for the Company s services. For example, tax authorities in various states and abroad may impose taxes on the Internet-related revenue the Company generates based on regulations currently being applied to similar but not directly comparable industries.

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There are many transactions and calculations where the ultimate tax determination is uncertain. In addition, domestic and international taxation laws are subject to change. In the future, the Company may come under audit, which could result in changes to its tax estimates. The Company believes it maintains adequate tax reserves to offset potential liabilities that may arise upon audit. Although the Company believes its tax estimates and associated reserves are reasonable, the final determination of tax audits and any related litigation could be materially different than the amounts established for tax contingencies. To the extent these estimates ultimately prove to be inaccurate, the associated reserves would be adjusted, resulting in the recording of a benefit or expense in the period in which a change in estimate or a final determination is made.

**13. Net Loss per Share**

The Company calculates basic and diluted earnings per weighted average share based on net income (loss). The Company uses the weighted-average number of common shares outstanding during the period for the computation of basic earnings per share. Diluted earnings per share include the dilutive effect of convertible stock options and restricted stock units in the weighted-average number of common shares outstanding. Net income (loss) from continuing operations is utilized in determining whether potential common shares are dilutive or antidilutive for purposes of computing diluted net income (loss) per share.

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, | |
|---|---|---|
| | **2013** | **2012** |
| Net loss from continuing operations | $ (8,136) | $ (9,697) |
| Net loss from discontinued operations | | (309) |
| Net loss attributable to common stockholders | $ (8,136) | $ (10,006) |
| Basic weighted average common shares | 96,818 | 104,226 |
| Basic weighted average common shares | 96,818 | 104,226 |
| Dilutive effect of stock options and restricted stock units | | |
| Diluted weighted average common shares | 96,818 | 104,226 |
| Basic loss per share: | | |
| Continuing operations | $ (0.08) | $ (0.09) |
| Discontinued operations | | (0.01) |
| Basic net loss per share | $ (0.08) | $ (0.10) |
| Diluted loss per share: | | |
| Continuing operations | $ (0.08) | $ (0.09) |
| Discontinued operations | | (0.01) |
| Diluted net loss per share | $ (0.08) | $ (0.10) |

For the three month periods ended March 31, 2013 and 2012, outstanding options and restricted stock units of approximately 1.4 million and 2.0 million, respectively, were excluded from the computation of diluted net loss per common share because including them would have been anti-dilutive.

**14. Stockholders Equity**

***Common Stock***

On October 29, 2012, the Company s board of directors authorized and approved a third common stock repurchase plan that authorized the Company to repurchase up to $10 million of its shares of common stock, exclusive of any commissions, markups or expenses, from time to time through May 9, 2013. During the three months ended March 31, 2013, the Company purchased and cancelled approximately 2.3 million shares under the third repurchase plan for approximately $5.5 million, including commissions. Any repurchased shares were cancelled and returned to authorized but unissued status. As of March 31, 2013, the Company s third repurchase plan was complete.

**15. Accumulated Other Comprehensive Loss**

Changes in the components of other comprehensive loss for the three month period ended March 31, 2013 was as follows (in thousands):

| | Foreign Currency | Unrealized Gains (Losses) on Available for Sale Securities | Total |
|---|---|---|---|
| Balance, December 31, 2012 | $ (747) | $ 38 | $ (709) |
| Other comprehensive income (loss) before reclassifications | (1,475) | (55) | (1,530) |
| Amounts reclassified from accumulated other comprehensive income (loss) | | | |
| Net current period other comprehensive loss | (1,475) | (55) | (1,530) |
| Balance, March 31, 2013 | $ (2,222) | $ (17) | $ (2,239) |

**16. 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, 2013 and 2012 (in thousands):

| | For the Three Months Ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| Share-based compensation expense by type of award: | | |
| Stock options | $ 1,886 | $ 1,941 |
| Restricted stock awards and units | 1,464 | 2,010 |
| Total share-based compensation expense | $ 3,350 | $ 3,951 |
| Effect of share-based compensation expense on statement of operations by categories: | | |
| Cost of services | $ 505 | $ 506 |
| General and administrative expense | 1,621 | 1,777 |
| Sales and marketing expense | 663 | 837 |
| Research and development expense | 561 | 831 |
| Total cost related to share-based compensation expense | $ 3,350 | $ 3,951 |

Unrecognized share-based compensation expense totaled $26.6 million at March 31, 2013, of which approximately $13.2 million related to stock options and approximately $13.4 million related to restricted stock awards. The Company currently expects to recognize share-based compensation expense of approximately $9.2 million during the remainder of 2013, $9.4 million in 2014 and the remainder thereafter based upon the scheduled vesting of the stock options and restricted stock units outstanding at March 31, 2013.

**17. Related Party Transactions**

The Company leased office space to an entity in which current members of its board of directors have an ownership interest. During the three month periods ended March 31, 2013 and 2012, the Company invoiced this entity approximately $0 and $15,640, respectively, for office space rental.

The Company sells services to entities owned, in whole or in part, by certain of the Company s executive staff and board of directors. Revenue derived from related parties was approximately 1% of total revenue for the three month periods ended March 31, 2013 and 2012.

Total outstanding accounts receivable from all related parties as of March 31, 2013 and December 31, 2012, was approximately $1.3 million. As of March 31, 2013 and December 31, 2012, the Company had an allowance for doubtful accounts receivable of approximately $1.3 million and $0.8 million, respectively, for an outstanding related party accounts receivable.

**18. Leases and Commitments**

***Operating Leases***

The Company is committed to various non-cancelable operating leases for office space and office equipment that expire through 2019. Certain leases contain provisions for renewal options and rent escalations upon expiration of the initial lease terms. Approximate future minimum lease payments over the remaining lease periods as of March 31, 2013 are as follows (in thousands):

| | |
|---|---|
| 2013 | $ 3,041 |
| 2014 | 3,375 |
| 2015 | 2,731 |
| 2016 | 2,054 |
| 2017 and thereafter | 4,034 |
| Total minimum payments | $ 15,235 |

***Purchase Commitments***

The Company has long-term commitments for bandwidth usage, co-location with various networks and Internet service providers, or ISPs, and for other purchase obligations. The following summarizes minimum commitments as of March 31, 2013 (in thousands):

| | |
|---|---|
| 2013 | $ 30,000 |
| 2014 | 24,373 |
| 2015 | 16,358 |
| 2016 | 4,014 |
| 2017 and thereafter | 374 |
| Total minimum payments | $ 75,119 |

***Capital Leases***

The Company leases equipment under capital lease agreements that extend through 2017. As of March 31, 2013 and December 31, 2012, the outstanding balance for capital leases was approximately $1.7 million and $2.1 million, respectively. The Company has recorded assets under capital lease obligations of approximately $5.1 million as of March 31, 2013 and December 31, 2012. Related accumulated amortization totaled approximately $3.3 million and $2.9 million, respectively, as of March 31, 2013 and December 31, 2012. The assets acquired under capital leases and the related accumulated amortization is included in property and equipment, net in the condensed consolidated balance sheet. The related amortization is included in depreciation and amortization expense in the condensed consolidated statements of operations. Interest expense related to capital leases was approximately $27,000 and $51,000, respectively, for the three month periods ended March 31, 2013 and 2012.

