

# Section 1: 10-Q (10-Q)

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**Form 10-Q**

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(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended June 30, 2016

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

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**Limelight Networks, Inc.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**20-1677033**  
(I.R.S. Employer  
Identification No.)

**222 South Mill Avenue, 8<sup>th</sup> Floor**  
**Tempe, AZ 85281**  
(Address of principal executive offices, including Zip Code)  
**(602) 850-5000**  
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant 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  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.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller Reporting Company   
(Do not check if a smaller reporting company)

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

The number of shares outstanding of the registrant's Common Stock, par value \$0.001 per share, as of July 19, 2016: 104,674,965 shares.

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LIMELIGHT NETWORKS, INC.  
FORM 10-Q  
Quarterly Period Ended June 30, 2016  
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### Special Note Regarding Forward-Looking Statement

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements contained in this Quarterly Report on Form 10-Q, other than statements of historical fact, are forward-looking statements. Forward-looking statements generally can be identified by the words “may,” “will,” “expect,” “believe,” “anticipate,” “intend,” “could,” “estimate,” or “continue,” and similar expressions. We have based these forward-looking statements largely on our current expectations and projections about future events, as well as trends that we believe may affect our financial condition, results of operations, business strategy, short-term and long-term business operations and objectives, and financial needs. These statements include, among other things:

- our expectations regarding revenue, costs and expenses;
- our plans regarding investing in our content delivery network, as well as other products and technologies;
- our beliefs regarding the growth of, and competition within, the content delivery industry;
- our beliefs regarding the growth of our business and how that impacts our liquidity and capital resources requirements;
- the impact of certain new accounting standards and guidance as well as the time and cost of continued compliance with existing rules and standards;
- our plans with respect to investments in marketable securities;
- our expectations regarding litigation and other pending or potential disputes;
- our estimations regarding taxes and belief regarding our tax reserves;
- our beliefs regarding the use of Non-GAAP financial measures;
- our approach to identifying, attracting and keeping new and existing customers, as well as our expectations regarding customer turnover;
- the sufficiency of our sources of funding;
- our belief regarding our interest rate risk;
- our beliefs regarding inflation risks;
- our beliefs regarding expense and productivity of and competition for our sales force; and
- our beliefs regarding the significance of our large customers.

These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including those described under the caption “Risk Factors” in Part II, Item 1A in this Quarterly Report on Form 10-Q and those discussed in other documents we file with the Securities and Exchange Commission (SEC).

In addition, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties and assumptions, the future events and trends discussed in this Quarterly Report on Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

The forward-looking statements contained herein are based on our current expectations and assumptions and on information available as of the date of the filing of this Quarterly Report on Form 10-Q. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

Unless expressly indicated or the context requires otherwise, the terms “Limelight,” “we,” “us,” and “our” in this document refer to Limelight Networks, Inc., a Delaware corporation, and, where appropriate, its wholly owned subsidiaries. All information is presented in thousands, except per share amounts, customer count and where specifically noted.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

**Limelight Networks, Inc.**  
**Consolidated Balance Sheets**  
**(In thousands, except per share data)**

	June 30, 2016	December 31, 2015
	(Unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 30,885	\$ 44,680
Restricted cash	62,790	—
Marketable securities	—	28,322
Accounts receivable, net	24,872	26,795
Income taxes receivable	135	170
Deferred income taxes	80	89
Prepaid expenses and other current assets	6,278	9,578
Total current assets	125,040	109,634
Property and equipment, net	30,647	36,143
Marketable securities, less current portion	40	40
Deferred income taxes, less current portion	1,284	1,252
Goodwill	76,242	76,143
Other assets	1,903	2,415
Total assets	\$ 235,156	\$ 225,627
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 7,630	\$ 9,137
Deferred revenue	2,469	2,890
Capital lease obligations	1,119	466
Income taxes payable	165	204
Provision for litigation	18,000	—
Other current liabilities	10,391	10,857
Total current liabilities	39,774	23,554
Long-term debt	12,790	—
Capital lease obligations, less current portion	3,008	1,436
Deferred income taxes	145	137
Deferred revenue, less current portion	52	92
Provision for litigation, less current portion	36,000	—
Other long-term liabilities	1,963	2,311
Total liabilities	93,732	27,530
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock, \$0.001 par value; 7,500 shares authorized; no shares issued and outstanding	—	—
Common stock, \$0.001 par value; 300,000 shares authorized; 104,653 and 102,299 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	104	102
Additional paid-in capital	483,903	477,202
Accumulated other comprehensive loss	(10,304)	(10,812)
Accumulated deficit	(332,279)	(268,395)
Total stockholders' equity	141,424	198,097
Total liabilities and stockholders' equity	\$ 235,156	\$ 225,627



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*The accompanying notes are an integral part of the consolidated financial statements.*

**Limelight Networks, Inc.**  
**Unaudited Consolidated Statements of Operations**  
(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues	\$ 43,560	\$ 43,795	\$ 84,982	\$ 86,124
Cost of revenue:				
Cost of services (1)	20,271	21,271	40,380	42,928
Depreciation — network	4,489	4,376	9,157	8,528
Total cost of revenue	24,760	25,647	49,537	51,456
Gross profit	18,800	18,148	35,445	34,668
Operating expenses:				
General and administrative	7,241	6,081	14,049	12,932
Sales and marketing	8,117	10,002	17,020	20,278
Research and development	6,289	7,646	12,614	13,909
Depreciation and amortization	626	635	1,249	1,276
Provision for litigation	54,000	—	54,000	—
Total operating expenses	76,273	24,364	98,932	48,395
Operating loss	(57,473)	(6,216)	(63,487)	(13,727)
Other income (expense):				
Interest expense	(279)	—	(459)	(4)
Interest income	8	75	14	149
Other, net	(79)	(131)	321	1,682
Total other income (expense)	(350)	(56)	(124)	1,827
Loss before income taxes	(57,823)	(6,272)	(63,611)	(11,900)
Income tax expense	115	90	273	145
Net loss	(57,938)	(6,362)	(63,884)	(12,045)
Net loss per share:				
Basic and diluted	\$ (0.56)	\$ (0.06)	\$ (0.62)	\$ (0.12)
Weighted average shares used in per share calculation:				
Basic and diluted	103,904	99,841	103,299	99,239

- (1) Cost of services excludes amortization related to intangibles, including existing technologies, and customer relationships, which are included in depreciation and amortization.

*The accompanying notes are an integral part of the consolidated financial statements.*

**LIMELIGHT NETWORKS, INC.**  
**Unaudited Consolidated Statements of Comprehensive Loss**  
**(In thousands)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net loss	\$ (57,938)	\$ (6,362)	\$ (63,884)	\$ (12,045)
Other comprehensive income (loss), net of tax:				
Unrealized (loss) gain on investments	—	(19)	—	42
Foreign exchange translation (loss) gain	(195)	1,020	464	(2,051)
Other comprehensive (loss) gain, net of tax	(195)	1,001	464	(2,009)
Comprehensive loss	\$ (58,133)	\$ (5,361)	\$ (63,420)	\$ (14,054)

*The accompanying notes are an integral part of the consolidated financial statements.*



**Limelight Networks, Inc.**  
**Unaudited Consolidated Statements of Cash Flows**  
(In thousands)

	<b>Six Months Ended June 30,</b>	
	<b>2016</b>	<b>2015</b>
<b>Operating activities</b>		
Net loss	\$ (63,884)	\$ (12,045)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	10,406	9,804
Share-based compensation	6,789	6,349
Provision for litigation	54,000	—
Foreign currency remeasurement loss (gain)	166	(1,595)
Deferred income taxes	14	(115)
Gain on sale of property and equipment	(134)	—
Accounts receivable (recoveries) charges	(33)	470
Amortization of premium on marketable securities	19	106
Realized loss on marketable securities	32	—
Changes in operating assets and liabilities:		
Accounts receivable	1,957	(9,292)
Prepaid expenses and other current assets	3,392	(202)
Income taxes receivable	38	11
Other assets	508	1,009
Accounts payable and other current liabilities	(2,439)	1,666
Deferred revenue	(461)	317
Income taxes payable	(55)	—
Other long term liabilities	(337)	(444)
Net cash provided by (used in) operating activities	<u>9,978</u>	<u>(3,961)</u>
<b>Investing activities</b>		
Purchases of marketable securities	—	(11,921)
Sale and maturities of marketable securities	28,315	11,760
Change in restricted cash	(62,790)	—
Purchases of property and equipment	(1,680)	(12,061)
Net cash used in investing activities	<u>(36,155)</u>	<u>(12,222)</u>
<b>Financing activities</b>		
Principal payments on capital lease obligations	(478)	(358)
Payments of employee tax withholdings related to restricted stock vesting	(944)	(1,944)
Cash paid for purchase of common stock	—	(957)
Proceeds from line of credit	12,790	—
Proceeds from employee stock plans	856	2,519
Net cash provided by (used in) financing activities	<u>12,224</u>	<u>(740)</u>
Effect of exchange rate changes on cash and cash equivalents	158	(342)
Net decrease in cash and cash equivalents	<u>(13,795)</u>	<u>(17,265)</u>
Cash and cash equivalents, beginning of period	44,680	57,767
Cash and cash equivalents, end of period	<u>\$ 30,885</u>	<u>\$ 40,502</u>
<b>Supplemental disclosure of cash flow information</b>		
Cash paid during the period for interest	<u>\$ 354</u>	<u>\$ 4</u>
Cash paid during the period for income taxes, net of refunds	<u>\$ 281</u>	<u>\$ 284</u>
Property and equipment acquired through capital leases	<u>\$ 2,659</u>	<u>\$ —</u>

*The accompanying notes are an integral part of the consolidated financial statements.*

**Limelight Networks, Inc.**  
**Notes to Unaudited Consolidated Financial Statements**  
**June 30, 2016**

**1. Nature of Business**

Limelight operates a globally distributed, high-performance network and provides a suite of integrated services marketed under the Orchestrate Platform which include content delivery, video content management, website and web application acceleration, website and content security, and cloud storage services.

We were incorporated in Delaware in 2003, and have operated in the Phoenix metropolitan area since 2001 and elsewhere throughout the United States since 2003. We began international operations in 2004.

**2. Summary of Significant Accounting Policies**

*Basis of Presentation*

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. They do not include all of the information and footnotes required by U.S. generally accepted accounting principles (U.S. GAAP) for complete financial statements. Such interim financial information is unaudited but reflects all adjustments that are, in the opinion of management, necessary for the fair presentation of the interim periods presented and 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, 2016, or for any future periods. This quarterly report on Form 10-Q should be read in conjunction with our audited financial statements and footnotes included in our annual report on Form 10-K for the fiscal year ended December 31, 2015. All information is presented in thousands, except per share amounts and where specifically noted.

The consolidated financial statements include accounts of Limelight and our wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated. In addition, certain other reclassifications have been made to prior year amounts to conform to the current year presentation.

*Use of Estimates*

The preparation of the consolidated financial statements and related disclosures in conformity with U.S. GAAP requires management to make judgments, assumptions, and estimates that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results and outcomes may differ from those estimates. 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, 2016, or for any other future periods.

*Recent Accounting Standards*

*Recently Issued Accounting Pronouncements*

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, which provides guidance for revenue recognition. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under today's guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In August 2015, the FASB issued ASU 2015-14, which defers the effective date of ASU 2014-09 for all entities by one year. Accordingly, public business entities should apply the guidance in ASU 2014-09 to annual reporting periods (including interim periods within those periods) beginning after December 15, 2017. Early adoption is permitted but not before annual periods beginning after December 15, 2016. The standard permits the use of the retrospective or the modified approach method. We have not yet selected a transition method, and are currently in the process of evaluating the impact of adoption of this ASU on our consolidated financial statements and disclosures.

In November 2015, the FASB issued ASU 2015-17, which will require entities to present deferred tax assets (DTAs) and deferred tax liabilities (DTLs) as noncurrent in a classified balance sheet. ASU 2015-17 simplifies the current guidance, which requires entities to separately present DTAs and DTLs as current and noncurrent in a classified balance sheet. ASU 2015-17 is effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. At this time we do not anticipate early adoption of this ASU, and we do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.



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In February 2016, the FASB issued ASU No. 2016-02, which establishes a right-of-use model that requires a lessee to record a right-of-use asset and a lease liability on the balance sheet for most leases. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within that reporting period. Early adoption is permitted and should be applied using a modified retrospective approach. We are in the process of evaluating the potential impacts of this new guidance on our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-08, which clarifies the implementation guidance on principal versus agent considerations. The guidance includes indicators to assist an entity in determining whether it controls a specified good or service before it is transferred to the customers. We are in the process of evaluating the potential impact that adopting this new accounting standard will have on our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-09, which updated guidance to include changes to simplify the accounting for several aspects of share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, accounting for forfeitures, and classification on the statement of cash flows. This guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is permitted. We are in the process of evaluating the timing of adoption and potential impacts of this new guidance on our consolidated financial statements.

### 3. Restricted Cash

We consider cash that is legally restricted and cash that is held as a compensating balance for letters of credit arrangements as restricted cash. As of June 30, 2016, restricted cash of \$62,790 represents collateral for the stand-by letter of credit for the previously estimated upper end of our range of potential loss in our intellectual property dispute with Akamai Technologies, Inc., or Akamai. Refer to Note 12 "Contingencies - Legal Matters" for further information, including developments subsequent to June 30, 2016.

### 4. Investments in Marketable Securities

During the quarter ended March 31, 2016, we sold the majority of our marketable securities.

