

Limelight Networks, Inc.
Form 10-Q
November 14, 2007

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

(Mark One)

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

For the quarterly period ended September 30, 2007

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from **to**

Commission file number 001-33508
LIMELIGHT NETWORKS, INC.

(Exact name of registrant as specified in its charter)

Delaware

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

20-1677033

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

2220 W. 14th Street
Tempe, AZ 85281

(Address of principal executive offices, including Zip Code)

(602) 850-5000

(Registrant's telephone number, including area code)

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

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒

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

The number of shares outstanding of the registrant's common stock as of November 09, 2007: 82,058,952 shares.

LIMELIGHT NETWORKS, INC.
FORM 10-Q
Quarterly Period Ended September 30, 2007
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LIMELIGHT NETWORKS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	September 30, 2007 (Unaudited)	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 128,750	\$ 7,611
Marketable securities	65,370	
Accounts receivable, net of reserves of \$2,354 at September 30, 2007 and \$1,204 at December 31, 2006, respectively	18,431	17,526
Income taxes receivable	4,136	2,980
Deferred income taxes		362
Prepaid expenses and other current assets	5,506	3,011
Total current assets	222,193	31,490
Property and equipment, net	47,544	41,784
Marketable securities, less current portion	32	285
Deferred income taxes	259	106
Other assets	1,495	759
Total assets	\$ 271,523	\$ 74,424
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,805	\$ 6,419
Accounts payable, related parties	17	781
Deferred revenue, current portion	431	197
Credit facilities, current portion		2,938
Capital lease obligations, current portion		245
Deferred income taxes, current portion	33	
Other current liabilities	13,748	6,314
Total current liabilities	16,034	16,894
Deferred revenue, less current portion	11,860	
Credit facilities, less current portion (net of discount of \$-0- and \$424 at September 30, 2007 and December 31, 2006, respectively)		20,456
Capital lease obligations, less current portion		5
Deferred income taxes, less current portion	30	
Other long-term liabilities	30	30
Total liabilities	27,954	37,385

Commitments and contingencies

Stockholders' equity:

Series A convertible preferred stock, \$0.001 par value; 6,921 shares authorized; 0 and 5,070 shares issued and outstanding at September 30, 2007 and December 31, 2006, respectively, (liquidation preference: \$733 at December 31, 2006)		5
Series B convertible preferred stock, \$0.001 par value; 43,050 shares authorized; 0 and 39,870 shares issued and outstanding at September 30, 2007 and December 31, 2006, respectively, (liquidation preference: \$260,000 at December 31, 2006)		40
Convertible preferred stock, \$0.001 par value; 7,500 shares authorized; 0 shares issued and outstanding		
Common stock, \$0.001 par value; 150,000 and 120,150 shares authorized at September 30, 2007 and December 31, 2006, respectively; 82,056 and 21,832 shares issued and outstanding at September 30, 2007 and December 31, 2006, respectively	82	22
Additional paid-in capital	266,102	41,803
Accumulated other comprehensive loss	(222)	(113)
Accumulated deficit	(22,393)	(4,718)
Total stockholders' equity	243,569	37,039
Total liabilities and stockholders' equity	\$ 271,523	\$ 74,424

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

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

	For the Three Months Ended September 30,		For the Nine months Ended September 30,	
	2007	2006	2007	2006
Revenues	\$ 29,190	\$ 17,454	\$ 73,979	\$ 43,133
Cost of revenue:				
Cost of services	12,171	7,300	31,796	16,338
Depreciation network	5,602	2,900	15,310	6,408
Total cost of revenue	17,773	10,200	47,106	22,746
Gross Margin	11,417	7,254	26,873	20,387
Operating expenses:				
General and administrative	7,849	4,616	24,144	8,418
Sales and marketing	7,421	1,860	16,843	4,391
Research and development	1,294	1,193	4,119	1,951
Depreciation and amortization	268	63	579	135
Total operating expenses	16,832	7,732	45,685	14,895
Operating (loss) income	(5,415)	(478)	(18,812)	5,492
Other income (expense):				
Interest expense	(18)	(373)	(1,412)	(1,397)
Interest income	2,456	79	3,118	79
Other income	33	70	33	70
Total other income (expense)	2,471	(224)	1,739	(1,248)
(Loss) income before income taxes	(2,944)	(702)	(17,073)	4,244
Income tax expense	181	688	602	2,642
Net (loss) income	\$ (3,125)	\$ (1,390)	\$ (17,675)	\$ 1,602
Net (loss) income allocable to common stockholders	\$ (3,125)	\$ (1,390)	\$ (17,675)	\$ 1,065
Net (loss) income per weighted average share:				
Basic	\$ (0.04)	\$ (0.09)	\$ (0.35)	\$ 0.04
Diluted	\$ (0.04)	\$ (0.09)	\$ (0.35)	\$ 0.03