Future minimum capital lease payments at March 31, 2013 are as follows (in thousands):

| | |
|---|---|
| 2013 | $ 921 |
| 2014 | 498 |
| 2015 | 238 |
| 2016 | 134 |
| 2017 and thereafter | 5 |

| | |
|---|---|
| Total | 1,796 |
| Amounts representing interest | (100) |
| Present value of minimum lease payments | $ 1,696 |

**19. Concentrations**

For the three month periods ended March 31, 2013 and 2012, Netflix, Inc. represented approximately 13% and 11%, respectively, of the Company s total revenue.

Revenue from customers outside North America totaled approximately $14.4 million and $13.8 million, respectively, for the three month periods ended March 31, 2013 and 2012. During the three month periods ended March 31, 2013 and 2012, respectively, no single country outside of the United States accounted for 10% or more of the Company s total revenues.

**20. Income taxes**

Income taxes for the interim periods presented have been included in the accompanying condensed consolidated financial statements on the basis of an estimated annual effective tax rate. Based on an estimated annual effective tax rate and discrete items, the income tax expense from continuing operations for the three months ended March 31, 2013 and 2012 was $80,000 and $137,000, respectively. Income tax expense on the loss from continuing operations before taxes was different than the statutory income tax rate primarily due to the Company providing for a valuation allowance on deferred tax assets in certain jurisdictions, and the recording of state and foreign tax expense for the quarter.

The Company files income tax returns in jurisdictions with varying statues of limitations. Tax years 2009 through 2012 generally remain subject to examination by federal and most state tax authorities. As of March 31, 2013, the Company is not under any federal or state examinations.

**21. Segment Reporting**

The Company operates in one industry segment content delivery and related services. The Company operates in three geographic areas North America, Europe, Middle East and Africa (EMEA) and Asia Pacific, including Japan.

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, | |
|---|---|---|
| | 2013 | 2012 |
| Domestic revenue | $ 31,447 | $ 30,537 |
| International revenue Asia Pacific | 7,311 | 6,964 |
| International revenue EMEA | 7,055 | 6,815 |
| Total revenue | $ 45,813 | $ 44,316 |

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

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| Domestic long-lived assets | $ 30,541 | $ 35,318 |
| International long-lived assets | 10,511 | 12,320 |
| Total long-lived assets | $ 41,052 | $ 47,638 |

**22. Fair Value Measurements**

The Company evaluates certain of its financial instruments within the 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, 2013 and December 31, 2012, the Company held certain assets and liabilities that were required to be measured at fair value on a recurring basis. These include money market funds, commercial paper, corporate notes and bonds, U.S. government agency bonds, and publicly traded stocks, which are classified as either cash and cash equivalents or marketable securities. The Company also had acquisition related contingent consideration which is classified as a current liability on the Company s consolidated balance sheet.

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The Company s financial assets are valued using market prices on both active markets (Level 1) and less active markets (Level 2). Level 1 instrument valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets. Level 2 instrument valuations are obtained from readily available pricing sources for comparable instruments or identical instruments in less active markets. Level 3 inputs are valued using models that take into account the terms of the arrangement as well as multiple inputs where applicable, such as estimated units sold and other customer utilization metrics.

The following is a summary of fair value measurements at March 31, 2013 (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)** |
| Assets: | | | | |
| Government agency bonds (1) | $ 3,093 | $ | $ 3,093 | $ |
| Money market funds (2) | 10,762 | 10,762 | | |
| Corporate notes and bonds (1) | 24,208 | | 24,208 | |
| Commercial paper (1) | 3,996 | | 3,996 | |
| Certificate of deposit (1) | 2,744 | | 2,744 | |
| Publicly traded common stock (1) | 11 | 11 | | |
| Total assets measured at fair value | $ 44,814 | $ 10,773 | $ 34,041 | $ |

(1) Classified in marketable securities
(2) Classified in cash and cash equivalents

For the three month period ended March 31, 2013, 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. For the three month period ended March 31, 2013, the Company had net unrealized losses of approximately $55,000.

The following is a summary of fair value measurements at December 31, 2012 (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)** |
| Assets: | | | | |
| Government agency bonds (1) | $ 6,270 | $ | $ 6,270 | $ |
| Money market funds (2) | 14,697 | 14,697 | | |
| Corporate notes and bonds (1) | 9,529 | | 9,529 | |
| Commercial paper (1) | 500 | | 500 | |
| Certificate of deposit (1) | 2,741 | | 2,741 | |
| Publicly traded common stock (1) | 18 | 18 | | |
| Total assets measured at fair value | $ 33,755 | $ 14,715 | $ 19,040 | $ |

(1) Classified in marketable securities
(2) Classified in cash and cash equivalents

The carrying amount of cash equivalents approximates fair value because their maturity is less than three months. The carrying amount of short-term and long-term marketable securities represents fair value as the securities are marked to market as of each balance sheet date with any unrealized gains and losses reported in stockholders equity. The carrying amount of accounts receivable, accounts payable, and accrued liabilities approximates fair value due to the short-term maturity of the amounts.

**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, 2012 included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC, on March 1, 2013. 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, among other things, statements as to industry trends, our future expectations, operations, financial condition and prospects, business strategies 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 the Quarterly Report on Form 10-Q. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements. Prior period information has been modified to conform to current year presentation.*

**Overview**

We were founded in 2001 as a provider of content delivery network services to deliver digital content over the Internet. We began development of our infrastructure in 2001 and began generating meaningful revenue in 2002. Today, we operate a globally distributed, high-performance computing platform (our global computing platform) and provide a suite of integrated services including content delivery, web and video content management, mobility, web application acceleration, cloud storage, and related consulting services that enable companies and other organizations to create, manage, and deliver a global digital presence.