The following is a summary of marketable securities, designated as available-for-sale, at June 30, 2016:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Certificate of deposits	\$ 40	\$ —	\$ —	\$ 40

The amortized cost and estimated fair value of marketable securities at June 30, 2016, by maturity, are shown below:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities				
Due in one year or less	\$ —	\$ —	\$ —	\$ —
Due after one year and through five years	40	—	—	40
	<u>\$ 40</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 40</u>

The following is a summary of marketable securities, designated as available-for-sale, at December 31, 2015:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Certificate of deposit	\$ 12,480	\$ 1	\$ 17	\$ 12,464
Corporate notes and bonds	15,940	2	44	15,898
Total marketable securities	<u>\$ 28,420</u>	<u>\$ 3</u>	<u>\$ 61</u>	<u>\$ 28,362</u>



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The amortized cost and estimated fair value of marketable securities at December 31, 2015, by maturity, are shown below:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
Available-for-sale securities				
Due in one year or less	\$ 18,075	\$ 2	\$ 12	\$ 18,065
Due after one year and through five years	10,345	1	49	10,297
	<u>\$ 28,420</u>	<u>\$ 3</u>	<u>\$ 61</u>	<u>\$ 28,362</u>

### 5. Accounts Receivable, net

Accounts receivable, net include:

	<u>June 30, 2016</u>	<u>December 31, 2015</u>
Accounts receivable	\$ 26,198	\$ 28,599
Less: credit allowance	(270)	(460)
Less: allowance for doubtful accounts	(1,056)	(1,344)
Total accounts receivable, net	<u>\$ 24,872</u>	<u>\$ 26,795</u>

### 6. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets include:

	<u>June 30, 2016</u>	<u>December 31, 2015</u>
Prepaid bandwidth and backbone	\$ 2,440	\$ 2,417
VAT receivable	1,046	2,720
Prepaid expenses and insurance	2,026	3,641
Vendor deposits and other	766	800
Total prepaid expenses and other current assets	<u>\$ 6,278</u>	<u>\$ 9,578</u>

### 7. Property and Equipment, net

Property and equipment, net include:

	<u>June 30, 2016</u>	<u>December 31, 2015</u>
Network equipment	\$ 119,670	\$ 129,172
Computer equipment and software	11,659	11,408
Furniture and fixtures	2,464	2,472
Leasehold improvements	5,006	4,976
Other equipment	169	166
Total property and equipment	138,968	148,194
Less: accumulated depreciation	(108,321)	(112,051)
Total property and equipment, net	<u>\$ 30,647</u>	<u>\$ 36,143</u>

Depreciation expense related to property and equipment classified in operating expense was \$620 and \$434 for the three months ended June 30, 2016 and 2015, respectively and was \$1,237 and \$877 for the six months ended June 30, 2016 and 2015, respectively.



## 8. Goodwill

We have recorded goodwill as a result of past business acquisitions. Goodwill is recorded when the purchase price paid for an acquisition exceeds the estimated fair value of the net identified tangible and intangible assets acquired. In each of our acquisitions, the objective of the acquisition was to expand our product offerings and customer base and to achieve synergies related to cross selling opportunities, all of which contributed to the recognition of goodwill.

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 concluded that we have one reporting unit and assigned the entire balance of goodwill to this reporting unit. The estimated 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 and/or unfavorable outcomes of intellectual property disputes;
- decline in overall market or economic conditions leading to a decline in our stock price; and
- decline in observed control premiums paid in business combinations involving comparable companies.

No interim indicators of impairment were identified as of June 30, 2016. Foreign currency translation adjustments decreased the carrying amount of goodwill for the three months ended June 30, 2016 by \$(128). For the six months ended June 30, 2016, foreign currency translation adjustments increased the carrying value of goodwill by \$99.

## 9. Other Current Liabilities

Other current liabilities include:

	June 30, 2016	December 31, 2015
Accrued compensation and benefits	\$ 4,033	\$ 4,786
Accrued cost of revenue	2,641	2,698
Deferred rent	712	782
Accrued legal fees	386	143
Other accrued expenses	2,619	2,448
Total other current liabilities	<u>\$ 10,391</u>	<u>\$ 10,857</u>

## 10. Line of Credit

On November 2, 2015, we entered into a Loan and Security Agreement (the Credit Agreement) with Silicon Valley Bank (SVB). The Credit Agreement provides for revolving credit borrowings up to a maximum principal amount of \$25,000. We are subject to a borrowing base calculation to determine the amount available to us. Our borrowing capacity is the lesser of the commitment amount or 80% of eligible accounts receivable. All outstanding borrowings owed under the Credit Agreement become due and payable no later than the final maturity date of November 2, 2017. We had no outstanding borrowings at December 31, 2015, and had availability under the Credit Agreement of approximately \$18,000. As of June 30, 2016, we had drawn \$12,790 against the line of credit and our remaining availability under the Credit Agreement was approximately \$5,400.

Borrowings under the Credit Agreement bear interest at our option of one, two, three or six-month LIBOR plus a margin of 2.75% or an Alternative Base Rate (ABR), which is defined as the higher of (a) Wall Street Journal prime rate or (b) Federal Funds Rate plus 0.50%, plus a margin of 0.50% or 1.50% depending on our minimum liquidity, as defined in the Credit Agreement. If we fall below a minimum liquidity of \$17,500, we are required to use the ABR interest rate. We incurred a commitment fee (issuance costs) of 0.25% upon entering into the Credit Agreement and 0.20% to be paid on the one year anniversary of closing. In addition, there is an unused line fee of 0.375% if our minimum liquidity is greater than \$17,500. If our minimum liquidity falls below \$17,500, the unused line fee is 0.250%. Commitment fees are included in prepaid expenses and other current assets and as amortized are charged to interest expense. During the three months ended June 30, 2016, interest expense was \$109 and commitment fees expense and amortization was \$114. During the six months ended June 30, 2016, interest expense was \$181 and commitment fees expense and amortization was \$140.



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Any borrowings are secured by essentially all of our domestic personal property, with a negative pledge on intellectual property. SVB's security interest in our foreign subsidiaries is limited to 65% of voting stock of each such foreign subsidiary.

The Credit Agreement contains a covenant that requires us to maintain a minimum tangible net worth of \$100,000. Tangible net worth is defined as total stockholders' equity less cash held by our foreign subsidiaries, goodwill and other intangible assets. The tangible net worth requirement is adjusted by up to \$52,500 upon recording a provision or making a payment related to the Akamai '703 Litigation. We are also subject to certain customary limitations on our ability to, among other things, incur debt, grant liens, make acquisitions and other investments, make certain restricted payments such as dividends, dispose of assets or undergo a change in control.

In addition, the Credit Agreement contains a covenant limiting the maximum unfinanced capital expenditures amount to \$25,000 per annum. As of June 30, 2016, we were in compliance with all covenants under the Credit Agreement.

Refer to Note 12 "Contingencies - Legal Matters" for further information, including developments subsequent to June 30, 2016.

### 11. Other Long Term Liabilities

Other long term liabilities include:

	June 30, 2016	December 31, 2015
Deferred rent	\$ 1,569	\$ 1,907
Income taxes payable	394	404
Total other long term liabilities	<u>\$ 1,963</u>	<u>\$ 2,311</u>

### 12. Contingencies

#### *Legal Matters*

##### *Akamai '703 Litigation*

In June 2006, Akamai Technologies, Inc. and the Massachusetts Institute of Technology filed a lawsuit against us in the United States District Court for the District of Massachusetts alleging that we were infringing multiple patents assigned to MIT and exclusively licensed by MIT to Akamai. In February 2008, a jury returned a verdict in this lawsuit, finding that we infringed four claims of U.S. Patent No. 6,108,703 (the '703 patent) and awarded Akamai damages of approximately \$45,500, which included lost profits, reasonable royalties and price erosion damages for the period April 2005 through December 31, 2007. On April 24, 2009, the court granted our motion for judgment as a matter of law, thus overturning the jury's verdict finding us liable for infringing the '703 patent.

On August 13, 2015, after more than six years of appeals by both Akamai and us in the Federal Circuit and the Supreme Court of the United States, the Federal Circuit issued an opinion establishing a new standard for direct infringement in a divided actor scenario. The Federal Circuit then reinstated the 2008 jury verdict that we were liable for infringement of the '703 patent and denied any remaining legacy appeals. The case was remanded back to the District Court for the District of Massachusetts (the District Court) on December 23, 2015, to resolve questions of supplemental damages, applicable interest on the existing damages award and entry of final judgment, among other things. At that time, Akamai sought entry of final judgment on the original jury award, an accounting of post-suit damages, damages for willful infringement and pre-judgment interest, which Akamai estimated to be approximately \$99,000 in the aggregate, and a permanent injunction against us.

After a series of motions filed by the parties in District Court, Akamai agreed to waive its right to supplemental damages, which limited the maximum potential damages for us to approximately \$62,790 plus future accruing interest (if any). We also petitioned review by the Supreme Court of the United States of the Federal Circuit's decision to reinstate the jury verdict. Our request for review was denied on April 18, 2016. Our motion seeking to challenge the validity of the '703 patent based on intervening changes in law was denied on April 25, 2016 by the District Court.

On July 1, 2016, the District Court entered final judgment in the case and reduced total damages payable by us to \$50,956, which is significantly less than the previously disclosed upper-end of range of loss of \$62,790. As a result, in July 2016, we have regained access to \$11,834 of availability under our line of credit.



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On August 1, 2016, we entered into a settlement and license agreement with Akamai with respect to the '703 and certain other related patents. The agreement settles all asserted and unasserted claims with respect to the licensed patents. The terms of the agreement require us to pay \$54,000 over twelve equal quarterly installments beginning on August 1, 2016. The settlement and license agreement requires Akamai to release us from the letter of credit promptly following its receipt of the initial license payment. In accordance with ASC 855, Subsequent Events, this is a recognized subsequent event. Accordingly, we have taken a charge in the quarter ended June 30, 2016 for the full, undiscounted amount of \$54,000, per our accounting policy.

Legal and other expenses associated with this case have been significant. We include these litigation expenses in general and administrative expenses as incurred, as reported in the consolidated statement of operations.

### *Akamai and XO Litigation*

On November 30, 2015, we filed a lawsuit against Akamai and XO Communications in the District Court for the Eastern District of Virginia alleging the infringement of six of our patents covering a broad range of inventions that we believe are critical to the effective and efficient delivery of bytes by a content delivery network (the Akamai and XO Litigation). In April 2016, the District Court denied a request for transfer by Akamai and XO Communications and set the trial date in this case for January 3, 2017. Akamai also filed counterclaims on April 29, 2016, alleging the infringement of five of its patents. We filed an answer to Akamai's counterclaims, denying each of the allegations of infringement on May 23, 2016. At this time, we do not believe a loss is probable nor reasonably possible, and as such, no provision for this lawsuit has been recorded in the consolidated financial statements. We intend to vigorously protect our intellectual property rights in this matter and vigorously defend against each of the counterclaims.

### *2016 Akamai Litigation*

On February 16, 2016, Akamai filed a complaint against us in the District Court for the District of Massachusetts alleging infringement of three of its patents (the 2016 Akamai Litigation). In April 2016, Akamai amended its complaint by withdrawing one of the asserted patents. We filed our answer to the complaint, denying each of the allegations of infringement, and asserting two counterclaims alleging infringement of two of our patents. At this time, we do not believe a loss is probable nor reasonably possible, and as such, no provision for this lawsuit has been recorded in the consolidated financial statements. We intend to vigorously defend against Akamai's claims and vigorously protect our intellectual property rights in this matter.

### *Other Matters*

We are 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 our business, financial position, results of operations, or cash flows. Litigation relating to the content delivery services industry is not uncommon, and we are, and from time to time have been, subject to such litigation. No assurances can be given with respect to the extent or outcome of any such litigation in the future.

### *Taxes*

We are 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 us conducting business online or providing Internet-related services. Increased regulation could negatively affect our business directly, as well as the businesses of our customers, which could reduce their demand for our services. For example, tax authorities in various states and abroad may impose taxes on the Internet-related revenue we generate based on regulations currently being applied to similar but not directly comparable industries.

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, we may come under audit, which could result in changes to our tax estimates. We believe we maintain adequate tax reserves to offset potential liabilities that may arise upon audit. Although we believe our 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

We calculate basic and diluted loss per weighted average share. We use the weighted-average number of shares of common stock outstanding during the period for the computation of basic earnings per share. Diluted earnings per share include the dilutive effect of all potentially dilutive common stock, including awards granted under our equity incentive compensation plans, in the weighted-average number of shares of common stock outstanding.

The following table sets forth the components used in the computation of basic and diluted net loss per share for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net loss	\$ (57,938)	\$ (6,362)	\$ (63,884)	\$ (12,045)
Basic and diluted weighted average outstanding shares of common stock	103,904	99,841	103,299	99,239
Basic and diluted net loss per share:	\$ (0.56)	\$ (0.06)	\$ (0.62)	\$ (0.12)

For the three and six months ended June 30, 2016 and 2015, the following potentially dilutive common stock, including awards granted under our equity incentive compensation plans, were excluded from the computation of diluted net loss per share because including them would have been anti-dilutive.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Employee stock purchase plan	205	66	205	66
Stock options	84	2,787	109	2,088
Restricted stock units	482	3,145	502	2,997
	771	5,998	816	5,151

### 14. Stockholders' Equity

#### *Common Stock*

On February 12, 2014, our board of directors authorized a \$15,000 share repurchase program. Under this program, we may repurchase shares periodically in the open market or through privately negotiated transactions, in accordance with applicable securities rules regarding issuer repurchases. We did not purchase any shares during the three and six month periods ended June 30, 2016. During the six months ended June 30, 2015, we purchased and canceled 293 shares for \$818, including commissions and expenses. All repurchased shares were canceled and returned to authorized but unissued status.

#### *Amended and Restated Equity Incentive Plan*

We established the 2007 Equity Incentive Plan, or the 2007 Plan, which allows for the grant of equity, including stock options and restricted stock unit awards. In June 2016, our stockholders approved the Amended and Restated Equity Incentive Plan, or the Restated 2007 Plan, which amended and restated the 2007 Plan. Approval of the Restated 2007 Plan replaced the terms and conditions of the 2007 Plan with the terms and conditions of the Restated 2007 Plan and extended the term of the plan to April 2026. There was no increase in the aggregate amount of shares available for issuance. The total number of shares authorized for issuance under the Restated 2007 Plan as of June 30, 2016 was 9,762.

#### *Employee Stock Purchase Plan*

In June 2013, our stockholders approved our 2013 Employee Stock Purchase Plan (ESPP). The ESPP allows participants to purchase our common stock at a 15% discount of the lower of the beginning or end of the offering period using the closing price on that day. During the three and six months ended June 30, 2016, we issued 719 shares under the ESPP. Total cash proceeds from the purchase of the shares under the ESPP was approximately \$813. As of June 30, 2016, shares reserved for issuance to employees under this plan totaled 1,923, and we held employee contributions of \$237 (included in other current liabilities) for future purchases under the ESPP.

#### *Preferred Stock*



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Our board of directors has authorized the issuance of up to 7,500 shares of preferred stock at June 30, 2016. The preferred stock may be issued in one or more series pursuant to a resolution or resolutions providing for such issuance duly adopted by the board of directors. As of June 30, 2016, the board of directors had not adopted any resolutions for the issuance of preferred stock.