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Shares used in per weighted average share calculations:

Basic	82,045	15,670	49,929	27,502
Diluted	82,045	15,670	49,929	34,136

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

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

	For the Nine months Ended September 30, 2007 2006 (Unaudited)	
Cash flows from operating activities:		
Net (loss) income	\$ (17,675)	\$ 1,602
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	15,889	6,543
Share-based compensation	15,285	3,393
Deferred income tax expense	286	(1)
Accounts receivable charges	3,536	419
Accretion of debt discount	424	69
Accretion of marketable securities	(277)	
Changes in operating assets and liabilities:		
Accounts receivable	(4,441)	(8,102)
Prepaid expenses and other current assets	(2,495)	(1,572)
Income taxes receivable	(126)	144
Other assets	(698)	(261)
Accounts payable	(5,595)	9,799
Accounts payable, related parties	(781)	(362)
Deferred revenue and other current liabilities	20,138	2,805
Net cash provided by operating activities	23,470	14,476
Cash flows from investing activities:		
Purchase of marketable securities	(72,001)	
Sale of marketable securities	7,000	
Purchases of property and equipment	(20,650)	(27,327)
Net cash used in investing activities	(85,651)	(27,327)
Cash flows from financing activities:		
Borrowings on credit facilities		9,055
Payments on credit facilities	(23,818)	(11,933)
Borrowings on line of credit	1,500	
Payments on line of credit	(1,500)	(1,000)
Payments on capital lease obligations	(250)	(171)
Payments on notes payable related parties		(195)
Escrow funds returned from share repurchase	3,418	412
Tax benefit from share-based compensation	23	
Proceeds from exercise of stock options	35	1,886
Net proceeds from preferred stock issuance		126,423
Repurchase of common stock		(102,121)

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Proceeds from initial public offering, net of issuance costs	203,912	
Net cash provided by financing activities	183,320	22,356
Net increase in cash and cash equivalents	121,139	9,505
Cash and cash equivalents at beginning of period	7,611	1,536
Cash and cash equivalents at end of period	\$ 128,750	\$ 11,041
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 1,020	\$ 1,023
Cash paid for income taxes	\$ 360	\$ 3,720
Property and equipment purchases remaining in accounts payable	\$ 998	\$ 4,057

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

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LIMELIGHT NETWORKS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Business

Limelight Networks, Inc. (the Company) is a provider of high-performance content delivery network (CDN) services. The Company delivers content for traditional and emerging media companies, or content providers, including businesses operating in the television, music, radio, newspaper, magazine, movie, videogame, software and social media industries. The Company was formed in June 2001 as an Arizona limited liability company, Limelight Networks, LLC, and converted into a Delaware corporation, Limelight Networks, Inc., in August 2003. The Company has operated in the Phoenix metropolitan area since 2001 and elsewhere throughout the United States since 2003. The Company began international operations in 2004.

2. Summary of Significant Accounting Policies and Use of Estimates

Basis of Presentation

The condensed consolidated financial statements include accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated. The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). The accompanying interim condensed consolidated balance sheet as of September 30, 2007, the condensed consolidated statements of operations for the three months and nine months ended September 30, 2007 and 2006, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2007 and 2006, are unaudited. The condensed consolidated balance sheet information as of December 31, 2006 is derived from the audited consolidated financial statements which were restated in a Current Report on Form 8-K filed with the SEC on October 29, 2007. The consolidated financial information contained in this Quarterly Report on Form 10-Q should be read in conjunction with the audited consolidated financial statements and related notes contained in the Current Report on Form 8-K filed on October 29, 2007.