The integrated suite of services that we offer collectively comprises our Orchestrate Platform. We provide the Orchestrate Platform as SaaS and IaaS, which, other than content delivery services, are referred to collectively as VAS. We offer VAS both collectively as the end-to-end Orchestrate Platform and individually for customers that may not be inclined or able to adopt the entire platform.

The Orchestrate Platform and services help our customers optimize and streamline their online digital presence across web, mobile, social, and large screen channels. The Orchestrate Platform and services enable our customers to remove the complexity of creating, managing, delivering, and optimizing their digital presence, which helps them to deliver a high quality online media experience, improve brand awareness, drive revenue, and enhance their customer relationships. The Orchestrate Platform and services provide advanced features which include website content management, personalization and targeting, video publishing, mobile enablement, content delivery, transcoding and cloud storage, combined with social media integration and reporting analytics. These services are provided through the cloud and leverage our global computing platform, which provides highly available, highly redundant storage, bandwidth, and computing resources, as well as connectivity to last-mile broadband network providers. Our professional consulting services team helps organizations assess their digital presence requirements and improve their digital presence activities.

We derive revenue primarily from the sale of the Orchestrate Platform and its individual components as managed services. We also generate revenue through the sale of professional services and other infrastructure services, such as transit and rack space services.

We provide our services to customers that we believe view Internet, mobile, and social initiatives as critical to their success, including traditional and emerging media companies operating in the television, music, radio, newspaper, magazine, movie, videogame, software, and social media industries, as well as to enterprises, technology companies, and government entities conducting business online. Our offerings enable organizations to remove the complexity of creating, managing, delivering, and optimizing their digital presence by streamlining processes and optimizing business results across all customer interaction channels, which helps them to deliver a high quality online media experience, improve brand awareness, drive revenue, and enhance their customer relationships.

We provide services to customers in three geographic areas North America, EMEA, and Asia Pacific, including Japan. As of March 31, 2013, we had 1,406 active customers worldwide.

In addition to expanding our suite of VAS, we continue to expand the capacity and capabilities, and to enhance the performance and efficiency, of our global computing platform. Although we believe that we may have improved margins in our content delivery services as we expand our customer base and use a greater proportion of our capacity, we expect the majority of our margin increases to result from our VAS increasing as a percentage of our revenue.

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On November 26, 2012, we announced the appointment of Robert A. Lento as interim Chief Executive Officer effective immediately. We had previously announced on November 1, 2012 that Jeffrey W. Lunsford would be stepping down as our Chief Executive Officer in January 2013 and that an executive search firm was engaged to recruit his successor. On January 22, 2013, we announced that the board of directors completed its executive search and appointed Mr. Lento as our President and Chief Executive Officer and that Mr. Lunsford had tendered his resignation as a board member and Chairman of the board of directors. On February 12, 2013, we announced George E. Vonderhaar as Chief Sales Officer and recently appointed Jonathan Smith as Managing Director and Vice President of Europe, Middle East and Africa. On February 19, 2013, we announced the appointment of Walter D. Amaral to serve as our non-executive Chairman of the board of directors. Mr. Amaral fills the Chairman role vacated by the resignation of Mr. Lunsford.

On October 29, 2012, our board of directors authorized and approved a third common stock repurchase plan that authorized us to repurchase up to $10 million of our shares of common stock, exclusive of any commissions, markups or expenses, from time to time through May 9, 2013. During the three months ended March 31, 2013, we purchased and cancelled approximately 2.3 million shares under the third repurchase plan for approximately $5.5 million including commissions. Repurchased shares were cancelled and returned to authorized but unissued status. Our third common stock repurchase plan is now complete.

Traffic on our network and our VAS offerings continued to grow during the three month period ended March 31, 2013. This traffic growth is primarily the result of growth in the traffic delivered to existing customers, and to a lesser extent to new customers. Our content delivery revenue is generated by charging for traffic delivered. Our content delivery revenue decreased during the three month period ended March 31, 2013, compared to the three month period ended March 31, 2012. The decrease was primarily due to a decrease in our reseller revenue from Global Crossing, whose reseller contract ended during the second quarter of 2012, and a decrease in our transit and colocation services revenue. Our VAS revenue represented substantially all of our revenue growth during the three month period ended March 31, 2013. During 2012, we continued to add new customers, experienced some attrition and elected not to renew some customers. During the three month period ended March 31, 2013, we continued with that same focus to add new customers and also elected to not renew some customers as we continue to focus on customer quality. Our customer churn has been higher than we would like and is an area of focus for us. While the rate is not significant, it is less than 1% per month for the quarter, which we still think is too high and led to a net customer loss during the quarter. Our average number of products per customer during the three month period ended March 31, 2013 was 1.8. For new customers added during the quarter we averaged 2.1 products. We continue to have success selling new products to our customer base.

Our international revenue has continued to grow, 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, 2012, revenue derived from customers outside North America accounted for approximately 31% of our total revenue. For the year ended December 31, 2012, we derived approximately 47% of our international revenue from EMEA, and approximately 53% of our international revenue from Asia Pacific. During 2012, two countries, Japan and the United States, accounted for 10% or more of our total revenues. For the three month periods ended March 31, 2013 and 2012, respectively, revenue derived from customers outside North America accounted for approximately 31%, respectively, of our total revenue. For the three month periods ended March 31, 2013 and 2012, respectively, we derived approximately 49%, respectively, of our international revenue from EMEA and approximately 51%, respectively, of our international revenue from Asia Pacific. For the three month periods ended March 31, 2013 and 2012, no single country outside of the United States accounted for 10% or more of our total revenue. We expect foreign revenue to continue to increase in absolute dollars in 2013. Our business is managed as a single 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 2012, sales to our top 10 customers accounted for approximately 33% of our total revenue, and we had one customer, Netflix, which represented approximately 11% of our total revenue. For the three month periods ended March 31, 2013 and 2012, sales to our top 10 customers accounted for approximately 35% and 33%, respectively, of our total revenue. During the three month periods ended March 31, 2013 and 2012, Netflix represented approximately 13% and 11%, respectively, of our total revenue. In 2013, we anticipate that our top 10 customer concentration levels will remain consistent with 2012. In the past, the customers that comprised our top 10 customers have continually changed, and our large customers may not continue to be as significant going forward as they have been in the past.