### 15. Accumulated Other Comprehensive Loss

Changes in the components of accumulated other comprehensive loss, net of tax, for the six months ended June 30, 2016, was as follows:

	Foreign Currency	Unrealized Gains (Losses) on Available for Sale Securities	Total
Balance, December 31, 2015	\$ (10,768)	\$ (44)	\$ (10,812)
Other comprehensive income before reclassifications	464	—	464
Amounts reclassified from accumulated other comprehensive income (loss)	—	44	44
Net current period other comprehensive income	464	44	508
Balance, June 30, 2016	\$ (10,304)	\$ —	\$ (10,304)

### 16. Share-Based Compensation

The following table summarizes the components of share-based compensation expense included in our consolidated statement of operations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Share-based compensation expense by type:				
Stock options	\$ 960	\$ 1,031	\$ 1,943	\$ 2,213
Restricted stock units	2,108	2,157	4,468	3,970
ESPP	225	92	378	166
Total share-based compensation expense	\$ 3,293	\$ 3,280	\$ 6,789	\$ 6,349
Share-based compensation expense included in the consolidated statements of operations:				
Cost of services	\$ 436	\$ 571	\$ 909	\$ 1,084
General and administrative expense	1,677	1,476	3,503	2,882
Sales and marketing expense	638	608	1,375	1,297
Research and development expense	542	625	1,002	1,086
Total share-based compensation expense	\$ 3,293	\$ 3,280	\$ 6,789	\$ 6,349

Unrecognized share-based compensation expense totaled approximately \$18,500 at June 30, 2016, of which \$5,449 related to stock options and \$13,051 related to restricted stock units. We currently expect to recognize share-based compensation expense of \$5,771 during the remainder of 2016, \$8,204 in 2017 and the remainder thereafter based on scheduled vesting of the stock options and restricted stock units outstanding at June 30, 2016.

### 17. Leases and Commitments

#### *Operating Leases*

We are committed to various non-cancellable operating leases for office space and office equipment which expire through 2022. 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 June 30, 2016, are as follows:



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Remainder of 2016	\$	1,993
2017		3,260
2018		3,001
2019		1,488
2020		566
Thereafter		414
Total minimum payments	\$	<u>10,722</u>

### *Purchase Commitments*

We have long-term commitments for bandwidth usage and co-location with various networks and Internet service providers (ISPs). The following summarizes minimum commitments as of June 30, 2016:

Remainder of 2016	\$	18,465
2017		20,342
2018		9,875
2019		2,576
2020		51
Thereafter		23
Total minimum payments	\$	<u>51,332</u>

### *Capital Leases*

We lease equipment under capital lease agreements which extend through 2020. As of June 30, 2016, and December 31, 2015, the outstanding balance for capital leases was approximately \$4,127 and \$1,902, respectively. We have recorded assets under capital lease obligations of approximately \$4,588 and \$1,679, respectively, as of June 30, 2016 and December 31, 2015. Related accumulated amortization totaled approximately \$816 and \$210, respectively as of June 30, 2016 and December 31, 2015. The assets acquired under capital leases and related accumulated amortization are included in property and equipment, net in the consolidated balance sheets. The related amortization is included in depreciation - network (cost of revenue) and depreciation and amortization expense (operating expenses) in the consolidated statements of operations. Interest expense related to capital leases was approximately \$49 and \$0, respectively, for the three months ended June 30, 2016 and 2015. Interest expense related to capital leases was approximately \$84 and \$4, respectively, for the six months ended June 30, 2016 and 2015. Future minimum capital lease payments at June 30, 2016 were as follows:

Remainder of 2016	\$	493
2017		1,331
2018		1,331
2019		1,236
2020		193
Thereafter		—
Total		<u>4,584</u>
Amounts representing interest		(457)
Total minimum lease payments	\$	<u>4,127</u>

## **18. Concentrations**

During the three and six months ended June 30, 2016, we had one customer, Microsoft, who represented 10% or more of our total revenue. During the three and six months ended June 30, 2015, we had no customer who represented 10% or more of our total revenue.

Revenue from customers located within the United States, our country of domicile, was \$23,627 for the three months ended June 30, 2016, compared to \$25,661 for the three months ended June 30, 2015. For the six months ended June 30, 2016, revenue from customers located within the United States was \$46,037, compared to \$51,272 for the six months ended June 30, 2015.





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During the three and six months ended June 30, 2016 and 2015, we had two countries, based on customer location, the United States and Japan that accounted for 10% or more of our total revenues.

### 19. Income Taxes

Income taxes for the interim periods presented have been included in the accompanying consolidated financial statements on the basis of an estimated annual effective tax rate. Based on an estimated annual effective tax rate and discrete items, income tax expense for the three months ended June 30, 2016 and 2015, was \$115 and \$90, respectively. For the six months ended June 30, 2016 and 2015, income tax expense was \$273 and \$145, respectively. Income tax expense was different than the statutory income tax rate primarily due to us providing for a valuation allowance on deferred tax assets in certain jurisdictions, and the recording of state and foreign tax expense for the three month periods.

We file income tax returns in jurisdictions with varying statutes of limitations. Tax years 2013 through 2015 remain subject to examination by federal tax authorities. Tax years 2012 through 2015 generally remain subject to examination by state tax authorities. As of June 30, 2016, we are not under any federal or state examination for income taxes.

### 20. Segment Reporting and Geographic Areas

Our chief operating decision maker (whom is our Chief Executive Officer) reviews the financial information presented on a consolidated basis for purposes of allocating resources and evaluating our financial performance. We operate in one industry segment — content delivery and related services and we operate in three geographic areas — Americas, Europe, Middle East and Africa (EMEA) and Asia Pacific.

Revenue by geography is based on the location of the customer from which the revenue is earned. The following table sets forth our revenue by geographic area:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016		2015		2016		2015	
Americas	\$ 26,102	59.9%	\$ 26,968	61.6%	\$ 50,110	59.0%	\$ 54,228	63.0%
EMEA	7,476	17.2%	7,527	17.2%	16,388	19.2%	15,575	18.0%
Asia Pacific	9,982	22.9%	9,300	21.2%	18,484	21.8%	16,321	19.0%
Total revenue	\$ 43,560	100.0%	\$ 43,795	100.0%	\$ 84,982	100.0%	\$ 86,124	100.0%

The following table sets forth long-lived assets by geographic area in which the assets are located:

	June 30, 2016	December 31, 2015
Americas	\$ 17,578	\$ 19,692
International	13,071	16,466
Total long-lived assets	\$ 30,649	\$ 36,158

### 21. Fair Value Measurements

As of June 30, 2016, and December 31, 2015, we held certain assets and liabilities that were required to be measured at fair value on a recurring basis.

The following is a summary of fair value measurements at June 30, 2016:

Description	Total	Fair Value Measurements at Reporting Date Using		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds (2)	\$ 1	\$ 1	\$ —	\$ —
Certificate of deposit (1)	40	—	40	—
Total assets measured at fair value	\$ 41	\$ 1	\$ 40	\$ —



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

The following is a summary of fair value measurements at December 31, 2015:

Description	Total	Fair Value Measurements at Reporting Date Using		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds (2)	\$ 725	\$ 725	\$ —	\$ —
Corporate notes and bonds (1)	15,898	—	15,898	—
Certificate of deposit (1)	12,464	—	12,464	—
Total assets measured at fair value	<u>\$ 29,087</u>	<u>\$ 725</u>	<u>\$ 28,362</u>	<u>\$ —</u>

- 
- (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 approximates 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.

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### **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 together with our consolidated financial statements and related notes included in Part I, Item 1 of this Quarterly Report on Form 10-Q, as well as 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, 2015, included in Part II of our annual report on Form 10-K filed with the SEC, on February 11, 2016.*

*Prior period information has been modified to conform to current year presentation. All information in this Item 2 is presented in thousands, except per share amounts, customer count and where specifically noted.*

#### **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 network) and provide a suite of integrated services including content delivery services, video content management services, performance services for website and web application acceleration and security, and cloud storage services. The suite of services that we offer collectively comprise our Limelight Orchestrate Platform (the Orchestrate Platform)

We derive revenue primarily from the sale of components of the Orchestrate Platform. Our delivery services represented approximately 74% of our total revenue during the three and six months ended June 30, 2016. We also generate revenue through the sale of professional services and other infrastructure services, such as transit and rack space services.

We compete in markets that are highly competitive. We have experienced and expect to continue to experience increased competition in price, features, functionality, integration and other factors leading to customer churn and customers operating their own network. Competition and technology advancements have resulted in declining average selling prices in the industry. We believe continued increases in content delivery traffic growth rates is an important trend that will continue to outpace declining average selling prices in the industry.

For the three and six months ended June 30, 2016, we had one customer, Microsoft, who accounted for 10% or more of our total revenue. During the three and six months ended June 30, 2015, we had no customer who accounted for 10% or more of our total revenue. Changes in revenue are driven by a small subset of large customers who have low contractually committed obligations.

In addition to these revenue-related trends, our profitability is impacted by trends in our costs of services and operating expenses. We continue to work with our vendors to consolidate our datacenter footprint and renegotiate our fixed rate infrastructure contracts to variable rate in order to scale our operations based on traffic levels and lower bandwidth costs per unit. Our operating expenses are largely driven by payroll and related employee costs. Our headcount increased from 509 at December 31, 2015, to 512 as of June 30, 2016.

On August 1, 2016, we entered into a settlement and license agreement with Akamai with respect to the '703 and certain other related patents. The agreement settles all asserted and unasserted claims with respect to the licensed patents. The terms of the agreement require us to pay \$54,000 over twelve equal quarterly installments beginning on August 1, 2016. The settlement and license agreement requires Akamai to release us from the letter of credit promptly following its receipt of the initial license payment. In accordance with ASC 855, Subsequent Events, this is a recognized subsequent event. Accordingly, we have taken a charge in the quarter ended June 30, 2016 for the full, undiscounted amount of \$54,000, per our accounting policy.

Please see our discussion in Note 12 "Contingencies - Legal Matters" of the Notes to Consolidated Financial Statements included in Part I, of this quarterly report on Form 10-Q for more information on this and other lawsuits.

On November 2, 2015, we entered into a Loan and Security Agreement (the Credit Agreement) with Silicon Valley Bank (SVB). The Credit Agreement provides for revolving credit borrowings up to a maximum principal amount of \$25,000. This Credit Agreement will also provide additional liquidity as we continue to execute our growth strategy through innovative product development and select global market expansion.

Please see our discussion in Note 10 "Line of Credit" of the Notes to Consolidated Financial Statements included in Part I, of this quarterly report on Form 10-Q for more information on our line of credit.

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Based on current conditions, we expect revenue to grow in the single-digits year-over-year for the remainder of 2016. We expect gross margin improvement for the full year of over 250 basis points. We also expect non-GAAP net income to be between break-even and \$0.05 per share. We expect capital expenditures to be less than \$17,000 for the full year.

The following table summarizes our revenue, costs and expenses in thousands of dollars and as a percentage of total revenue.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016		2015		2016		2015	
Revenues	\$ 43,560	100.0 %	\$ 43,795	100.0 %	\$ 84,982	100.0 %	\$ 86,124	100.0 %
Cost of revenue	24,760	56.8 %	25,647	58.6 %	49,537	58.3 %	51,456	59.7 %
Gross profit	18,800	43.2 %	18,148	41.4 %	35,445	41.7 %	34,668	40.3 %
Operating expenses	22,273	51.1 %	24,364	55.6 %	44,932	52.9 %	48,395	56.2 %
Provision for litigation	54,000	124.0 %	—	— %	54,000	63.5 %	—	— %
Operating loss	(57,473)	(131.9)%	(6,216)	(14.2)%	(63,487)	(74.7)%	(13,727)	(15.9)%
Total other income (expense)	(350)	(0.8)%	(56)	(0.1)%	(124)	(0.1)%	1,827	2.1 %
Loss before income taxes	(57,823)	(132.7)%	(6,272)	(14.3)%	(63,611)	(74.9)%	(11,900)	(13.8)%
Income tax expense	115	0.3 %	90	0.2 %	273	0.3 %	145	0.2 %
Net loss	<u>(57,938)</u>	<u>(133.0)%</u>	<u>(6,362)</u>	<u>(14.5)%</u>	<u>(63,884)</u>	<u>(75.2)%</u>	<u>(12,045)</u>	<u>(14.0)%</u>

### Use of Non-GAAP Financial Measures

To evaluate our business, we consider and use non-generally accepted accounting principles (Non-GAAP) net income (loss), EBITDA and Adjusted EBITDA as supplemental measures 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. We define Non-GAAP net income (loss) to be U.S. GAAP net loss, adjusted to exclude provision for litigation, share-based compensation, litigation expenses, and amortization of intangible assets. We believe that EBITDA provides a useful metric to investors to compare us with other companies within our industry and across industries. We define EBITDA as U.S. GAAP net loss, adjusted to exclude interest and other (income) expense, interest expense, income tax expense, and depreciation and amortization. We define Adjusted EBITDA as EBITDA adjusted to exclude provision for litigation, share-based compensation and litigation expenses. We use Adjusted EBITDA as a supplemental measure to review and assess operating performance. Our management uses these Non-GAAP financial measures because, collectively, they provide valuable information on the performance of our on-going operations, excluding non-cash charges, taxes and non-core activities (including interest payments related to financing activities). These measures also enable our management to compare the results of our on-going operations from period to period, and allow management to review the performance of our on-going operations against our peer companies and against other companies in our industry and adjacent industries. We believe these measures also provide similar insights to investors, and enable investors to review our results of operations “through the eyes of management.”

Furthermore, our management uses these Non-GAAP financial measures to assist them in making decisions regarding our strategic priorities and areas for future investment and focus.

In our July 27, 2016, 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 U.S. GAAP, and are not measures of operating income, operating performance or liquidity presented in accordance with U.S. GAAP. Our Non-GAAP net income (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 loss or other consolidated income statement data prepared in accordance with U.S. GAAP. Some of these limitations include, but are not limited to:

- EBITDA and Adjusted EBITDA do not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments;
- these measures do not reflect changes in, or cash requirements for, our working capital needs;
- Non-GAAP net income (loss) and Adjusted EBITDA do not reflect the cash requirements necessary for litigation costs, including provision for litigation and litigation expenses;

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- these measures do not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debt that we may incur;
- these measures 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 Non-GAAP net income (loss), EBITDA and Adjusted EBITDA differently than we do, limiting their usefulness as comparative measures.

We compensate for these limitations by relying primarily on our U.S. GAAP results and using Non-GAAP net income (loss), EBITDA, 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 Item 10(e) of Regulation S-K, we are presenting the most directly comparable U.S. GAAP financial measures and reconciling the unaudited Non-GAAP financial metrics to the comparable U.S. GAAP measures.

