NAVISITE INC
Form 10-K
November 06, 2008

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

Form 10-K

(Mark One)

þ	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **For Fiscal Year Ended July 31, 2008**
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **For the Transition Period From to**

Commission File 000-27597

NaviSite, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**52-2137343**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
400 Minuteman Road Andover, Massachusetts	**01810**
(Address of principal executive offices)	*(zip code)*

Registrant s telephone number, including area code
(978) 682-8300

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.01 par value	**The NASDAQ Stock Market LLC**

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No þ

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

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

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

The approximate aggregate market value of registrant s common stock held by non-affiliates of the Registrant on January 31, 2008, based upon the closing price of a share of the Registrant s common stock on such date as reported by the NASDAQ Capital Market: $67,813,160.

On October 24, 2008, the Registrant had outstanding 35,389,790 shares of common stock, $0.01 par value.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement for its annual meeting of stockholders for the fiscal year ended July 31, 2008, which will be filed with the Securities and Exchange Commission within 120 days after the end of the registrant s fiscal year, are incorporated by reference into Part III hereof.

NAVISITE, INC.

2008 ANNUAL REPORT
ON FORM 10-K

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PART I
SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended, that involve risks and uncertainties. All statements other than statements of historical information provided herein are forward-looking statements and may contain information about financial results, economic conditions, trends and known uncertainties. Our actual results could differ materially from those discussed in the forward-looking statements as a result of a number of factors, which include those discussed in this section and elsewhere in this report and the risks discussed in our other filings with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management s analysis, judgment, belief or expectation only as of the date hereof. Investors are warned that actual results may differ materially from management s expectations. We undertake no obligation to publicly reissue or update these forward-looking statements to reflect events or circumstances that arise after the date hereof.

Item 1. ***Business***

Our Business

NaviSite is an enterprise hosting and application services provider to middle market companies. We offer a range of hosting and Enterprise Resource Planning (ERP) application solutions to more than 1,400 customers, helping them to achieve a scalable, outsourced technology solution at lower total cost of ownership. Our goal is to be the leading provider for enterprise hosting and managed application services to the middle market, leveraging our deep knowledge and technology platform, our customer base and our commitment to flexibility and responsiveness to our customers.

Our core competencies are to provide complex enterprise hosting solutions and to customize, implement and support outsourced ERP applications. These packaged, third party applications include Oracle e-Business Suite, PeopleSoft Enterprise, Siebel, JD Edwards, Hyperion, Lawson, Kronos and Microsoft Dynamics. By managing both the application and infrastructure we are able to address the key challenges faced by middle market IT organizations today increasing complexity, competitive pressures and declining or limited resources.

We provide our services from a global platform of 14 data centers in the United States, two in the United Kingdom, comprising approximately 225,000 square feet of usable space, and a Network Operations Center (NOC) in India. Using this platform we leverage innovative and scalable uses of technology along with subject matter expertise of our professional staff to deliver what we believe are cost-effective, flexible solutions that provide responsive and predictable levels of service to meet our customers business needs. Combining our technology, domain expertise and a competitive fixed cost infrastructure, we demonstrate to our customers the cost and functional advantages of outsourcing with a proven partner like NaviSite. We are dedicated to delivering quality services and meeting rigorous standards including maintenance of SAS 70 Type II compliance and Microsoft Gold and Oracle Certified Partner certifications.

In addition to delivering enterprise hosting and application services, we are able to leverage our infrastructure and application management platform, NaviView[tm], to enable our partners software to be delivered on-demand, providing an alternative delivery model to the traditional licensed software model. As the platform provider for an increasing number of independent software vendors (ISV), we enable solutions and services to a wider and growing customer base.

Our services include:

Enterprise Hosting Services

Platform as a Service Hardware and software support delivered from one of our 16 data centers. Services include dedicated and virtualized hosting, business continuity and disaster recovery, connectivity, content distribution, database administration and performance tuning, hardware management, monitoring, network management, security management, server and operating system management and storage management.

Software as a Service (SaaS) Enablement of SaaS to the ISV community. Services include SaaS starter kits and services specific to the needs of ISVs who offer their software in an on-demand or subscription model.

Co-location Physical space offered in a data center. In addition to providing the physical space, NaviSite offers environmental support, specified power with back-up power generation and network connectivity options.

Application Services

ERP Application and Messaging Management Services Customer defined services for specific packaged applications.

Applications include:

Oracle e-Business Suite

PeopleSoft Enterprise

Siebel

JD Edwards

Hyperion

Lawson

Kronos

Microsoft Dynamics

Microsoft Exchange

Lotus Notes

Services include implementation, upgrade support, monitoring, diagnostics, problem resolution and functional end-user support.

ERP Professional Services Planning, implementation, optimization, enhancement and upgrade support for third party ERP applications we support.

Custom Development Services Planning, implementation, optimization and enhancement for custom applications that we or our customers have developed.

We provide these services to a range of vertical industries, including financial services, healthcare and pharmaceutical, manufacturing and distribution, publishing, media and communications, business services and public sector and software, through both our own sales force and sales channel relationships.