On September 21, 2006, we entered into a service agreement with Netflix. This agreement sets forth the terms by which our delivery of services will be subject if and when Netflix places a service order form with us for specified services, upon which such order form will be incorporated into the agreement. The term of the agreement continues until the expiration of Netflix s last active service order form and is cancellable by either party if the other party is in material breach of the agreement upon 30 days prior notice. Netflix s last active service order form placed to date will expire on December 31, 2013.

In addition to selling to our direct customers, we maintain relationships with a number of resellers that purchase our services for resale to their end customers. Revenue generated from sales to reseller customers accounted for approximately 3% of our total revenue for the year ended December 31, 2012. For the three month periods ended March 31, 2013 and 2012, revenue generated from sales to reseller customers accounted for approximately 3%, respectively, of our total revenue.

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In addition to the revenue-related business trends, our cost of revenue increased in absolute dollars and increased as a percentage of revenue for the three month period ended March 31, 2013, compared to the three month period ended March 31, 2012. The increase in absolute dollars was primarily due to increased aggregate bandwidth and co-locations fees, increased professional fees, and increased payroll and related employee costs. These increases were offset by a decrease in other costs of revenue and decreased fees and licenses.

We enter into contracts with third party network and data center providers, with terms typically ranging from several months to several years. Our contracts related to transit bandwidth provided by network operators generally commit us to pay a fixed monthly fee or monthly fees, plus additional fees for bandwidth usage above a specified level. We entered into an agreement with Global Crossing in January 2009 for use of private lines for additional bandwidth and backbone services with a term of four years from installation. We executed subsequent amendments in September 2009, March 2011, and January 2012 for additional bandwidth and backbone services. The agreement and subsequent amendments required substantial prepayment for such services, and the amendments extended the original term for some services through June 2014. In addition to purchasing services from communications providers, we connect directly to approximately 600 broadband ISPs, generally without either party paying the other. This industry practice, known as settlement free peering, benefits us by allowing us to place content objects directly on user access networks, which helps us provide higher performance delivery for our customers, and eliminate paying transit bandwidth fees to network operators. This practice also benefits the ISP and its customers by allowing them to receive improved content delivery through our local servers and eliminate the cost of transit bandwidth associated with delivery receipt of the traffic. We do not consider these relationships to represent the culmination of an earnings process. Accordingly, we do not recognize as revenue the value to the ISPs associated with the use of our servers nor do we recognize as expense the value of the bandwidth received at discounted or no cost. These peering relationships are mutually beneficial and are not contractual commitments. In addition to settlement free peering, we incur costs for non-settlement free peering as well as costs associated with connecting to the ISPs.

During 2012, we continued to reduce our network transit bandwidth delivery costs per gigabyte transferred by entering into new supplier contracts with lower pricing and amending existing contracts to take advantage of price reductions from our existing suppliers associated with higher purchase commitments. While we had increased traffic delivered over our network, our total transit bandwidth delivery costs decreased during 2012. We anticipate our overall transit bandwidth delivery costs will increase in absolute dollars as a result of expected higher traffic levels, and we expect this increase to be partially offset by continued reductions in bandwidth costs per unit. We expect that our overall transit bandwidth delivery costs as a percentage of revenue will increase slightly in 2013 compared to 2012.

For the three month period ended March 31, 2013, operating expenses decreased in absolute dollars and decreased as a percentage of revenue compared to the three month period ended March 31, 2012. This decrease was primarily due to decreased general and administrative costs and decreased sales and marketing expenses. The decrease in general and administrative costs was primarily due to decreased professional fees for accounting and legal services, decreased share-based compensation, and the receipt of a non-income tax based refund of approximately $0.8 million. The decrease in sales and marketing expenses was primarily due to decreased payroll and related employee costs, including decreased variable compensation, decreased salaries, and decreased travel and travel related expenses. These decreases were offset by an increase in research and development costs. For the three month period ended March 31, 2013, research and development costs increased primarily as a result of increased payroll and related employee costs due to increased staffing.

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 2012, 2011, and 2010 we made capital purchases of $18.4 million, $30.4 million, and $33.5 million, respectively, which represented 10%, 18% and 22%, respectively, of total revenue for each of those years. For the three month period ended March 31, 2013, we made capital investments of $2.6 million, which represented 6% of total revenue for that period. We expect to have ongoing capital expenditure requirements as we continue to invest in, refresh, and expand our global computing platform.

Our future results will be affected by many factors identified in the section captioned Risk Factors, in this Quarterly Report on Form 10-Q, including our ability to:

- 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 Technologies, Inc. or Akamai to a favorable conclusion;

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

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

- successfully integrate the businesses we have acquired; and

- successfully manage the disposition of businesses we have divested from.

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 critical accounting policies and estimates are disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012. During the three months ended March 31, 2013, there have been no significant changes in our critical accounting policies and estimates. However, we have supplemented our disclosures contained in our Annual Report on Form 10-K for the year ended December 31, 2012, as noted below.

***Goodwill and Other Intangible Assets***

We test goodwill for impairment on an annual basis or more frequently if events or changes in circumstances indicate that goodwill might be impaired. We have concluded that we have one reporting unit and have assigned the entire balance of goodwill to this reporting unit. The fair value of the reporting unit is determined using our market capitalization as of our annual impairment assessment date or each reporting date if circumstances indicate the goodwill might be impaired. Items that could reasonably be expected to negatively affect key assumptions used in estimating fair value include but are not limited to:

- Sustained decline in our stock price due to a decline in our financial performance due to the loss of key customers, loss of key personnel, emergence of new technologies or new competitors

- Decline in overall market/economic conditions leading to decline in our stock price

- Decline in observed control premiums paid in business combinations involving comparable companies

The estimated fair value of the reporting unit is determined using a market approach utilizing our market capitalization as adjusted for a control premium based on the estimated average and median control premiums of transactions involving companies comparable to us. As of the annual impairment testing date and at December 31, 2012, we determined that goodwill was not impaired. We also performed a similar analysis at March 31, 2013 and noted that the estimated fair value of our reporting unit exceeded carrying value by approximately $24 million or 9% using the market capitalization on March 31, 2013. Based on this analysis, management determined that goodwill continues to not be impaired at March 31, 2013.