#### Reconciliation of U.S. GAAP Net Loss to Non-GAAP Net Income (Loss) (Unaudited)

	Three Months Ended			Six Months Ended	
	June 30, 2016	March 31, 2016	June 30, 2015	June 30, 2016	June 30, 2015
U.S. GAAP net loss	\$ (57,938)	\$ (5,946)	\$ (6,362)	\$ (63,884)	\$ (12,045)
Provision for litigation	54,000	—	—	54,000	—
Share-based compensation	3,293	3,496	3,280	6,789	6,349
Litigation expenses	1,271	1,178	(1,174)	2,449	(1,155)
Amortization of intangible assets	6	6	201	12	399
Non-GAAP net income (loss)	<u>\$ 632</u>	<u>\$ (1,266)</u>	<u>\$ (4,055)</u>	<u>\$ (634)</u>	<u>\$ (6,452)</u>

#### Reconciliation of U.S. GAAP Net Loss to EBITDA to Adjusted EBITDA (Unaudited)

	Three Months Ended			Six Months Ended	
	June 30, 2016	March 31, 2016	June 30, 2015	June 30, 2016	June 30, 2015
U.S. GAAP net loss	\$ (57,938)	\$ (5,946)	\$ (6,362)	\$ (63,884)	\$ (12,045)
Depreciation and amortization	5,115	5,291	5,011	10,406	9,804
Interest expense	279	179	—	459	4
Interest and other (income) expense	71	(406)	56	(335)	(1,831)
Income tax expense	115	158	90	273	145
EBITDA	\$ (52,358)	\$ (724)	\$ (1,205)	\$ (53,081)	\$ (3,923)
Provision for litigation	54,000	—	—	54,000	—
Share-based compensation	3,293	3,496	3,280	6,789	6,349
Litigation expenses	1,271	1,178	(1,174)	2,449	(1,155)
Adjusted EBITDA	<u>\$ 6,206</u>	<u>\$ 3,950</u>	<u>\$ 901</u>	<u>\$ 10,157</u>	<u>\$ 1,271</u>

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### 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, 2015. During the six months ended June 30, 2016, there have been no significant changes in our critical accounting policies and estimates.

### Results of Operations

#### Revenue

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

The following table reflects our revenue for the three and six months ended June 30, 2016, compared to the three and six months ended June 30, 2015:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016		2015		2016		2015	
	\$	%	\$	%	\$	%	\$	%
Revenue	\$ 43,560	\$ 43,795	\$ (235)	(0.5)%	\$ 84,982	\$ 86,124	\$ (1,142)	(1.3)%

Our revenue decreased during the three and six months ended June 30, 2016, versus the comparable 2015 periods primarily due to a decrease in our content delivery revenue, which was driven by a decrease in our average selling price, partially offset by increases in volumes primarily with certain of our larger customers.

Our active customers worldwide decreased to 904 as of June 30, 2016, compared to 1,035 as of June 30, 2015. We are continuing our selective approach to accepting profitable business by following a clear process for identifying customers that value quality, performance, availability, and service.

During the three months ended June 30, 2016 and 2015, sales to our top 20 customers accounted for approximately 62% and 59%, respectively, of our total revenue. For the six months ended June 30, 2016 and 2015, sales to our top 20 customers accounted for approximately 61% and 57%, respectively, of our total revenue. The customers that comprised our top 20 customers change from time to time, and our large customers may not continue to be as significant going forward as they have been in the past.

During the three and six months ended June 30, 2016, we had one customer, Microsoft, that represented 10% or more of our total revenue. For the three and six months ended June 30, 2015, we had no customer who represented 10% or more of our total revenue.

Revenue by geography is based on the location of the customer from which the revenue is earned. The following table sets forth revenue by geographic area (in thousands and as a percentage of total revenue):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016		2015		2016		2015	
Americas	\$ 26,102	59.9%	\$ 26,968	61.6%	\$ 50,110	59.0%	\$ 54,228	63.0%
EMEA	7,476	17.2%	7,527	17.2%	16,388	19.2%	15,575	18.0%
Asia Pacific	9,982	22.9%	9,300	21.2%	18,484	21.8%	16,321	19.0%
Total revenue	\$ 43,560	100.0%	\$ 43,795	100.0%	\$ 84,982	100.0%	\$ 86,124	100.0%

#### Cost of Revenue

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 Internet service providers or 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 leased warehouse space and utilities, 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. Other costs include professional fees and outside services, travel and travel-related expenses and royalty expenses.

Cost of revenue was composed of the following (in thousands and as a percentage of total revenue):





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	Three Months Ended June 30,				Six Months Ended June 30,			
	2016		2015		2016		2015	
Bandwidth and co-location fees	\$ 14,316	32.9%	\$ 14,546	33.2%	\$ 28,695	33.8%	\$ 28,815	33.5%
Depreciation - network	4,489	10.3%	4,376	10.0%	9,157	10.8%	8,528	9.9%
Payroll and related employee costs	3,835	8.8%	4,525	10.3%	7,799	9.2%	9,598	11.1%
Share-based compensation	436	1.0%	571	1.3%	909	1.1%	1,084	1.3%
Other costs	1,684	3.9%	1,629	3.7%	2,977	3.5%	3,431	4.0%
Total cost of revenue	<u>\$ 24,760</u>	56.8%	<u>\$ 25,647</u>	58.6%	<u>\$ 49,537</u>	58.3%	<u>\$ 51,456</u>	59.7%

Our cost of revenue decreased in aggregate dollars and as a percentage of revenue for the three and six months ended June 30, 2016, versus the comparable 2015 period primarily as a result of the following:

- decreased payroll and related employee costs due to lower operations headcount and lower average salary per employee. Our year to date decrease includes the reduction of payroll and related employee costs resulting from the reorganization of job responsibilities on April 1, 2015 (as further discussed below);
- decreased bandwidth and co-location fees. Co-location fees decreased as a result of our continued consolidation efforts, however, this decrease was partially offset by an increase in bandwidth costs due to increased traffic volume; and
- decreased other costs (year to date) primarily due to lower travel, professional fees and facilities. Other costs, were up slightly in the three months ended June 30, 2016, due to an increase in other recurring cost of sales,

These decreases were partially offset by increased depreciation as a result of new servers and network equipment placed in service.

Effective April 1, 2015, we reorganized the job responsibilities of certain employees, and as a result, such employee expenses were moved from cost of services to research and development, on a prospective basis. This reorganization resulted in approximately \$650 of payroll and related employee costs starting in the second quarter of 2015 to be allocated to research and development, which were previously allocated to cost of services.

We anticipate an improvement in gross margin for the full year 2016 compared to 2015 as a result of our co-location consolidation efforts, despite an increase in our depreciation expense related to our network equipment. Depreciation expense is expected to increase due to the increase in capital expenditures in 2015 compared to prior periods.

### *General and Administrative*

General and administrative expense was composed of the following (in thousands and as a percentage of total revenue)

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016		2015		2016		2015	
Payroll and related employee costs	\$ 2,253	5.2%	\$ 2,752	6.3%	\$ 4,218	5.0%	\$ 5,712	6.6%
Professional fees and outside services	813	1.9%	1,475	3.4%	1,639	1.9%	2,480	2.9%
Share-based compensation	1,677	3.8%	1,476	3.4%	3,503	4.1%	2,882	3.3%
Other costs	2,498	5.7%	378	0.9%	4,689	5.5%	1,858	2.2%
Total general and administrative	<u>\$ 7,241</u>	16.6%	<u>\$ 6,081</u>	13.9%	<u>\$ 14,049</u>	16.5%	<u>\$ 12,932</u>	15.0%

Our general and administrative expense increased in aggregate dollars and increased as a percentage of total revenue for the three and six months ended June 30, 2016, versus the comparable 2015 periods. The increase was primarily due to increased share-based compensation, and an increase in other costs, which was driven by increased litigation expenses related to our intellectual property lawsuits. Additionally, during the three months ended June 30, 2015, negotiations with a vendor resulted in a reduction to litigation expense of \$1,200.

These increases were partially offset by decreased payroll and related employee costs, which was driven by lower general and administrative headcount and lower average salary per employee and decreased professional fees.

We expect our general and administrative expenses for 2016 to increase from 2015 in aggregate dollars as a result of

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litigation expenses.

### **Sales and Marketing**

Sales and marketing expense was composed of the following (in thousands and as a percentage of total revenue):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016		2015		2016		2015	
Payroll and related employee costs	\$ 5,553	12.7%	\$ 6,670	15.2%	\$ 11,750	13.8%	\$ 13,425	15.6%
Share-based compensation	638	1.5%	608	1.4%	1,375	1.6%	1,297	1.5%
Marketing programs	401	0.9%	501	1.1%	723	0.9%	974	1.1%
Other costs	1,525	3.5%	2,223	5.1%	3,172	3.7%	4,582	5.3%
Total sales and marketing	<u>\$ 8,117</u>	<u>18.6%</u>	<u>\$ 10,002</u>	<u>22.8%</u>	<u>\$ 17,020</u>	<u>20.0%</u>	<u>\$ 20,278</u>	<u>23.5%</u>

Our sales and marketing expense decreased in both aggregate dollars and as a percentage of total revenue for the three and six months ended June 30, 2016, versus the comparable 2015 periods. The decrease in sales and marketing expense was primarily as a result of the following:

- decreased payroll and related employee costs due to decreased sales and marketing personnel and lower variable compensation;
- decreased other costs which was primarily lower professional fees (consulting, recruiting, and outside services) and decreased travel and entertainment expenses; and
- decreased marketing and public relations spending related to advertising and trade shows.

These decreases were partially offset by increased share-based compensation costs.

We expect our sales and marketing expenses for the remainder of 2016 to remain consistent with the first half of 2016.

### **Research and Development**

Research and development expense was composed of the following (in thousands and as a percentage of total revenue):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016		2015		2016		2015	
Payroll and related employee costs	\$ 4,684	10.8%	\$ 5,640	12.9%	\$ 9,683	11.4%	\$ 10,460	12.1%
Share-based compensation	542	1.2%	625	1.4%	1,002	1.2%	1,086	1.3%
Other costs	1,063	2.4%	1,381	3.2%	1,929	2.3%	2,363	2.7%
Total research and development	<u>\$ 6,289</u>	<u>14.4%</u>	<u>\$ 7,646</u>	<u>17.5%</u>	<u>\$ 12,614</u>	<u>14.8%</u>	<u>\$ 13,909</u>	<u>16.1%</u>

Our research and development expense decreased in aggregate dollars and as a percentage of total revenue for the three and six months ended June 30, 2016, versus the comparable 2015 periods. The decrease was primarily due to decreased payroll and related employee costs due to decreased headcount and decreased other costs, which was driven by reduced travel and entertainment expenses and reduced professional fees, which were primarily consulting costs.

Effective April 1, 2015, we reorganized the job responsibilities of certain employees, and as a result, such employee expenses were moved from cost of services to research and development, on a prospective basis. This reorganization resulted in approximately \$650 of payroll and related employee costs starting in the second quarter of 2015 being allocated to research and development, which were previously allocated to cost of services.

We expect our research and development expenses for the remainder of 2016 to remain consistent with the first half of 2016.

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

Depreciation and amortization expense was \$626, or 1.4% of revenue, for the three months ended June 30, 2016, versus \$635, or 1.4% of revenue, for the comparable 2015 period. For the six months ended June 30, 2016, depreciation and

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amortization expense was \$1,249, or 1.5% of revenue versus \$1,276, or 1.5% of revenue, for the comparable 2015 period. Depreciation expense consists of depreciation on equipment and furnishings used by general administrative, sales and marketing, and research and development personnel. Amortization expense consists of amortization of intangible assets acquired in business combinations.

### *Interest Expense*

Interest expense was \$279 for the three months ended June 30, 2016, versus \$-0- for the comparable 2015 period. For the six months ended June 30, 2016 interest expense was \$459 versus \$4 for the comparable 2015 period. These increases were primarily due to interest on our line of credit borrowings, capital leases, fees and the amortization of fees associated with our Credit Agreement and stand-by letter of credit.

### *Interest Income*

Interest income was \$8 for the three months ended June 30, 2016, versus \$75 for the comparable 2015 period. For the six months ended June 30, 2016 interest income was \$14 versus \$149 for the comparable 2015 period. Interest income includes interest earned on invested cash balances and marketable securities.

### *Other Income (Expense)*

Other expense was \$79 for the three months ended June 30, 2016, versus other expense of \$131 for the comparable 2015 period. For the three months ended June 30, 2016, other expense consisted primarily of foreign currency transaction gains and losses and the gain on sale of fixed assets. For the three months ended June 30, 2015, other expense consisted primarily of foreign currency transaction losses, partially offset by the \$275 gain on the conversion of our convertible debt security into preferred shares.

For the six months ended June 30, 2016 other income was \$321 versus other income of \$1,682 for the comparable 2015 period. For the six months ended June 30, 2016, other income consisted primarily of foreign currency transaction gains and losses, the gain on sale of fixed assets, and the receipt of a state tax refund related to a previously divested business. For the six months ended June 30, 2015, other income consisted primarily of net foreign currency transaction gains and the \$275 gain on the conversion of our convertible debt into preferred shares.

### *Income Tax Expense*

Based on an estimated annual effective tax rate and discrete items, the estimated income tax expense for the three and six months ended June 30, 2016, was \$115 and \$273, respectively, versus \$90 and \$145 for the comparable 2015 periods. Income tax expense on our loss before income 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 and year to date periods. 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.

### *Liquidity and Capital Resources*

As of June 30, 2016, our cash, cash equivalents and marketable securities classified as current totaled \$30,885. Included in this amount is approximately \$5,005 of cash and cash equivalents held outside the United States. 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 purchases of property and equipment and 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, and available borrowing capacity 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.

The major components of changes in cash flows for the six months ended June 30, 2016 and 2015, are discussed in the following paragraphs.

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### *Operating Activities*

Net cash provided by operating activities was \$9,978 for the six months ended June 30, 2016, versus net cash used in operating activities of \$3,961 for the comparable 2015 period, an increase of \$13,939. Changes in operating assets and liabilities of \$2,603 during the six months ended June 30, 2016, versus (\$6,935) in the comparable 2015 period were primarily due to:

- accounts receivable decreased \$1,957 during the six months ended June 30, 2016, due to a decrease in days sales outstanding (DSO) as a result of timing of collections as compared to a \$9,292 increase in the comparable 2015 period;
- prepaid expenses and other current assets decreased \$3,392 during the six months ended June 30, 2016, due to the receipt of VAT refunds and the amortization of prepaid bandwidth expenses compared to a \$202 increase in the comparable 2015 period;
- other assets decreased \$508 during the six months ended June 30, 2016, due to a decrease in vendor deposits and other long term assets versus a decrease of \$1,009 for the comparable 2015 period; and
- accounts payable and other current liabilities decreased \$2,439 during the six months ended June 30, 2016 versus an increase of \$1,666 for the comparable 2015 period due to timing of vendor payments and the payment of 2015 accrued compensation.