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, 2007 or for any future periods. In the opinion of management, these unaudited condensed consolidated financial statements include all adjustments of a normal recurring nature that are necessary, in the opinion of management, to present fairly the results of all interim periods reported herein.

Revenue Recognition

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

At the inception of a customer contract for service, the Company makes an assessment as to that customer's ability to pay for the services provided. If the Company subsequently determines that collection from the customer is not reasonably assured, the Company records an allowance for doubtful accounts and bad debt expense for all of that customer's unpaid invoices and ceases recognizing revenue for continued services provided until cash is received.

The Company primarily derives revenue from the sale of content delivery network services to customers executing contracts having terms of one year or longer. These contracts generally commit the customer to a minimum monthly level of usage on a calendar month basis and provide the rate at which the customer must pay for actual usage above the monthly minimum. For these services, the Company recognizes the monthly minimum as revenue each month provided that an enforceable contract has been signed by both parties, the service has been delivered to the customer, the fee for the service is fixed or determinable and collection is reasonably assured. Should a customer's usage of the Company's services exceed the monthly minimum, the Company recognizes revenue for such excess in the period of the usage. The Company typically charges the customer an installation fee when the services are first activated. The installation fees are recorded as deferred revenue and recognized as revenue ratably over the estimated life of the customer arrangement. The Company also derives revenue from services sold as discrete, non-recurring events or

based solely on usage. For these services, the Company recognizes revenue after an enforceable contract has been signed by both parties, the fee is fixed or determinable, the event or usage has occurred and collection is reasonably assured.

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

The Company has entered a multi-element arrangement which includes a significant software component. In accounting for such an arrangement the Company applies the provisions of Statement of Position, 97-2, (SOP 97-2) *Software Revenue Recognition*, as amended by SOP 98-9, Modifications of SOP 97-2, *Software Revenue Recognition, With Respect to Certain Transactions*. The Company recognizes software license revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is

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fixed or determinable and collection of the receivable is probable. If a software license contains an undelivered element, the vendor-specific objective evidence (VSOE) of fair value of the undelivered element is deferred and the revenue recognized once the element is delivered. The undelivered elements are primarily software support and professional services. VSOE of fair value of software support and professional services is based upon hourly rates or fixed fees charged when those services are sold separately. If VSOE cannot be established for all elements to be delivered, the Company defers all amounts received under the arrangement and does not begin to recognize revenue until the delivery of the last element of the contract has started. Subsequent to commencement of delivery of the last element, the Company commences revenue recognition. Amounts to be received under the contract are then included in the amortizable base and then recognized as revenue ratably over the remaining term of the arrangement until the Company has delivered all elements and has no additional performance obligations.

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

The Company does not have VSOE of fair value to allocate the fee to the separate elements of the Multi-Element Arrangement as it has not licensed the intellectual property and software components, nor PCS separately. Accordingly the Company will recognize the revenues related to the professional services, license and PCS ratably over the four-year period over which the PCS has been contracted as allowed for by paragraph 12 of SOP 97-2. Because delivery of the license and PCS elements of this arrangement had not occurred at June 30, 2007, revenue on all services provided to this customer during the three months ended June 30, 2007, including the ongoing content delivery services, and the direct incremental costs incurred associated with these revenues, were deferred until such time as delivery occurs and PCS has commenced. Concurrently with the signing of the Multi-Element Arrangement, the Company also extended and amended a content delivery contract entered into originally in 2005. The arrangement for transmitting content is not a required element of the new software and node development project commencing under the Multi-Element Arrangement. The Company will continue to receive payments on a usage basis under the content delivery contract. Given that the services are priced at market rates and subject to regular adjustments and are cancelable with thirty days' notice, the amount of revenue and pricing is considered variable and contingent until services are delivered. As such, the Company has attributed revenue for the service as one that is contingent and becomes measurable as the services are delivered under the terms of the content delivery contract. Accordingly, the Company will record revenue on a monthly basis in an amount based upon usage. Because the content delivery agreement was amended concurrently with the Multi-Element Arrangement, the Company deferred revenue recognition until commencement of delivery of the last element of the Multi-Element Arrangement, which was determined to be July 27, 2007. For the three-month period ended June 30, 2007, the Company had a deferred revenue balance of \$3.4 million related to the Multi-Element Arrangement and related deferred direct costs of \$0.9 million. During the three months ended September 30, 2007, the Company recognized approximately \$2.7 million in revenue and approximately \$0.7 million in costs of revenue. As of September 30, 2007, the Company had deferred revenue related to the Multi-Element Arrangement of \$2.3 million, which is expected to be recognized ratably over the remaining original 44-month period commencing in July 2007 and had related deferred costs of \$0.2 million.