**Results of Continuing Operations**

***Three Months Ended March 31, 2013 Compared to Three Months Ended March 31, 2012***

***Revenue***

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2013 | 2012 | Increase (Decrease) | Percent Change |
| | (in thousands) | | | |
| Revenue | $ 45,813 | $ 44,316 | $ 1,497 | 3% |

Revenue increased 3%, or $1.5 million, to $45.8 million for the three month period ended March 31, 2013 as compared to $44.3 million for the three month period ended March 31, 2012. The increase in revenue for the three month period ended March 31, 2013 as compared to the same period in the prior year was attributable to an increase in our VAS revenue of approximately $2.2 million. The increase in VAS revenue was primarily attributable to increases in our video publishing and acceleration service offerings. The increase in VAS revenue was offset by a

decrease in our content delivery services revenue of approximately $0.7 million, even though we continued to increase the amount of traffic moving through our network. The decrease was primarily due to a decline in our reseller revenue from Global Crossing, whose reseller contract ended during the second quarter of 2012, and a decline in our transit and colocation services revenue.

As of March 31, 2013, we had 1,406 customers as compared to 1,562 as of March 31, 2012. Our customer churn has been higher than we would like and is an area of focus for us. The decrease in customer count was primarily attributable to the loss of smaller revenue generating customers.

In the past, the customers that comprise our top 10 customers have continually changed, and our large customers such as Netflix may not continue to be as significant going forward as they have been in the past. Netflix s last active service order form placed to date will expire on December 31, 2013.

We anticipate revenues will increase in 2013. We expect to deliver more traffic on our network and expect continued growth in our VAS. We anticipate that our customer concentrations levels will be consistent with 2012.

***Cost of Revenue***

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2013 | 2012 | Increase (Decrease) | Percent Change |
| | | (in thousands) | | |
| Cost of revenue | $ 28,732 | $ 27,330 | $ 1,402 | 5% |

Cost of revenue consists primarily of fees paid to network providers for bandwidth and backbone, costs incurred for non-settlement free peering and connection to ISPs, and fees paid to data center operators for housing of our network equipment in third party network data centers, also known as co-location costs. Cost of revenue also includes depreciation of network equipment used to deliver our content delivery services, payroll and related costs, and share-based compensation for our network operations and professional services personnel.

Cost of revenue increased 5%, or approximately $1.4 million, to $28.7 million for the three month period ended March 31, 2013 as compared to $27.3 million for the three month period ended March 31, 2012. This increase was primarily due to an increase in aggregate bandwidth and co-location fees of approximately $1.2 million, primarily associated with increased peering costs of approximately $0.5 million, increased rack fees of approximately $0.4 million, and increased other costs of recurring services of approximately $0.2 million. Additionally, we had increases in professional fees and outside services of approximately $0.4 million, primarily due to an increase in outside consulting expense, and we had an increase in payroll and related employee costs of approximately $0.2 million due to increased staffing, primarily related to professional services. These increases were offset by a decrease in other costs of approximately $0.3 million, which was the result of a reduction in other costs of revenue and a decrease in fees and licenses. In addition, depreciation expense decreased approximately $0.1 million.

Additionally, during the three month periods ended March 31, 2013 and 2012, cost of revenue included share-based compensation expense of approximately $0.5 million, respectively.

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

| | For the Three Months Ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| Bandwidth and co-location fees | $ 14.8 | $ 13.6 |
| Depreciation network | 6.7 | 6.8 |
| Payroll and related employee costs | 4.6 | 4.4 |
| Professional fees and outside services | 0.7 | 0.3 |
| Share-based compensation | 0.5 | 0.5 |
| Royalty expenses | 0.2 | 0.2 |
| Travel and travel-related expenses | 0.2 | 0.2 |
| Other costs | 1.0 | 1.3 |
| Total cost of revenue | $ 28.7 | $ 27.3 |

We anticipate cost of revenue will increase in 2013. We expect to deliver more traffic on our network, which would result in higher expenses associated with increased bandwidth, peering, rack and co-location costs to support increased traffic; however, such costs are likely to be partially offset by lower bandwidth costs per unit. We anticipate depreciation expense related to our network equipment to decrease compared to 2012 in absolute dollars. Additionally, we expect an increase in payroll and related costs, as we continue to make investments in our network to service our expanding customer base as well as our increase in VAS personnel. We expect that share-based compensation expense will decrease in absolute dollars and remain consistent with 2012 as a percentage of revenue.

***General and Administrative***

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2013 | 2012 | Increase (Decrease) | Percent Change |
| | | (in thousands) | | |
| General and administrative | $ 8,073 | $ 8,320 | $ (247) | (3)% |

General and administrative expenses consist primarily of the following components:

- payroll, share-based compensation and other related costs, including related expenses for executive, finance, legal, 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;
- the provision for doubtful accounts; and
- non-income based taxes.

General and administrative expenses decreased 3%, or $0.2 million, to $8.1 million for the three month period ended March 31, 2013 as compared to $8.3 million for the three month period ended March 31, 2012. This decrease was primarily due to lower professional fees of

approximately $0.4 million, which includes decreased accounting fees of approximately $0.3 million and decreased legal fees related to intellectual property of approximately $0.1 million. In addition, bad debt expense decreased $0.1 million. These decreases were offset by an increase in other costs of $0.3 million, which was primarily due to an increase in supplies and other employee costs, and an increase in payroll and related employee costs of approximately $0.2 million, which was primarily due to increased salaries. For the three month period ended March 31, 2013, other expenses included a refund of non-income based taxes of approximately $0.8 million. For the three months ended March 31, 2012, other expenses included the reversal of previously recorded contingent considerations of approximately $0.8 million. Other expenses include such items as rent, utilities, telephone, insurance, fees and licenses, office supplies, and non-income taxes.

Additionally, general and administrative share-based compensation expense decreased $0.2 million for the three months ended March 31, 2013 compared to March 31, 2012.

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

| | For the Three Months Ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| Payroll and related employee costs | $ 2.8 | $ 2.6 |
| Professional fees | 1.8 | 2.2 |
| Share-based compensation | 1.6 | 1.8 |
| Litigation expenses | | |
| Bad debt expense | 0.3 | 0.4 |
| Travel and travel-related expenses | 0.2 | 0.2 |
| Other expenses | 1.4 | 1.1 |
| Total general and administrative | $ 8.1 | $ 8.3 |

In 2013, we expect our general and administrative expenses to remain flat in absolute dollars and slightly decrease as a percentage of revenue. During 2013, we expect to see increased salaries and related employee costs and increased litigation expenses. These increases will be offset by lower recruiting, consulting, bad debt expense and lower non-income tax based taxes. We expect that share-based compensation expense will decrease in absolute dollars and decrease as a percentage of revenue compared to 2012.