Cash provided by operating activities may not be sufficient to cover new purchases of property and equipment during 2016 and potential litigation expenses associated with patent litigation, including any potential payment required on the ultimate outcomes of the associated 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*

Net cash used in investing activities was \$36,155 for the six months ended June 30, 2016, versus net cash used in investing activities of \$12,222 for the comparable 2015 period. During the six months ended June 30, 2016, we liquidated our investments in marketable securities in order to provide collateral for the stand-by letter of credit for the previously estimated upper end of our range of potential loss in our intellectual property dispute with Akamai. Refer to Note 12 "Contingencies - Legal Matters" of the Notes to Consolidated Financial Statements included in Part I for further information.

We expect to have ongoing capital expenditure requirements as we continue to invest in and expand our content delivery network. During the six months ended June 30, 2016, we made capital expenditures of \$1,680, which represented approximately 2% of our total revenue. We currently expect a decrease in capital expenditures in 2016 compared to 2015, as we believe technological enhancements in our software will provide increased capacity in our global network and systems. We will continue to utilize our vendor financing to acquire capital assets throughout the remainder of the year.

### *Financing Activities*

Net cash provided by financing activities was \$12,224 for the six months ended June 30, 2016, versus net cash used in financing activities of \$740 for the comparable 2015 period. Net cash provided by financing activities in the six months ended June 30, 2016, primarily relates to proceeds from borrowings against our line of credit of \$12,790, and cash received from the exercise of stock options and our employee stock purchase plan of \$856, offset by payments of employee tax withholdings related to the net settlement of vested restricted stock units of \$944 and principal payments made on our capital lease obligations of \$478.

Net cash used in financing activities in the six months ended June 30, 2015, related to payments of employee tax withholdings related to the net settlement of vested restricted stock units of \$1,944, cash paid for the repurchase of our common stock of \$957, and payments made on our capital lease obligations of \$358, offset by cash received from the exercise of stock options and our employee stock plan of \$2,519.

### *Line of Credit*

On November 2, 2015, we entered into a Credit Agreement with SVB. The Credit Agreement provides for revolving credit borrowings up to a maximum principal amount of \$25,000. As of June 30, 2016, we have outstanding borrowings against the line of credit of \$12,790. All outstanding borrowings owed under the Credit Agreement become due and payable no later than the final maturity date of November 2, 2017. For a more detailed discussion regarding our Credit Agreement, please

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refer to Note 10 "Line of Credit" of the Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

### ***Financial Covenants and Borrowing Limitations***

The Credit Agreement requires, and any future credit facilities will likely require, us to comply with specified financial requirements that may limit the amount we can borrow. A breach of any of these covenants could result in a default. Our ability to satisfy those covenants depends principally upon our ability to meet or exceed certain financial performance results. Any debt agreements we enter into in the future may further limit our ability to enter into certain types of transactions.

The Credit Agreement contains a covenant that requires us to maintain a minimum tangible net worth of \$100,000. Tangible net worth is defined as total shareholders' equity less cash held by our foreign subsidiaries, goodwill and other intangible assets. The tangible net worth requirement is adjusted by up to \$52,500 upon recording a provision or making a payment related to the Akamai '703 Litigation. We are also subject to certain customary limitations on our ability to, among other things, incur debt, grant liens, make acquisitions and other investments, make certain restricted payments such as dividends, dispose of assets or undergo a change in control. The tangible net worth covenant could have the effect of limiting our availability under the Credit Agreement, as additional borrowings would be prohibited if we would be in violation of such covenant. In addition, we have a maximum unfinanced capital expenditures amount of \$25,000 per annum. As of June 30, 2016, we remained in compliance with our debt covenants.

The maximum amount we can borrow under the Credit Agreement is subject to contractual and borrowing base limitations, which could significantly and negatively impact our future access to capital required to operate our business. Borrowing base limitations are based upon eligible accounts receivable. If the value of our accounts receivable decreases for any reason, or if some portion of our accounts receivable is deemed ineligible under the terms of the Credit Agreement, the amount we can borrow under the Credit Agreement could be reduced. These limitations could have a material adverse impact on our liquidity and financial condition. We had no outstanding borrowings at December 31, 2015, and had availability under the Credit Agreement of approximately \$18,000. As of June 30, 2016, we had borrowed \$12,790, and our remaining availability under the Credit Agreement was approximately \$5,400.

We may also be prevented from taking advantage of business opportunities that arise because of the limitations imposed on us by restrictive covenants within the Credit Agreement. These restrictions may also limit our ability to plan for or react to market conditions, meet capital needs or otherwise restrict our activities or business plans and adversely affect our ability to finance our operations, enter into acquisitions, execute our business strategy, effectively compete with companies that are not similarly restricted or engage in other business activities that would be in our interest. In the future, we may also incur debt obligations that might subject us to additional and different restrictive covenants that could affect our financial and operational flexibility. We cannot assure you that we will be granted waivers or amendments to the indenture governing the Credit Agreement, or such other debt obligations if for any reason we are unable to comply with our obligations thereunder or that we will be able to refinance our debt on acceptable terms, or at all, should we seek to do so. Any such limitations on borrowing under the Credit Agreement, including a payment related to the Akamai '703 Litigation toward the previously estimated upper end or in excess of the range of loss, could have a material adverse impact on our liquidity and our ability to continue as a going concern could be impaired.

On July 1, 2016, the District Court entered final judgment in the case and reduced total damages payable by us to \$50,956, which is significantly less than the previously disclosed upper-end of range of loss of \$62,790. As a result, in July 2016, we have regained access to \$11,834 of availability under our line of credit.

On August 1, 2016, we entered into a settlement and license agreement with Akamai with respect to the '703 and certain other related patents. The agreement settles all asserted and unasserted claims with respect to the licensed patents. The terms of the agreement require us to pay \$54,000 over twelve equal quarterly installments beginning on August 1, 2016. The settlement and license agreement requires Akamai to release us from the letter of credit promptly following its receipt of the initial license payment. In accordance with ASC 855, Subsequent Events, this is a recognized subsequent event. Accordingly, we have taken a charge in the quarter ended June 30, 2016 for the full, undiscounted amount of \$54,000, per our accounting policy.

### ***Capital leases***

In October 2015, we entered into a \$10,000 equipment financing arrangement. The arrangement allows us to finance equipment purchases over a period of 4 years at variable interest rates. As of June 30, 2016, our blended interest rate on our capital leases was 5.83%. As of June 30, 2016, and December 31, 2015, we have approximately \$4,127 and \$1,902 in capital leases outstanding.



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### *Share repurchases*

On February 12, 2014, our board of directors authorized a \$15,000 share repurchase program. During the three months ended March 31, 2015, we purchased and canceled approximately 293 shares. All repurchased shares were canceled and returned to authorized but unissued status. During the six months ended June 30, 2016, we did not purchase any shares. As of June 30, 2016, we have \$9,525 remaining under this share repurchase authorization.

### **Contractual Obligations, Contingent Liabilities, and Commercial Commitments**

In the normal course of business, we make certain long-term commitments for operating leases, primarily office facilities, bandwidth, and computer rack space. These leases expire on various dates ranging from 2016 to 2022. We expect that the growth of our business will require us to continue to add to and increase our long-term commitments in 2016 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 June 30, 2016, over the next five years and thereafter:

	Payments Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating Leases					
Bandwidth leases	\$ 25,057	\$ 17,538	\$ 7,412	\$ 81	\$ 26
Rack space leases	26,155	13,169	12,767	216	3
Real estate leases	10,722	3,690	5,598	1,235	199
Total operating leases	61,934	34,397	25,777	1,532	228
Capital leases	4,584	1,158	2,662	764	—
Bank debt (1)	12,790	—	12,790	—	—
Interest on bank debt (2)	557	415	142	—	—
Settlement agreement	54,000	18,000	36,000	—	—
Other purchase obligations	120	120	—	—	—
Total commitments	<u>\$ 133,985</u>	<u>\$ 54,090</u>	<u>\$ 77,371</u>	<u>\$ 2,296</u>	<u>\$ 228</u>

1. Please refer to Note 10 "Line of Credit" of the Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional information about our bank debt.

2. Amounts represent estimate of future interest payments on our bank debt using the interest rate in effect at June 30, 2016.

### **Off Balance Sheet Arrangements**

As of June 30, 2016, we are not involved in any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

### **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 variable interest rates and are impacted by fluctuations in interest rates. We do not believe that an interest rate increase related to our capital leases would be material to our results of operations. Interest expense on our line of credit will fluctuate as the interest rate for the line of credit floats based, at our option of one, two, three or six-month LIBOR plus a margin of 2.75% or an Alternative Base Rate (ABR), which is defined as the higher of (a) Wall Street Journal prime rate or (b) Federal Funds Rate plus 0.50%, plus a margin of 0.50% or 1.50% depending on our minimum liquidity, as defined in the Agreement. If we fall below a minimum liquidity of \$17,500, we are required to use the ABR interest rate. An increase in interest rates of 100 basis points would add \$10 of interest expense per year, to our

financial position or results of operations,

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for each \$1,000 drawn on the line of credit. As of June 30, 2016, there was \$12,790 in outstanding borrowings against the line of credit.

### ***Foreign Currency Risk***

We operate in the Americas, EMEA and Asia-Pacific. 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 our 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. Assuming a 10% weakening of the U.S. dollar relative to our foreign currency denominated revenues and expenses, our net loss for the year ended December 31, 2015, and the six months ended June 30, 2016, would have been higher by approximately \$2,979 and \$1,157, 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.

### ***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.

### ***Credit Risk***

During any given fiscal period, a relatively small number of customers typically account for a significant percentage of our revenue. During the three months ended June 30, 2016 and 2015, sales to our top 20 customers accounted for approximately 62% and 59%, respectively, of our total revenue. During the three months ended June 30, 2016, we had one customer, Microsoft, who represented 10% or more of our total revenue. During the three months ended June 30, 2015, we had no customer who represented 10% or more of our total revenue.

For the six months ended June 30, 2016 and 2015, sales to our top 20 customers accounted for approximately 61% and 57%, respectively, of our total revenue. During the six months ended June 30, 2016, we had one customer, Microsoft, who represented 10% or more of our total revenue. During the six months ended June 30, 2015, we had no customer who represented 10% or more of our total revenue. In 2016, we anticipate that our top 20 customer concentration levels will remain consistent with the concentration levels from 2015. In the past, the customers that comprised our top 20 customers have continually changed, and our large customers may not continue to be as significant going forward as they have been in the past.

## **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 Rules 13a-15(e) and 15d-15(e). We maintain disclosure controls and procedures, as such term is defined in SEC Rules 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 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 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 June 30, 2016. Based on the foregoing, our Chief Executive

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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 SEC Rules 13a-15(f) and 15d-15(f), during the fiscal quarter ended June 30, 2016, 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*

For a description of our material pending legal proceedings, please refer to Note 12 "Contingencies - Legal Matters" of the Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

#### Item 1A. *Risk Factors*

*Investing in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below, together with all of the other information in this Quarterly Report on Form 10-Q, including the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part I, Item II, and our consolidated financial statements and related notes, before making a decision to invest in our common stock. The risks and uncertainties described below may not be the only ones we face. If any of the risks actually occur, our business, financial condition, operating results and prospects could be materially and adversely affected. In that event, the market price of our common stock could decline, and you could lose part or all of your investment. All information is presented in thousands, except per share amounts, customer count, head count and where specifically noted.*

#### **Risks Related to Our Business**

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

We compete in markets that are intensely competitive, rapidly changing and characterized by frequently declining prices. In these markets, vendors offer a wide range of alternate solutions. We have experienced and expect to continue to experience increased competition on price, features, functionality, integration and other factors. Several of our current competitors, as well as a number of our potential competitors, have longer operating histories, greater name recognition, broader customer relationships and industry alliances, and substantially greater financial, technical and marketing resources than we do. As a consequence of the competitive dynamics in our markets, we have experienced reductions in our prices, and an increased requirement for product advancement and innovation in order to remain competitive, which in turn have adversely affected and may continue to adversely affect our revenue, gross margin and operating results.

Our primary competitors for the content delivery service offering of our Orchestrate Platform include Akamai, Level 3, Amazon, CDNetworks, and Verizon Digital Media Services. In addition, a number of companies have recently entered or are currently attempting to enter our market, either directly or indirectly, as a result of the growth in the content delivery market. Some of these new entrants may become significant competitors in the future. Given the relative ease by which customers typically can switch among content delivery service providers, differentiated offerings or pricing by competitors could lead to a rapid loss of customers. Some of our current or potential competitors may bundle their offerings with other services, software or hardware in a manner that may discourage content providers from purchasing the services that we offer. In addition, we face different market characteristics and competition with local content delivery service providers as we expand internationally. Many of these international competitors are very well positioned within their local markets. Increased competition could result in price reductions and revenue shortfalls, loss of customers and loss of market share, which could harm our business, financial condition and results of operations.

We face different competitors for the other service offerings of our Orchestrate Platform. However, the competitive landscape is different from content delivery in this area in that the process of changing vendors can be more costly and complicated for the customer, which could make it difficult for us to attract new customers and increase our market share.

Several of our competitors have greater financial and sales resources than we do. Many have been offering similar services in the markets in which we compete longer than we have. We may not be able to successfully compete against these or new competitors. If we are unable to increase our customer base and increase our market share, our business, financial condition and results of operations may suffer.

**Any unplanned interruption or degradation in the functioning or availability of our network or services, or attacks on or disruptions to our internal information technology systems, could lead to increased costs, a significant decline in our revenue and harm to our reputation.**

Our business is dependent on providing our customers with fast, efficient, and reliable distribution of content delivery and digital asset management services over the Internet every minute of every day. Many of our customers depend primarily or exclusively on our services to operate their businesses. Consequently, any disruption, or substantial and extensive degradation,

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of our services could have a material impact on our customers' businesses. Our network or services could be disrupted by numerous events, including natural disasters, failure or refusal of our third-party network providers to provide the necessary capacity or access, failure of our software or global network infrastructure and power losses. In addition, we deploy our servers in third-party co-location facilities, and these third-party co-location providers could experience system outages or other disruptions that could constrain our ability to deliver our services. We may also experience disruptions caused by software viruses, unauthorized hacking of our systems, security breaches or other cyberattacks by unauthorized users. Any hacking of our systems or other cyberattacks could lead to the unauthorized release of confidential information that could damage our customers' business and reputation, as well as our own. The economic costs to us to eliminate or alleviate cyber or other security problems, viruses, worms, malicious software programs, and other security vulnerabilities could be significant, and our efforts to address these problems may not be successful and could result in interruptions, delays, cessation of service, and loss of existing or potential customers. In addition, our release of a security-related solution may increase our visibility as a security-focused company and make us a more attractive target for attacks on our infrastructure intended to steal information about our technology, financial data, or customer information or take other actions that would be damaging to our customers and us.