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

From time to time, the Company enters into contracts to sell services to unrelated companies at or about the same time the Company enters into contracts to purchase products or services from the same companies. If the Company concludes that these contracts were negotiated concurrently, the Company records as revenue only the net cash received from the vendor. For certain non-cash arrangements whereby the Company provides rack space and bandwidth services to several companies in exchange for advertising the Company records barter revenue and expense if the services are objectively measurable. The various types of advertising include radio, website, print and signage. The Company recorded barter revenue and expense of approximately \$196,000 and \$164,000, for the three-month periods ended September 30, 2007 and 2006, and approximately \$648,000 and \$456,000 for the nine-month periods ended September 30, 2007, and 2006, respectively.

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

Cash and Cash Equivalents

The Company holds its cash and cash equivalents in checking, money market, and investment accounts with high credit quality financial instruments. The Company considers all highly liquid investments with maturities of three months or less when purchased to be cash equivalents.

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The Company accounts for its investments in equity securities under FASB's Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Management determines the appropriate classification of such securities at the time of purchase and reevaluates such classification as of each balance sheet date. Realized gains and losses and declines in value judged to be other than temporary are determined based on the specific identification method and would be reported in the statements of operations. To date, there have been no such realized losses.

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

The following is a summary of available-for-sale securities at September 30, 2007 (in thousands):

	Amortized	Gross Unrealized	Gross Unrealized	Estimated Fair Value
	Cost	Gains	Losses	
Government agency bonds	\$ 16,945	\$ 43	\$	\$ 16,988
Commercial paper	28,967	2	(10)	28,959
Corporate notes and bonds	19,366	64	(7)	19,423
Total available-for-sale debt securities	65,278	109	(17)	65,370
Publicly traded common stock	472		(440)	32
Total available-for-sale securities	\$ 65,750	\$ 109	\$ (457)	\$ 65,402

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

The amortized cost and estimated fair value of the available-for-sale debt securities at September 30, 2007, by maturity, are shown below (in thousands).

	Amortized	Gross Unrealized	Gross Unrealized	Estimated Fair Value
	Cost	Gains	Losses	
Available-for-sale debt securities				
Due in one year or less	\$ 46,300	\$ 22	\$ (17)	\$ 46,305
Due after one year and through five years	18,978	87		19,065
Due after five years and through ten years				
Due after ten years				
	\$ 65,278	\$ 109	\$ (17)	\$ 65,370

During the three and six month periods ended September 30, 2007, the Company did not have any gross realized gains or losses on sales of available-for-sale securities.

3. Other Current Liabilities

Other current liabilities consist of the following (in thousands)

	As of September 30, 2007	As of December 31, 2006
Accrued cost of revenue	\$ 3,076	\$ 845
Accrued compensation and benefits	1,767	675
Non-income taxes payable	4,101	3,549
Proceeds from early exercise of stock options		610
Accrued purchases of property and equipment	1,071	
Other accrued expenses	3,733	635
 Total other current liabilities	 \$ 13,748	 \$ 6,314

4. Initial Public Offering (IPO)

On June 8, 2007, the Company completed an initial public offering of its common stock in which the Company sold and issued

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14,900,000 shares of its common stock and selling stockholders sold 3,500,000 shares of the Company's common stock, in each case at a price to the public of \$15.00 per share. The common shares began trading on the NASDAQ Global Market on June 8, 2007. The Company raised a total of \$223.5 million in gross proceeds from the IPO, or approximately \$203.9 million in net proceeds after deducting underwriting discounts and commissions of approximately \$15.6 million and other offering costs of approximately \$4.0 million. On June 14, 2007, approximately \$23.8 million of the net proceeds were used to repay in full the outstanding balance of the Company's equipment financing facility.

5. Net Income (Loss) Per Share

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

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