***Sales and Marketing***

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2013 | 2012 | Increase (Decrease) | Percent Change |
| | | (in thousands) | | |
| Sales and marketing | $ 10,484 | $ 11,632 | $ (1,148) | (10)% |

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, travel and travel-related expenses, and advertising and promotional expenses.

Sales and marketing expenses decreased 10%, or $1.1 million, to $10.5 million for the three month period ended March 31, 2013 compared to $11.6 million for the three month period ended March 31, 2012. The decrease in sales and marketing expenses was primarily due to a decrease in payroll and related employee costs of approximately $1.0 million, primarily due to decreased variable compensation costs of approximately $0.5 million and a decrease in salaries of approximately $0.4 million. In addition, our travel and travel-related expenses decreased approximately $0.3 million. These decreases were offset by an increase in other costs of approximately $0.3 million and an increase in marketing expenses of approximately $0.1 million. The increase in other costs was primarily due to increased fees and licenses and increased facility and facility-related costs.

Additionally, sales and marketing share-based compensation expense decreased $0.1 million for the three months ended March 31, 2013 compared to March 31, 2012.

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

| | For the Three Months Ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| Payroll and related employee costs | $ 6.3 | $ 7.3 |

| | | |
|---|---|---|
| Travel and travel-related expenses | 0.7 | 1.0 |
| Share-based compensation | 0.7 | 0.8 |
| Marketing programs | 0.6 | 0.5 |
| Professional fees and outside services | 0.4 | 0.5 |
| Other expenses | 1.8 | 1.5 |
| Total sales and marketing | $ 10.5 | $ 11.6 |

We anticipate our sales and marketing expenses will decrease in 2013 in absolute dollars and as a percentage of revenue compared to 2012. The decrease in absolute dollars is due to expected decreases in salaries and related employee costs and travel and entertainment expenses. These decreases are offset by expected increases in variable compensation on higher forecast sales, and an expected increase in facility and facility-related expenses for our sales and marketing personnel. We expect that share-based compensation expense will decrease slightly in absolute dollars and remain constant as a percentage of revenue in 2013 compared to 2012.

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***Research and Development***

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2013 | 2012 | Increase (Decrease) | Percent Change |
| | (in thousands) | | | |
| Research and development | $ 5,741 | $ 5,166 | $ 575 | 11% |

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 11%, or $0.6 million, to $5.7 million for the three month period ended March 31, 2013 as compared to $5.2 million for the three month period ended March 31, 2012. The increase in research and development expenses was primarily due to an increase of approximately $0.4 million in payroll and related employee costs and an increase in professional fees of approximately $0.1 million, an increase in travel and travel-related expenses of $0.1 million and an increase in other costs of $0.1 million. The increase in payroll and related employee costs was primarily due to increased salaries as result of additional network, software engineering and product management personnel. Other expenses include such items as fees and licenses, telephone, and office supplies.

Additionally, research and development share-based compensation expense decreased $0.2 million for the three months ended March 31, 2013 compared to March 31, 2012.

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

| | For the Three Months Ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| Payroll and related employee costs | $ 4.3 | $ 3.9 |
| Share-based compensation | 0.6 | 0.8 |
| Professional fees and outside services | 0.3 | 0.2 |
| Travel and travel-related expenses | 0.2 | 0.1 |
| Other expenses | 0.3 | 0.2 |
| Total research and development | $ 5.7 | $ 5.2 |

We anticipate our research and development expenses will increase in 2013 in absolute dollars and slightly increase as a percentage of revenue as we continue to make investments in our core technology, refinements, and additions to our other service offerings. We expect increased payroll and related employee costs associated with continued hiring of research and development personnel. We expect that share-based compensation expense will decrease in both absolute dollars and as a percentage of revenue in 2013 compared to 2012.

***Depreciation and Amortization (Operating Expenses)***

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2013 | 2012 | Increase (Decrease) | Percent Change |
| | (in thousands) | | | |
| Depreciation and amortization | $ 1,450 | $ 1,398 | $ 52 | 4% |

Depreciation expense consists of depreciation on equipment and furnishing used by general administrative, sales and marketing, and research and development personnel. Amortization expense consists of amortization of intangible assets acquired in business combinations.

Depreciation and amortization expense was approximately $1.4 million, for each of the three month periods ended March 31, 2013 and 2012. General administrative depreciation and amortization expense was approximately $0.7 million, in each of the three month periods ended March 31, 2013 and 2012. Amortization of intangible assets was approximately $0.7 million, for each of the three month periods ended March 31, 2013 and 2012. Based on our intangible assets at March 31, 2013, we expect amortization of other intangible assets to be approximately $2.1 million for the remainder of 2013, and $2.2 million, $1.1 million, and $0.3 million for fiscal years 2014, 2015, and 2016, respectively.

***Interest Expense***

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2013 | 2012 | Increase (Decrease) | Percent Change |
| | (in thousands) | | | |
| Interest expense | $ 27 | $ 50 | $ (23) | (46)% |

Interest expense consists of interest accrued and paid.

Interest expense decreased to $27,000 for the three month period ended March 31, 2013, as compared to $50,000 for the three month period ended March 31, 2012. Interest expense for the three month periods ended March 31, 2013 and 2012, was primarily comprised of interest paid on capital leases. As of March 31, 2013, with the exception of our capital leases, we had no outstanding credit facilities.

***Interest Income***

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2013 | 2012 | Increase (Decrease) | Percent Change |
| | (in thousands) | | | |
| Interest income | $ 70 | $ 106 | $ (36) | (34)% |

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

Interest income was approximately $0.1 million for each of the three month periods ended March 31, 2013 and 2012, respectively.

***Other Income (Expense)***

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2013 | 2012 | Increase (Decrease) | Percent Change |
| | (in thousands) | | | |
| Other (expense) income | $ 568 | $ (86) | $ (654) | 760% |

Other income was approximately $0.6 million for three month period ended March 31, 2013 compared to $0.1 million other expense for the three month period ended March 31, 2012. Other income for the three month period ended March 31, 2013 consists primarily of foreign currency transaction gains. Other expense for the three month period ended March 31, 2012, consists primarily of foreign currency transaction losses.