We could experience a significant, unplanned disruption, or substantial and extensive degradation of our services, or our network may fail in the future. Despite our significant infrastructure investments, we may have insufficient communications and server capacity to address these or other disruptions, which could result in interruptions in our services. Any widespread interruption or substantial and extensive degradation in the functioning of our Orchestrate Platform services for any reason would reduce our revenue and could harm our business and results of operations. If such a widespread interruption occurred, or if we failed to deliver content to users as expected during a high-profile media event, game release or other well-publicized circumstance, our reputation could be damaged severely. Moreover, any disruptions, significant degradation, cybersecurity threats, security breaches, or attacks on our internal information technology systems could undermine confidence in our services and cause us to lose customers or make it more difficult to attract new ones, either of which could harm our business and results of operations.

### **We have a history of losses and we may not achieve or maintain profitability in the future.**

Since 2006, we have been profitable only one year, which was as a result of a reversal of a significant reserve for litigation. We incur significant share-based compensation expense, which has substantial impact on our results of operations. We have also incurred, and may continue to incur, significant costs associated with litigation. Our share-based compensation expense and any material ongoing litigation costs could adversely affect our ability to achieve and maintain profitability in the future.

We also may not achieve sufficient revenue to achieve or maintain profitability and thus may continue to incur significant losses in the future for a number of reasons, including, among others:

- slowing demand for our services,
- increasing competition and competitive pricing pressures,
- any inability to provide our services in a cost-effective manner,
- the incurrence of unforeseen expenses, difficulties, complications and delays, and
- other risks described in this quarterly report on Form 10-Q.

If we fail to achieve and maintain profitability, the price of our common stock could decline, and our business, financial condition and results of operations could suffer.

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

Prices for content delivery services have fallen in recent years and are likely to fall further in the future. We have invested significant amounts in purchasing capital equipment to increase the capacity of our global content delivery network. Our investments in our infrastructure are based upon our assumptions regarding future demand, as well as prices that we will be able to charge for our services. These assumptions may prove to be wrong. If the price that we are able to charge customers to deliver their content falls to a greater extent than we anticipate, if we overestimate future demand for our services, or if our costs to deliver our services do not fall commensurate with any future price declines, we may not be able to achieve acceptable rates of return on our infrastructure investments, and our gross profit and results of operations may suffer dramatically.

As we further expand our global network and the Orchestrate Platform, and as we refresh our network equipment, we are dependent on significant future growth in demand for our services to justify additional capital expenditures. If we fail to generate significant additional demand for our services, our results of operations will suffer, and we may fail to achieve planned or expected financial results. There are numerous factors that could, alone or in combination with other factors, impede our ability to increase revenue, moderate expenses or maintain gross margins, including:



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- continued price declines arising from significant competition;
- increasing settlement fees for certain peering relationships;
- failure to increase sales of our Orchestrate Platform services;
- increases in electricity, bandwidth and rack space costs or other operating expenses, and failure to achieve decreases in these costs and expenses relative to decreases in the prices we can charge for our Orchestrate Platform services and products;
- failure of our current and planned services and software to operate as expected;
- loss of any significant customers or loss of existing customers at a rate greater than our increase in new customers or our sales to existing customers;
- failure to increase sales of our Orchestrate Platform services to current customers as a result of their ability to reduce their monthly usage of our services to their minimum monthly contractual commitment;
- failure of a significant number of customers to pay our fees on a timely basis or at all or to continue to purchase our Orchestrate Platform services in accordance with their contractual commitments; and
- inability to attract high quality customers to purchase and implement our current and planned services.

A significant portion of our revenue is derived collectively from our video content management services, performance services for website and web application acceleration, and cloud storage services. These services tend to have higher gross margins than our content delivery services. We do not have a long history of offering these services, and we may not be able to achieve the growth rates in revenue from such services that we or our investors expect or have experienced in the past. If we are unable to achieve the growth rates in revenue that we expect for these service offerings, our revenue and operating results could be significantly and negatively affected.

### **Our involvement in litigation may have a material adverse effect on our financial condition and operations.**

We are currently involved in multiple intellectual property lawsuits (see discussion of such lawsuits in Note 12 "Contingencies - Legal Matters" of the Notes to Consolidated Financial Statements included in Part I, Item 1 of this quarterly report on Form 10-Q).

The outcome of all litigation, including intellectual property litigation, is inherently unpredictable. If we are ultimately held liable for patent infringement in the Akamai and XO Litigation, it could seriously impact our ability to conduct our business and to offer our products and services to our customers. For example, a permanent injunction could prevent us from providing our content delivery services or from delivering certain types of traffic, which could impact the viability of those portions of our business. Similarly, if we are ultimately held liable for patent infringement in the 2016 Akamai Litigation, one or more of our products and services could be adversely affected. Any such finding of infringement in either case could also harm our revenue, expenses, market share, reputation, liquidity and overall financial position. If we are unsuccessful in the Akamai and XO Litigation, which alleges that both of those companies infringed six of our patents that we believe are critical to the effective and efficient delivery of bytes by a content delivery network, our rights to enforce the intellectual property asserted by us may be impaired or we could lose some or all of our rights to such intellectual property. Similarly, if we are unsuccessful with our counterclaims of patent infringement in the 2016 Akamai Litigation, our rights to enforce the intellectual property asserted by us in that case may be impaired or we could lose some or all of our rights to such intellectual property.

We are from time to time party to other lawsuits in addition to that described above. The expenses of defending these lawsuits, particularly fees paid to our lawyers and expert consultants, have been significant to date. If the cost of prosecuting or defending current or future lawsuits continues to be significant, it may continue to adversely affect our operating results during the pendency of such lawsuits. Lawsuits also require a diversion of management and technical personnel time and attention away from other activities to pursue the defense or prosecution of such matters. In addition, adverse rulings in such lawsuits either alone or cumulatively may have an adverse impact on our revenue, expenses, market share, reputation, liquidity and financial condition.

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

We may need to obtain funding due to a number of factors, including a shortfall in revenue, increased expenses, final adverse judgments in litigation matters, increased investment in capital equipment or the acquisition of significant businesses or technologies. We believe that our cash, cash equivalents and marketable securities classified as current plus cash from operations will be sufficient to fund our operations and proposed capital expenditures for at least the next 12 months. However, we may need or desire funding before such time. If we do need to obtain funding, it may not be available on commercially reasonable terms or at all. If we are unable to obtain sufficient funding, our business would be harmed. Even if we were able to find outside funding sources, we might be required to issue securities in a transaction that could be highly dilutive to our investors or we may be required to issue securities with greater rights than the securities we have outstanding today. We might also be required to take other actions that could lessen the value of our common stock, including borrowing money on terms



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that are not favorable to us. If we are unable to generate or raise capital that is sufficient to fund our operations, we may be required to curtail operations, reduce our capabilities or cease operations in certain jurisdictions or completely.

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

Our content delivery and other Orchestrate Platform services are highly complex and are designed to be deployed in and across numerous large and complex networks. Our global network infrastructure has to perform well and be reliable for us to be successful. The greater the user traffic and the greater the complexity of our solutions and services, the more resources we will need to invest in additional infrastructure and support. Further, as a result of the '703 Litigation, we made significant investment in designing and implementing changes to our network architecture in order to implement our content delivery services in a manner we believe does not infringe the claims of Akamai's '703 patent as alleged in the February 2008 trial. We have spent and expect to continue to spend substantial amounts on the purchase and lease of equipment and data centers and the upgrade of our technology and network infrastructure to handle increased traffic over our network, implement changes to our network architecture and integrate existing solutions and to roll out new solutions and services. This expansion is expensive and complex and could result in inefficiencies, operational failures or defects in our network and related software. If we do not implement such changes or expand successfully, or if we experience inefficiencies and operational failures, the quality of our solutions and services and user experience could decline. From time to time, we have needed to correct errors and defects in our software or in other aspects of our network. In the future, there may be additional errors and defects that may harm our ability to deliver our services, including errors and defects originating with third party networks or software on which we rely. These occurrences could damage our reputation and lead to the loss of current and potential customers, which would harm our operating results and financial condition. We must continuously upgrade our infrastructure in order to keep pace with our customers' evolving demands. Cost increases or the failure to accommodate increased traffic or these evolving business demands without disruption could harm our operating results and financial condition.

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

The market for our Orchestrate Platform services is characterized by rapidly changing technology, evolving industry standards, and new product and service introductions. Our operating results depend on our ability to understand user preferences or predict industry changes. Our operating results also depend on our ability to modify our solutions and services on a timely basis or develop and introduce new services into existing and emerging markets. The process of developing new technologies is complex and uncertain. We must commit significant resources to developing new services or enhancements to our existing services before knowing whether our investments will result in services the market will accept. Furthermore, we may not successfully execute our technology initiatives because of errors in planning or timing, technical hurdles that we fail to overcome in a timely fashion, misunderstandings about market demand or a lack of appropriate resources. As prices for content delivery services fall, we will increasingly rely on new product offerings and other Orchestrate Platform service offerings to maintain or increase our gross margins. Failures in execution, delays in bringing new or improved products or services to market, failure to effectively integrate service offerings, or market acceptance of new services we introduce could result in competitors providing those solutions before we do, which could lead to loss of market share, revenue and earnings.

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

During any given fiscal period, a relatively small number of customers typically account for a significant percentage of our revenue. For the six months ended June 30, 2016, sales to our top 20 customers accounted for approximately 61% of our total revenue. During the six months ended June 30, 2016, we had one customer, Microsoft, who represented 10% or more of our total revenue.

In the past, the customers that comprised our top 20 customers have continually changed, and we also have experienced significant fluctuations in our individual customers' usage of, or decreased usage of, our services. As a consequence, we may not be able to adjust our expenses in the short term to address the unanticipated loss of a large customer during any particular period. As such, we may experience significant, unanticipated fluctuations in our operating results that may cause us to not meet our expectations or those of stock market analysts, which could cause our stock price to decline.

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

Customers, potential customers or third parties may develop technological or business model innovations that address digital delivery requirements in a manner that is, or is perceived to be, equivalent or superior to our Orchestrate Platform



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service offerings. This is particularly true as our customers increase their operations and begin expending greater resources on delivering their content using third party solutions. If we fail to offer content delivery, video content management and other related services that are competitive to in-sourced solutions, we may lose additional customers or fail to attract customers that may consider pursuing this in-sourced approach, and our business and financial results would suffer.

If competitors introduce new products or services that compete with or surpass the quality or the price or performance of our services, we may be unable to renew our agreements with existing customers or attract new customers at the prices and levels that allow us to generate attractive rates of return on our investment. We may not anticipate such developments and may be unable to adequately compete with these potential solutions. In addition, our customers' business models may change in ways that we do not anticipate, and these changes could reduce or eliminate our customers' needs for our services. If this occurred, we could lose customers or potential customers, and our business and financial results would suffer.

As a result of these or similar potential developments, it is possible that competitive dynamics in our market may require us to reduce our prices faster than we anticipate, which could harm our revenue, gross margin and operating results.

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

Increasing our customer base and achieving broader market acceptance of our services will depend to a significant extent on our ability to enhance our sales and marketing operations. We have a concentration of our sales force at our headquarters in Tempe, Arizona, but we also have a widely deployed field sales force. We have aligned our sales resources to improve our sales productivity and efficiency and to bring our sales personnel closer to our current and potential customers. Adjustments to our sales force have been and will continue to be expensive and could cause some near-term productivity impairments. As a result, we may not be successful in improving the productivity and efficiency of our sales force, which could cause our results of operations to suffer.

We believe that there is significant competition for both inside and direct sales personnel with the sales skills and technical knowledge that we require. Our ability to achieve significant growth in revenue in the future will depend, in large part, on our success in recruiting, training and retaining sufficient numbers of inside and direct sales personnel. New hires require significant training and, in most cases, take a significant period of time before they achieve full productivity. Our recent hires and planned hires may not become as productive as we would like, and we may be unable to hire or retain sufficient numbers of qualified individuals in the future in the markets where we do business. Our business will be seriously harmed if our sales force productivity efforts do not generate a corresponding significant increase in revenue.

### **Many of our significant current and potential customers are pursuing emerging or unproven business models, which, if unsuccessful, or ineffective at monetizing delivery of their content, could lead to a substantial decline in demand for our content delivery and other Orchestrate Platform services.**

Because the proliferation of broadband Internet connections and the subsequent monetization of content libraries for distribution to Internet users are relatively recent phenomena, many of our customers' business models that center on the delivery of rich media and other content to users remain unproven. Some of our customers will not be successful in selling advertising, subscriptions, or otherwise monetizing the content we deliver on their behalf and consequently may not be successful in creating a profitable business model. This will result in some of our customers discontinuing their Internet or web-based business operations and discontinuing use of our services and solutions. Further, any deterioration and related uncertainty in the global financial markets and economy could result in, among other things, reductions in available capital and liquidity from banks and other providers of credit, fluctuations in equity and currency values worldwide, and concerns that portions of the worldwide economy may be in a prolonged recessionary period. Any one or more of these occurrences could materially adversely impact our customers' access to capital or willingness to spend capital on our services or, in some cases, ultimately cause the customer to file for protection from creditors under applicable insolvency or bankruptcy laws or simply go out of business. This uncertainty may also impact our customers' levels of cash liquidity, which could affect their ability or willingness to timely pay for services that they will order or have already ordered from us. From time to time we discontinue service to customers for non-payment of services. We expect further customers may discontinue operations or not be willing or able to pay for services that they have ordered from us. Further loss of customers may adversely affect our financial results.

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

To increase our revenue, we must add new customers and sell additional services to existing customers and encourage existing customers to increase their usage levels. If our existing and prospective customers do not perceive our services to be of sufficiently high value and quality, we may not be able to retain our current customers or attract new customers. We sell our services pursuant to service agreements that generally include some form of financial minimum commitment. Our customers



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have no obligation to renew their contracts for our services after the expiration of their initial commitment, and these service agreements may not be renewed at the same or higher level of service, if at all. Moreover, under some circumstances, some of our customers have the right to cancel their service agreements prior to the expiration of the terms of their agreements. Aside from minimum financial commitments, customers are not obligated to use our services for any particular type or amount of traffic. These facts, in addition to the changing competitive landscape in our market, means that we cannot accurately predict future customer renewal rates or usage rates. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including:

- their satisfaction or dissatisfaction with our services;
- the quality and reliability of our content delivery network;
- the prices of our services;
- the prices of services offered by our competitors;
- discontinuation by our customers of their Internet or web-based content distribution business;
- mergers and acquisitions affecting our customer base; and
- reductions in our customers' spending levels.

If our customers do not renew their service agreements with us, or if they renew on less favorable terms, our revenue may decline and our business may suffer. Similarly, our customer agreements often provide for minimum commitments that are often significantly below our customers' historical usage levels. Consequently, even if we have agreements with our customers to use our services, these customers could significantly curtail their usage without incurring any penalties under our agreements. In this event, our revenue would be lower than expected and our operating results could suffer.

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

### **Rapid increase in the use of mobile and alternative devices to access the Internet present significant development and deployment challenges.**

The number of people who access the Internet through devices other than PCs, including mobile devices, game consoles and television set-top devices, has increased dramatically in the past few years. The capabilities of these devices are advancing dramatically and the increasing need to provide a high quality video experience will present us and other providers with significant challenges. If we are unable to deliver our service offerings to a substantial number of alternative device users and at a high quality, or if we are slow to develop services and technologies that are more compatible with these devices, we may fail to capture a significant share of an increasingly important portion of the market. Such a failure could limit our ability to compete effectively in an industry that is rapidly growing and changing, which, in turn, could cause our business, financial condition and results of operations to suffer.

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

Companies, organizations or individuals, including our competitors and non-practicing entities, may hold or obtain patents or other proprietary rights that would prevent, limit or interfere with our ability to make, use or sell our services or develop new services, which could make it more difficult for us to operate our business. From time to time, we may receive inquiries from holders of patents inquiring whether we infringe their proprietary rights. Companies holding Internet-related patents or other intellectual property rights are increasingly bringing suits alleging infringement of such rights or otherwise asserting their rights and seeking licenses. Any litigation or claims, whether or not valid, could result in substantial costs and diversion of resources from the defense of such claims. In addition, many of our agreements with customers require us to defend and indemnify those customers for third-party intellectual property infringement claims against them, which could result in significant additional costs and diversion of resources. If we are determined to have infringed upon a third party's intellectual property rights, we may also be required to do one or more of the following:

- cease selling, incorporating or using products or services that incorporate the challenged intellectual property;
- pay substantial damages;
- obtain a license from the holder of the infringed intellectual property right, which license may or may not be available on reasonable terms or at all; or
- redesign products or services.

If we are forced to litigate any claims or to take any of these other actions, our business may be seriously harmed.

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

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

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

Our results of operations may fluctuate as a result of a variety of factors, many of which are outside of our control. If our results of operations fall below the expectations of securities analysts or investors, the price of our common stock could decline substantially. In addition to the effects of other risks discussed in this section, fluctuations in our results of operations may be due to a number of factors, including, among others:

- our ability to increase sales to existing customers and attract new customers to our content delivery and other Orchestrate Platform services;
- the addition or loss of large customers, or significant variation in their use of our content delivery and other Orchestrate Platform services;
- costs associated with current or future intellectual property lawsuits and other lawsuits;
- service outages or third party security breaches to our platform or to one or more of our customers' platforms;
- the amount and timing of operating costs and capital expenditures related to the maintenance and expansion of our business, operations and infrastructure and the adequacy of available funds to meet those requirements;
- the timing and success of new product and service introductions by us or our competitors;
- the occurrence of significant events in a particular period that result in an increase in the use of our content delivery and other Orchestrate Platform services, such as a major media event or a customer's online release of a new or updated video game or operating system;
- changes in our pricing policies or those of our competitors;
- the timing of recognizing revenue;
- limitations of the capacity of our global network and related systems;
- the timing of costs related to the development or acquisition of technologies, services or businesses;
- the potential write-down or write-off of intangible or other long-lived assets;
- general economic, industry and market conditions (such as fluctuations experienced in the stock and credit markets during times of deteriorated global economic conditions) and those conditions specific to Internet usage;
- limitations on usage imposed by our customers in order to limit their online expenses; and
- war, threat of war or terrorist actions, including cyber terrorism targeted at us, our customers, or both, and inadequate cybersecurity.

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

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

While we offer our customers a number of services and solutions associated with our Orchestrate Platform, we generate the majority of our revenue from charging our customers for the content delivered on their behalf through our global network. We are subject to an elevated risk of reduced demand for these services. Furthermore, if the market for delivery of rich media content in particular does not continue to grow as we expect or grows more slowly, then we may fail to achieve a return on the significant investment we are making to prepare for this growth. Our success, therefore, depends on the continued and increasing reliance on the Internet for delivery of media content and our ability to cost-effectively deliver these services. Many different factors may have a general tendency to limit or reduce the number of users relying on the Internet for media content,

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the amount of content consumed by our customers' users, or the number of providers making this content available on-line, including, among others:

- a general decline in Internet usage;
- third party restrictions on on-line content (including copyright restrictions, digital rights management and restrictions in certain geographic regions);
- system impairments or outages, including those caused by hacking or cyberattacks; and
- a significant increase in the quality or fidelity of off-line media content beyond that available online to the point where users prefer the off-line experience.

The influence of any of these or other factors may cause our current or potential customers to reduce their spending on content delivery services, which would seriously harm our operating results and financial condition.

### **We could incur charges due to impairment of goodwill and long-lived assets.**

As of June 30, 2016, we had a goodwill balance of approximately \$76,242, which is subject to periodic testing for impairment. Our long-lived assets also are subject to periodic testing for impairment. A significant amount of judgment is involved in the periodic testing. Failure to achieve sufficient levels of cash flow could result in impairment charges for goodwill or fixed asset impairment for long-lived assets, which could have a material adverse effect on our reported results of operations. Our goodwill impairment analysis also includes a comparison of the aggregate estimated fair value of our reporting unit to our total market capitalization. If our stock trades below our book value, a significant and sustained decline in our stock price and market capitalization could result in goodwill impairment charges. During times of financial market volatility, significant judgment will be used to determine the underlying cause of the decline and whether stock price declines are short-term in nature or indicative of an event or change in circumstances. Impairment charges, if any, resulting from the periodic testing are non-cash.

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

We lease private line capacity for our backbone from third party providers. Our contracts for private line capacity generally have terms of three to four years. The communications capacity we have leased may become unavailable for a variety of reasons, such as physical interruption, technical difficulties, contractual disputes, or the financial health of our third party providers. Alternative providers are available; however, it could be time consuming and expensive to promptly identify and obtain alternative third party connectivity. Additionally, as we grow, we anticipate requiring greater private line capacity than we currently have in place. If we are unable to obtain such capacity from third party providers on terms commercially acceptable to us or at all, our business and financial results would suffer. Similarly, if we are unable to timely deploy enough network capacity to meet the needs of our customer base or effectively manage the demand for our services, our reputation and relationships with our customers would be harmed, which, in turn, could harm our business, financial condition and results of operations.

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

We have operations in numerous foreign countries and may continue to expand our sales and support organizations internationally. As part of our business strategy, we intend to expand our international network infrastructure. Expansion could require us to make significant expenditures, including the hiring of local employees, in advance of generating any revenue. As a consequence, we may fail to achieve profitable operations that will compensate our investment in international locations. We are subject to a number of risks associated with international business activities that may increase our costs, lengthen our sales cycle and require significant management attention. These risks include:

- increased expenses associated with sales and marketing, deploying services and maintaining our infrastructure in foreign countries;
- competition from local content delivery service providers, many of which are very well positioned within their local markets;
- challenges caused by distance, language and cultural differences;
- unexpected changes in regulatory requirements preventing or limiting us from operating our global network or resulting in unanticipated costs and delays;
- interpretations of laws or regulations that would subject us to regulatory supervision or, in the alternative, require us to exit a country, which could have a negative impact on the quality of our services or our results of operations;
- longer accounts receivable payment cycles and difficulties in collecting accounts receivable;
- corporate and personal liability for violations of local laws and regulations;



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- currency exchange rate fluctuations and repatriation of funds;
- potentially adverse tax consequences;
- credit risk and higher levels of payment fraud; and
- foreign exchange controls that might prevent us from repatriating cash earned in countries outside the United States.

International operations are subject to significant additional risks not generally faced in our domestic operations, including, but not limited to, risks relating to legal systems that may not adequately protect contract and intellectual property rights, policies and taxation, the physical infrastructure of the country, as well as risks relating to potential political turmoil and currency exchange controls. There can be no assurance that these international risks will not materially adversely affect our business. For example, our operations include software development and quality assurance activities in Ukraine, which has recently experienced a period of social unrest. Should there be significant productivity losses, or if we become unable to conduct operations in Ukraine in the future, and our contingency plans are unsuccessful in addressing the related risks, our business could be adversely affected.

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

Our content delivery services depend on our ability to access certain end-user access networks in order to complete the delivery of rich media and other on-line content to end-users. Some operators of these networks may take measures that could degrade, disrupt or increase the cost of our or our customers' access to certain of these end-user access networks. Such measures may include restricting or prohibiting the use of their networks to support or facilitate our services, or charging increased fees to us, our customers or end-users in connection with our services. In 2015, the U.S. Federal Communications Commission (FCC) released new network neutrality and open internet rules that reclassified broadband Internet access services as a telecommunications service subject to some elements of common carrier regulation. Among other things, the FCC order prohibits blocking or discriminating against lawful services and applications and prohibits "paid prioritization," or providing faster speeds or other benefits in return for compensation. Nevertheless, the rules are subject to legal challenges, and if they are overturned, we or our customers could experience increased cost or slower data on these third-party networks. If we or our customers experience increased cost in delivering content to end users, or otherwise, or if end users perceive a degradation of quality, our business and that of our customers may be significantly harmed. This or other types of interference could result in a loss of existing customers, increased costs and impairment of our ability to attract new customers, thereby harming our revenue and growth.

In addition, the performance of our infrastructure depends in part on the direct connection of our global network to a large number of end-user access networks, known as peering, which we achieve through mutually beneficial cooperation with these networks. In some instances, network operators charge us for the peering connections. If, in the future, a significant percentage of these network operators elected to no longer peer with our network or peer with our network on less favorable economic terms, then the performance of our infrastructure could be diminished, our costs could increase and our business could suffer.

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

Our business depends on our ability to deliver media content in all major formats. If our legal right or technical ability to store and deliver content in one or more popular proprietary content formats, such as HTTP Live Streaming and Multimedia Messaging Services, was limited, our ability to serve our customers in these formats would be impaired and the demand for our content delivery and other Orchestrate Platform services would decline by customers using these formats. Owners of propriety content formats may be able to block, restrict or impose fees or other costs on our use of such formats, which could lead to additional expenses for us and for our customers, or which could prevent our delivery of this type of content altogether. Such interference could result in a loss of existing customers, increased costs and impairment of our ability to attract new customers, which would harm our revenue, operating results and growth.

### **We use certain "open-source" software the use of which could result in our having to distribute our proprietary software, including our source code, to third parties on unfavorable terms, which could materially affect our business.**

Certain of our service offerings use software that is subject to open-source licenses. Open-source code is software that is freely accessible, usable and modifiable. Certain open-source code is governed by license agreements, the terms of which could require users of such open-source code to make any derivative works of such open-source code available to others on unfavorable terms or at no cost. Because we use open-source code, we may be required to take remedial action to protect our proprietary software. Such action could include replacing certain source code used in our software, discontinuing certain of our products or features or taking other actions that could divert resources away from our development efforts.



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In addition, the terms relating to disclosure of derivative works in many open-source licenses are unclear. We periodically review our compliance with the open-source licenses we use and do not believe we will be required to make our proprietary software freely available. Nevertheless, if a court interprets one or more such open-source licenses in a manner that is unfavorable to us, we could be required to make some components of our software available at no cost, which could materially and adversely affect our business and financial condition.

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

Our future success depends upon the continued services of our executive officers and other key technology, sales, marketing and support personnel who have critical industry experience and relationships that they rely on in implementing our business plan. There is increasing competition for talented individuals with the specialized knowledge to deliver Orchestrate Platform services and this competition affects both our ability to retain key employees and hire new ones. Historically, we have experienced a significant amount of employee turnover, especially with respect to our sales personnel. As a result, a significant number of our sales personnel are relatively new and may need time to become fully productive. The loss of the services of any of our key employees could disrupt our operations, delay the development and introduction of our services, and negatively impact our ability to sell our services.

### **We are subject to the effects of fluctuations in foreign exchange rates, which could affect our operating results.**

The financial condition and results of operations of our operating foreign subsidiaries are reported in the relevant local currency and are then translated into U.S. dollars at the applicable currency exchange rate for inclusion in our consolidated U.S. dollar financial statements. Also, although a large portion of our customer and vendor agreements are denominated in U.S. dollars, we may be exposed to fluctuations in foreign exchange rates with respect to customer agreements with certain of our international customers. Exchange rates between these currencies and U.S. dollars in recent years have fluctuated significantly and may do so in the future. In addition to currency translation risk, we incur currency transaction risk whenever one of our operating subsidiaries enters into a transaction using a different currency than the relevant local currency. Given the volatility of exchange rates, we may be unable to manage our currency transaction risks effectively. Currency fluctuations could have a material adverse effect on our future international sales and, consequently, on our financial condition and results of operations.

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

We have completed a number of business acquisitions and may seek to acquire businesses or technologies that are complementary to our business in the future. Acquisitions are often complex and involve a number of risks to our business, including, among others;

- the difficulty of integrating the operations, services, solutions and personnel of the acquired companies;
- the potential disruption of our ongoing business;
- the potential distraction of management;
- the possibility that our business culture and the business culture of the acquired companies will not be compatible;
- the difficulty of incorporating or integrating acquired technology and rights with or into our other services and solutions;
- expenses related to the acquisition and to the integration of the acquired companies;
- the impairment of relationships with employees and customers as a result of any integration of new personnel;
- employee turnover from the acquired companies or from our current operations as we integrate businesses;
- risks related to the businesses of acquired companies that may continue to impact the businesses following the merger; and
- potential unknown liabilities associated with acquired companies.

Any inability to integrate services, solutions, operations or personnel in an efficient and timely manner could harm our results of operations.

If we are not successful in completing acquisitions that we may pursue in the future, we may be required to reevaluate our business strategy, and we may incur substantial expenses and devote significant management time and resources without a productive result. In addition, future acquisitions will require the use of our available cash or dilutive issuances of securities. Future acquisitions or attempted acquisitions could also harm our ability to achieve profitability.