***Income Tax Expense***

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2013 | 2012 | Increase (Decrease) | Percent Change |
| | (in thousands) | | | |
| Income tax expense | $ 80 | $ 137 | $ (57) | (42)% |

Based on an estimated annual effective tax rate and discrete items, the estimated tax expense from continuing operations for the three months ended March 31, 2013 and 2012 was $80,000 and $137,000, respectively. Income tax expense on the loss from continuing operations before taxes was different than the statutory income tax rate primarily due to our providing for a valuation allowance on deferred tax assets in certain jurisdictions, and recording of state and foreign tax expense for the quarter. 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.

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*Income (loss) from Discontinued Operations*

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2013 | 2012 | Increase (Decrease) | Percent Change |
| | | (in thousands) | | |
| Income (loss) from discontinued operations | $ | $ (309) | $ (309) | (100)% |

Discontinued operations relates to our EyeWonder and chors rich media advertising services. On September 1, 2011, we completed the sale of EyeWonder, LLC (EyeWonder) and chors GmbH (chors) to DG FastChannel, Inc. (currently Digital Generation, Inc.) (DG). See Note 4 of Notes to Unaudited Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional information about discontinued operations.

**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;
- an underwritten public offering of our common stock in March 2011;
- borrowing on capital leases;
- borrowing on credit facilities;
- sale of EyeWonder and chors in September 2011;
- sale of our cost basis investment in Gaikai in August 2012; and
- cash generated from operations.

As of March 31, 2013, our cash, cash equivalents, and marketable securities classified as current totaled $120.2 million. Included in this amount is approximately $8.4 million of cash and cash equivalents held outside the United States.

*Operating Activities*

Net cash provided by operating activities of continuing operations increased by $4.6 million, with net cash provided by operating activities of continuing operations equaling $2.7 million for the three month period ended March 31, 2013, compared to net cash used in operating activities of continuing operations of approximately $1.9 million for the three month period ended March 31, 2012. The change in operating cash flows comparing the three month period ended March 31, 2013 to the three month period ended March 31, 2012 was primarily due to a larger net loss in 2012 compared to 2013 offset by changes in operating assets and liabilities. Cash used in operating activities of continuing operations related to changes in operating assets and liabilities was $0.1 million in the three months ended March 31, 2013, compared to $4.4 million in the three months ended March 31, 2012. The change relates primarily to changes in accounts receivable, prepaid expenses, other assets, income taxes

payable, and deferred revenue during each period.

We expect that cash provided by operating activities may not be sufficient to cover new purchases of property and equipment during 2013 and potential litigation expenses associated with patent litigation. The timing and amount of future working capital changes 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 used in investing activities of continuing operations was $17.8 million for the three months ended March 31, 2013, compared to $8.0 million for the three months ended March 31, 2012. Cash used in investing activities was principally comprised of cash generated from maturities 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 global computing platform.

We expect to have ongoing capital expenditure requirements as we continue to invest in and expand our global computing platform.

***Financing Activities***

Net cash used in financing activities of continuing operations was approximately $7.3 million for the three month period ended March 31, 2013, compared to $1.7 million of cash used in financing activities of continuing operations for the three month period ended March 31, 2012. Net cash used in financing activities of continuing operations in the three months ended March 31, 2013 primarily related to payments made for the repurchase of our common stock of approximately $5.5 million, payments of employee tax withholdings related to restricted stock of approximately $1.4 million, and payments made on our capital lease obligations of approximately $0.4 million.

Net cash used in financing activities of continuing operations was approximately $1.7 million for the three month period ended March 31, 2012. Net cash used in financing activities of continuing operations in the three months ended March 31, 2012 primarily related to payments made for the repurchase of our common stock of approximately $1.2 million, payments of employee tax withholdings related to restricted stock of approximately $0.3 million, and payments made on our capital lease obligations of approximately $0.4 million, off-set by cash received from the exercise of stock options of $0.1 million.

As of March 31, 2013, the Company had no outstanding bank debt other than the aforementioned capital leases.

On October 29, 2012, our board of directors authorized and approved a third common stock repurchase plan that authorized us to repurchase up to $10 million of our shares of common stock, exclusive of any commissions, markups or expenses, from time to time through May 9, 2013. During the three months ended March 31, 2013, we purchased and cancelled approximately 2.3 million shares under the third repurchase plan for approximately $5.5 million including commissions. Any repurchased shares were cancelled and returned to authorized but unissued status. Our third common stock repurchase plan is now complete.

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, accrued provision for litigation, 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.

We believe that our existing cash, cash equivalents, and marketable securities 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 change, or if unexpected opportunities or needs arise, we may seek to raise additional cash by selling equity or debt securities.

**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, computer rack space, and other purchase obligations. These leases and obligations expire on various dates ranging from 2013 to 2019. We expect that the growth of our business will require us to continue to add to and increase our long-term commitments in 2013 and beyond. As a result of our growth strategies, we believe that our liquidity and capital resources requirements will grow.

The following table presents our contractual obligations and commercial commitments, as of March 31, 2013 over the next five years and thereafter (in thousands):

| | | Payments Due by Period | | | |
|---|---|---|---|---|---|
| **Contractual obligations as of March 31, 2013** | **Total** | **Less than 1 year** | **1-3 years** | **3-5 years** | **More than 5 years** |
| Operating Leases | | | | | |
| Bandwidth leases | $ 27,447 | $ 19,302 | $ 7,002 | $ 1,143 | $ |
| Rack space leases | 45,980 | 17,720 | 27,643 | 617 | |
| Real estate leases | 15,235 | 3,908 | 5,811 | 3,712 | 1,804 |
| Total operating leases | 88,662 | 40,930 | 40,456 | 5,472 | 1,804 |
| Capital leases | 1,796 | 1,092 | 624 | 80 | |
| Other purchase obligations | 1,692 | 517 | 1,128 | 47 | |
| Total commitments | $ 92,150 | $ 42,539 | $ 42,208 | $ 5,599 | $ 1,804 |

**Off Balance Sheet Arrangements**

As of March 31, 2013, we are not involved in any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

**Use of Non-GAAP Financial Measures**

To evaluate our business, we consider and use Non-GAAP net income (loss) and Adjusted EBITDA as a supplemental measure of operating performance. These measures include the same adjustments that management takes into account when it reviews and assesses operating performance on a period-to-period basis. We consider Non-GAAP net income (loss) 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, amortization of intangibles, acquisition related expenses, and discontinued operations. We define EBITDA as GAAP net income (loss) before interest income, interest expense, other income and expense, provision for income taxes, depreciation and amortization and discontinued operations. We believe that EBITDA provides a useful metric to investors to compare us with other companies within our industry and across industries. We define Adjusted EBITDA as EBITDA adjusted for operational expenses that we do not consider reflective of our ongoing operations. We use Adjusted EBITDA as a supplemental measure to review and assess operating performance. We also believe use of Adjusted EBITDA facilitates investors use of operating performance comparisons from period to period. In addition, it should be noted that our performance-based executive officer bonus structure is tied closely to our performance as measured in part by certain non-GAAP financial measures.