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

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Laws and regulations that apply to communications and commerce conducted over the Internet are becoming more prevalent, both in the United States and internationally, and may impose additional burdens on companies conducting business on-line or providing Internet-related services such as ours. Increased regulation could negatively affect our business directly, as well as the businesses of our customers, which could reduce their demand for our services. For example, tax authorities abroad may impose taxes on the Internet-related revenue we generate based on where our internationally deployed servers are located. In addition, domestic and international taxation laws are subject to change. Our services, or the businesses of our customers, may become subject to increased taxation, which could harm our financial results either directly or by forcing our customers to scale back their operations and use of our services in order to maintain their operations. Also, the Communications Act of 1934, as amended by the Telecommunications Act of 1996 (the Act), and the regulations promulgated by the FCC under Title II of the Act, may impose obligations on the Internet and those participants involved in Internet-related businesses. In addition, the laws relating to the liability of private network operators for information carried on, processed by or disseminated through their networks are unsettled, both in the United States and abroad. Network operators have been sued in the past, sometimes successfully, based on the content of material disseminated through their networks. We may become subject to legal claims such as defamation, invasion of privacy and copyright infringement in connection with content stored on or distributed through our network. In addition, our reputation could suffer as a result of our perceived association with the type of content that some of our customers deliver. If we need to take costly measures to reduce our exposure to the risks posed by laws and regulations that apply to communications and commerce conducted over the Internet, or are required to defend ourselves against related claims, our financial results could be negatively affected.

Several other federal laws also could expose us to liability and impose significant additional costs on us. For example, the Digital Millennium Copyright Act has provisions that limit, but do not eliminate, our liability for the delivery of customer content that infringe copyrights or other rights, so long as we comply with certain statutory requirements. In addition, the Children's On-line Privacy Protection Act restricts the ability of on-line services to collect information from minors and the Protection of Children from Sexual Predators Act of 1998 requires on-line service providers to report evidence of violations of federal child pornography laws under certain circumstances. Also, there are emerging regulation and industry standards regarding the collection and use of personal information and protecting the security of data on networks. Compliance with these laws, regulations and standards is complex and any failure on our part to comply with these regulations may subject us to additional liabilities.

### **Privacy concerns could lead to regulatory and other limitations on our business, including our ability to use “cookies” and video player “cookies” that are crucial to our ability to provide services to our customers.**

Our ability to compile data for customers depends on the use of “cookies” and video player “cookies” to identify certain on-line behavior that allows our customers to measure a website or video's effectiveness. A cookie is a small file of information stored on a user's computer that allows us to recognize that user's browser or video player when the user makes a request for a web page or to play a video. Government authorities inside the United States concerned with the privacy of Internet users have suggested the enactment of legislation that would regulate cookies and/or require certain disclosures regarding cookies. Bills aimed at regulating the collection, use and/or storage of personal data from Internet users are currently pending in United States Congress and many state legislatures. Attempts at such regulation may be drafted in such a way as to limit or otherwise regulate the collection of certain technology like cookies, thereby creating restrictions that could reduce our ability to use them. In addition, the Federal Trade Commission and the Department of Commerce have conducted hearings regarding user profiling, the collection of non-personally identifiable information and on-line privacy.

Our foreign operations may also be adversely affected by regulatory action outside the United States. These regulations, which can be enforced by private parties or governmental entities, are constantly evolving and can be subject to significant change. For example, the European Union has enacted an electronic communications directive that imposes certain restrictions on the use of cookies, requires certain disclosures with respect to cookie usages and also places restrictions on the sending of unsolicited communications. Each European Union member country was required to enact legislation to comply with the provisions of the electronic communications directive. Germany has also enacted additional laws limiting the use of user profiling, and other countries, both in and out of the European Union, may impose similar limitations.

Internet users may directly limit or eliminate the placement of cookies on their computers by using third-party software that blocks cookies, or by disabling or restricting the cookie functions of their Internet browser software and in their video player software. Internet browser software upgrades also may result in limitations on the use of cookies. Technologies like the Platform for Privacy Preferences Project may limit collection of cookies. Plaintiffs' attorneys also have organized class action suits against companies related to the use of cookies and several companies, including companies in the Internet advertising industry, have had claims brought against them before the Federal Trade Commission regarding the collection and use of Internet user information. We may be subject to such suits in the future, which could limit or eliminate our ability to collect such information. If our ability to use cookies were substantially restricted due to the foregoing, or for any other reason, we would have to generate and use other technology or methods that allow the gathering of user data in order to provide

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services to customers. This change in technology or methods could require significant re-engineering time and resources, and may not be complete in time to avoid negative consequences to our business. In addition, alternative technology or methods might not be available on commercially reasonable terms, if at all. If the use of cookies is prohibited and we are not able to efficiently and cost effectively create new technology, our business, financial condition and results of operations would be materially adversely affected. In addition, any compromise of security that results in the release of Internet users' and/or our customers' data could seriously limit the adoption of our service offerings as well as harm our reputation and brand, expose us to liability and subject us to reporting obligations under various state laws, which could have an adverse effect on our business. The risk that these types of events could seriously harm our business is likely to increase as the amount of data stored for customers on our servers and the number of countries where we operate has been increasing, and we may need to expend significant resources to protect against security breaches, which could have an adverse effect on our business, financial condition or results of operations.

Also, a number of new privacy laws coming into effect and/or proposals pending could affect our business. For example, the European Commission has enacted a general data protection regulation that becomes effective in May 2018 and will supersede current EU data protection legislation, impose more stringent EU data protection requirements, and provide for greater penalties for noncompliance. Additionally, in October 2015, the European Court of Justice invalidated the U.S.-EU Safe Harbor framework that had been in place since 2000, which allowed companies to meet certain European legal requirements for the transfer of personal data from the European Economic Area to the United States. Although U.S. and EU authorities reached a political agreement regarding a new potential means for legitimizing personal data transfers from the European Economic Area to the United States, the EU-U.S. Privacy Shield, there continue to be concerns about whether the EU-US Privacy Shield will face additional challenges (similar to the fate of the Safe Harbor framework). We expect that for the immediate future, we will continue to face uncertainty as to whether our efforts to comply with our obligations under European privacy laws will be sufficient. If we are investigated by a European data protection authority, we may face fines and other penalties. Any such investigation or charges by European data protection authorities could have a negative effect on our existing business and on our ability to attract and retain new customers. These existing and proposed laws and regulations can be costly to comply with, could expose us to significant penalties for non-compliance, can delay or impede the development or adoption of our products and services, reduce the overall demand for our services, result in negative publicity, increase our operating costs, require significant management time and attention, slow the pace at which we close (or prevent us from closing) sales transactions, and subject us to claims or other remedies, including fines or demands that we modify or cease existing business practices.

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

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

- implementing customer orders for services;
- delivering these services; and
- timely and accurate billing for these services.

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

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

As a public company, we have incurred, and will continue to incur, significant expenses, including accounting, legal and other professional fees, insurance premiums, investor relations costs, and costs associated with compensating our independent directors. In addition, rules implemented by the SEC and the Nasdaq Global Select Market impose additional requirements on public companies, including requiring changes in corporate governance practices. For example, the listing requirements of the Nasdaq Global Select Market require that we satisfy certain corporate governance requirements relating to independent directors, audit committees, distribution of annual and interim reports, stockholder meetings, stockholder approvals, solicitation of proxies, conflicts of interest, stockholder voting rights and codes of conduct. Our management and other personnel need to devote a substantial amount of time to these compliance initiatives. Moreover, these rules and regulations increase our legal and financial compliance costs and make some activities more time-consuming and costly. For example, these rules and regulations make it more difficult and more expensive for us to obtain director and officer liability insurance.

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

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

**If we fail to maintain proper and effective internal controls or fail to implement our controls and procedures with respect to acquired or merged operations, our ability to produce accurate financial statements could be impaired, which could adversely affect our operating results, our ability to operate our business and investors' views of us.**

We must ensure that we have adequate internal financial and accounting controls and procedures in place so that we can produce accurate financial statements on a timely basis. We are required to spend considerable effort on establishing and maintaining our internal controls, which is costly and time-consuming and needs to be re-evaluated frequently.

We have operated as a public company since June 2007, and we will continue to incur significant legal, accounting and other expenses as we comply with the Sarbanes-Oxley Act of 2002, as well as new rules implemented from time to time by the SEC and the Nasdaq Global Select Market. These rules impose various requirements on public companies, including requiring changes in corporate governance practices, increased reporting of compensation arrangements and other requirements. Our management and other personnel will continue to devote a substantial amount of time to these compliance initiatives. Moreover, new rules and regulations will likely increase our legal and financial compliance costs and make some activities more time-consuming and costly. These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers.

Section 404 of the Sarbanes-Oxley Act of 2002 requires that we include in our annual report our assessment of the effectiveness of our internal control over financial reporting and our audited financial statements as of the end of each fiscal year. Furthermore, our independent registered public accounting firm, Ernst & Young LLP (EY), is required to report on whether it believes we maintained, in all material respects, effective internal control over financial reporting as of the end of the year. Our continued compliance with Section 404 will require that we incur substantial expense and expend significant management time on compliance related issues, including our efforts in implementing controls and procedures related to acquired or merged operations. We currently do not have an internal audit group and use an international accounting firm to assist us with our assessment of the effectiveness of our internal controls over financial reporting. In future years, if we fail to timely complete this assessment, or if EY cannot timely attest, there may be a loss of public confidence in our internal controls, the market price of our stock could decline, and we could be subject to regulatory sanctions or investigations by the Nasdaq Global Select Market, the SEC or other regulatory authorities, which would require additional financial and management resources. In addition, any failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to timely meet our regulatory reporting obligations.

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

A change in accounting standards or practices can have a significant effect on our operating results and may affect our reporting of transactions completed before the change is effective. New accounting pronouncements and varying interpretations of existing accounting pronouncements have occurred and may occur in the future. Changes to existing rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business.

**Divestiture of our businesses or product lines, including those that we have acquired or will acquire, may materially adversely affect our financial condition, results of operations or cash flows, or may result in impairment charges that may adversely affect our results of operations.**

Divestitures involve risks, including difficulties in the separation of operations, services, products and personnel, the diversion of management's attention from other business concerns, the disruption of our business, the potential loss of key employees and the retention of uncertain contingent liabilities related to the divested business, any of which could result in a material adverse effect to our financial condition, results of operations or cash flows. Divestitures of previously acquired businesses may result in significant asset impairment charges, including those related to goodwill and other intangible assets,



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which could have a material adverse effect on our financial condition and results of operations. Future impairment may result from, among other things, deterioration in the performance of the acquired business or product line, adverse market conditions and changes in the competitive landscape, adverse changes in applicable laws or regulations, including changes that restrict the activities of the acquired business or product line, changes in accounting rules and regulations, and a variety of other circumstances. The amount of any impairment is recorded as a charge to the statement of operations. We may never realize the full value of our goodwill and intangible assets, and any determination requiring the write-off of a significant portion of these assets may have an adverse effect on our financial condition and results of operations. We cannot assure you that we will be successful in managing these or any other significant risks that we encounter in divesting a business or product line.

### **Risks Related to Ownership of Our Common Stock**

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

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

- variations in our operating results;
- announcements of technological innovations, new services or service enhancements, strategic alliances or significant agreements by us or by our competitors;
- commencement or resolution of, our involvement in and uncertainties arising from litigation;
- recruitment or departure of key personnel;
- changes in the estimates of our operating results or changes in recommendations by any securities analysts that elect to follow our common stock;
- developments or disputes concerning our intellectual property or other proprietary rights;
- the gain or loss of significant customers;
- market conditions in our industry, the industries of our customers and the economy as a whole; and
- adoption or modification of regulations, policies, procedures or programs applicable to our business.

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

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

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

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

As of June 30, 2016, our directors and executive officers and their affiliates beneficially owned, in the aggregate, approximately 32% of our outstanding common stock, including approximately 29% beneficially owned by investment entities affiliated with Goldman, Sachs & Co. These stockholders are able to exercise significant influence over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, such as a merger or other sale of our company or its assets. This concentration of ownership could limit other stockholders' ability to influence corporate matters and may have the effect of delaying or preventing a third party from acquiring control over us.

#### **Future equity issuances or a sale of a substantial number of shares of our common stock may cause the price of our common stock to decline.**

Because we may need to raise additional capital in the future to continue to expand our business and our research and development activities, among other things, we may conduct additional equity offerings. If we or our stockholders sell substantial amounts of our common stock (including shares issued upon the exercise of options and warrants) in the public



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market, the market price of our common stock could fall. A decline in the market price of our common stock could make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate.

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

Provisions of our amended and restated certificate of incorporation and bylaws, as well as provisions of Delaware law, could make it more difficult for a third party to acquire us, even if doing so would benefit our stockholders. These provisions:

- establish that members of the board of directors may be removed only for cause upon the affirmative vote of stockholders owning a majority of our capital stock;
- authorize the issuance of “blank check” preferred stock that could be issued by our board of directors to increase the number of outstanding shares and thwart a takeover attempt;
- limit who may call special meetings of stockholders;
- prohibit stockholder action by written consent, thereby requiring stockholder actions to be taken at a meeting of the stockholders;
- establish advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted upon at stockholder meetings;
- provide for a board of directors with staggered terms; and
- provide that the authorized number of directors may be changed only by a resolution of our board of directors.

In addition, Section 203 of the Delaware General Corporation Law, which imposes certain restrictions relating to transactions with major stockholders, may discourage, delay or prevent a third party from acquiring us.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Not applicable

### **Item 3. Defaults upon Senior Securities**

Not applicable

### **Item 4. Mine Safety Disclosures**

Not applicable

### **Item 5. Other Information**

None.



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### Item 6. Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference				Provided Herewith
		Form	File No.	Exhibit	Filing Date	
3.01	Amended and Restated Certificate of Incorporation of Limelight Networks, Inc.	8-K	001-33508	3.1	6/14/11	
3.02	Second Amended and Restated Bylaws of Limelight Networks, Inc.	8-K	001-33508	3.2	2/19/13	
31.1	Certification of Principal Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(a).					X
31.2	Certification of Principal Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(a).					X
32.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14 (b).*					X
32.2	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14 (b).*					X
101.INS	XBRL INSTANCE DOCUMENT					X
101.SCH	XBRL TAXONOMY EXTENSION SCHEMA DOCUMENT					X
101.CAL	XBRL TAXONOMY EXTENSION CALCULATION LINKBASE DOCUMENT					X
101.DEF	XBRL TAXONOMY EXTENSION DEFINITION LINKBASE DOCUMENT					X
101.LAB	XBRL TAXONOMY EXTENSION LABEL LINKBASE DOCUMENT					X
101.PRE	XBRL TAXONOMY EXTENSION PRESENTATION LINKBASE DOCUMENT					X

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







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