In our May 9, 2013 earnings press release, as furnished on Form 8-K, we included Non-GAAP net income (loss), EBITDA and Adjusted EBITDA. The terms Non-GAAP net income (loss), EBITDA, and Adjusted EBITDA are not defined under United States GAAP, and are not measures of operating income, operating performance, or liquidity presented in accordance with United States GAAP. Our Non-GAAP net income (loss), EBITDA, and Adjusted EBITDA have limitations as analytical tools, and when assessing our operating performance, Non-GAAP net income (loss), EBITDA, and Adjusted EBITDA should not be considered in isolation, or as a substitute for net income (loss) or other consolidated income statement data prepared in accordance with United States GAAP. Some of these limitations include, but are not limited to:

- EBITDA and Adjusted EBITDA 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;
- they do not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debt that we may incur;
- 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 Adjusted EBITDA 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 Adjusted EBITDA 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 (loss) and Adjusted EBITDA only as supplemental support for management s analysis of business performance. Non-GAAP net income (loss), EBITDA, and Adjusted EBITDA are calculated as follows for the periods presented.

**Reconciliation of Non-GAAP Financial Measures**

In accordance with the requirements of Regulation G issued by the SEC, we are presenting the most directly comparable GAAP financial measures and reconciling the non-GAAP financial metrics to the comparable GAAP measures.

**Reconciliation of GAAP Net Income (Loss) to Non-GAAP Net Income (Loss)**

**(In thousands)**

**(Unaudited)**

| | Three Months Ended | |
|---|---|---|
| | March 31, 2013 | March 31, 2012 |
| GAAP net loss | $ (8,136) | $ (10,006) |
| Share-based compensation | 3,350 | 3,951 |
| Litigation defense expenses | 42 | 49 |
| Acquisition related expenses | (24) | (488) |
| Amortization of intangible assets | 732 | 695 |
| Loss from discontinued operations | | 309 |
| Non-GAAP net loss | $ (4,036) | $ (5,490) |

**Reconciliation of GAAP Net Income (Loss) to EBITDA to Adjusted EBITDA**

**(In thousands)**

**(Unaudited)**

| | Three Months Ended | |
|---|---|---|
| | **March 31, 2013** | **March 31, 2012** |
| GAAP net loss | $ (8,136) | $ (10,006) |
| Depreciation and amortization | 8,130 | 8,227 |
| Interest expense | 27 | 50 |
| Interest and other income (expense) | (638) | (20) |
| Income tax expense | 80 | 137 |
| Loss from discontinued operations | | 309 |
| EBITDA | $ (537) | $ (1,303) |
| Share-based compensation | 3,350 | 3,951 |
| Litigation defense expenses | 42 | 49 |
| Acquisition related expenses | (24) | (488) |
| Adjusted EBITDA | $ 2,831 | $ 2,209 |

## 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. Our outstanding capital lease obligations bear fixed interest rates and fluctuations in interest rates. 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***

We operate in North America, EMEA and Asia-Pacific, including Japan. As a result of our international business activities, our financial results could be affected by factors such as changes in foreign currency exchange rates or economic conditions in foreign markets, and there is no assurance that exchange rate fluctuations will not harm our business in the future. We have foreign currency exchange rate exposure on our results of operations as it relates to revenues and expenses denominated in foreign currencies. A portion of our cost of revenues and operating expenses are denominated in foreign currencies as are revenues associated with certain international customers. To the extent that the U.S. dollar weakens, similar foreign currency denominated transactions in the future will result in higher revenues and higher cost of revenues and operating expenses, with expenses having the greater impact on our financial results. Similarly, our revenues and expenses will decrease if the U.S. dollar strengthens against these foreign currencies. Although we will continue to monitor our exposure to currency fluctuations, and, where appropriate, may use financial hedging techniques in the future to minimize the effect of these fluctuations, we are not currently engaged in any financial hedging transactions. We performed a sensitivity analysis of our foreign currency exposure as of December 31, 2012 to assess the potential impact of fluctuations in exchange rates for all foreign denominated revenues and expenses. Assuming a 10 percent weakening of the U.S. dollar relative to our foreign currency denominated revenues and expenses, our net loss for the year ended December 31, 2012 and the three months ended March 31, 2013 would have been higher by approximately $3.0 million and $1.0 million, respectively. There are inherent limitations in the sensitivity analysis presented, primarily due to the assumption that foreign exchange rate movements across multiple jurisdictions are similar and would be linear and instantaneous. As a result, the analysis is unable to reflect the potential effects of more complex markets or other changes that could arise which may positively or negatively affect our results of operations.

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*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) and 15d-15(e). We maintain disclosure controls and procedures, as such term is defined in SEC Rule 13a-15(e) and 15d-15(e), that are designed to ensure that information required to be disclosed in our reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC 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 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, 2013. 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 have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter ended March 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

We are involved in litigation with Akamai and the Massachusetts Institute of Technology (MIT) relating to a claim of patent infringement. The action was filed in June 2006 in the United States District Court for the District of Massachusetts. The trial date was set for February 2008 with respect to four claims relating to United States Patent No. 6,108,703 (the 703 patent). Before trial, Akamai waived by stipulation its claims of indirect or induced infringement and proceeded to trial only on the theory of direct infringement. 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. The jury awarded an aggregate of approximately $45.5 million which includes lost profits, reasonable royalties and price erosion damages for the period April 2005 through December 31, 2007. In addition, the jury awarded pre-judgment interest which we estimated to be $2.6 million at December 31, 2007. We recorded the aggregate $48.1 million as a provision for litigation as of December 31, 2007. During 2008, we recorded an additional provision of approximately $17.5 million for potential additional infringement damages and interest. On July 1, 2008, the court denied our motions for JMOL, Obviousness, and a New Trial. The court also denied Akamai s Motion for Permanent Injunction as premature and denied its Motions for Summary Judgment regarding our equitable defenses. The court conducted a bench trial in November 2008 regarding our equitabl