Our managed application and hosting services are facilitated by our proprietary NaviView[tm] collaborative infrastructure and application management platform. Our NaviView[tm] platform enables us to provide highly efficient, effective and customized management of enterprise applications and hosted infrastructure. Comprised of a suite of third-party and proprietary products, NaviView™ provides tools designed specifically to meet the needs of customers who outsource their IT needs.

Supporting both our managed hosting services and applications services is a range of hardware and software technologies designed for the specific needs of our customers. NaviSite is a leader in using virtualized processing, storage and networking as a platform to optimize services for performance, cost and operational efficiency. Utilizing both hardware and software based virtualization strategies, NaviSite continues to innovate as technology develops.

We believe that the combination of NaviView™, our dedicated and virtual platform, with our physical infrastructure and technical staff gives us a unique ability to provide complex enterprise hosting and application services for mid-market customers. NaviView™ is application and operating system neutral. Designed to enable enterprise hosting and software applications to be monitored and managed, the NaviView™ technology allows us to offer new solutions to our software vendors and new products to our current customers.

We believe that our data centers and infrastructure have the capacity necessary to expand our business for the foreseeable future. Further, trends in hardware virtualization and the density of computing resources, which reduce footprint in the data center, are favorable to NaviSite s services-oriented offerings as compared with traditional co-location or managed hosting providers. Our services combine our developed infrastructure with established processes and procedures for delivering hosting and application management services. Our high availability infrastructure, high performance monitoring systems, and proactive and collaborative problem resolution and change management processes are designed to identify and address potentially crippling problems before they disrupt our customers operations.

We currently service over 1,400 customers. Our hosted customers typically enter into service agreements for a term of one to five years, with monthly payments, that provide us with a recurring revenue base. Our revenue growth comes from adding new customers and delivering additional services to existing customers. Our recurring revenue base is affected by new customers and renewals and terminations with existing customers.

We were formed in 1996 within ModusLink Global Solutions, Inc. (formerly known as CMGI, Inc.), our former majority stockholder, to support the networks and host Web sites of ModusLink Global Solutions, Inc., its subsidiaries and several of its affiliated companies. In 1997, we began offering and supplying Web site hosting and management services to companies not affiliated with ModusLink Global Solutions,Inc. We were incorporated in Delaware in December 1998. In October 1999, we completed our initial public offering of common stock and remained a majority-owned subsidiary of ModusLink Global Solutions, Inc. until September 2002, at which time ClearBlue Technologies, Inc., or CBT, became our majority stockholder. In addition:

In December 2002, we acquired all of the issued and outstanding stock of ClearBlue Technologies Management, Inc., or CBTM, a subsidiary of CBT, which previously had acquired assets from the bankrupt estate of AppliedTheory Corporation related to application management and application hosting services. This acquisition added application management and development capabilities to our managed application services.

In February 2003, we acquired Avasta, Inc., a provider of application management services, adding automated application and device monitoring software capabilities to our managed application services.

In April 2003, we acquired Conxion Corporation, a provider of application hosting, content and electronic software distribution and security services. This acquisition added proprietary content delivery software and related network agreements to our managed application services and managed infrastructure services.

In May 2003, we acquired assets of Interliant, Inc. related to managed messaging, application hosting and application development services. This acquisition added messaging-specific services and capabilities and IBM Lotus Domino expertise, and formed the core of our managed messaging services.

In August 2003, we acquired assets of CBT related to co-location, bandwidth, security and disaster recovery services, enhancing our managed infrastructure services and adding physical plant assets. Specifically, we acquired all of the outstanding shares of six wholly-owned subsidiaries of CBT with data centers located in Chicago, Illinois, Las Vegas, Nevada, Los Angeles, California, Milwaukee, Wisconsin, Oakbrook, Illinois, and Vienna, Virginia and assumed the revenue and expenses of four additional wholly-owned subsidiaries of CBT with data centers located in Dallas, Texas, New York, New York, San Francisco, California, and Santa Clara, California, which four entities we later acquired.

In June 2004, we completed the acquisition of substantially all of the assets and liabilities of Surebridge, Inc., a privately held provider of managed application services for mid-market companies. This acquisition broadened our managed application services, particularly in the areas of financial management, supply chain management, human resources management and customer relationship management.

In August 2007, we acquired the assets of Alabanza LLC and Hosting Ventures LLC and all of the issued and outstanding stock of Jupiter Hosting, Inc.. These acquisitions provided additional managed hosting customers, proprietary software for provisioning and additional data center space in the Bay Area market.

In September 2007, we acquired netASPx, Inc. Based in Minneapolis, Minnesota, the acquisition of netASPx, Inc. added functional expertise in the Lawson and Kronos ERP applications and approximately 18,000 square feet of data center capacity.

In October 2007, we acquired the assets of iCommerce, Inc.

Our Industry

The dramatic and continued growth in Internet use and the enhanced functionality, accessibility and security of Internet-enabled applications have made conducting business on the Internet a necessity in the mid-market. In addition, the challenges faced by mid-market companies have them increasingly looking to outsourcing IT services. Driven by the increased complexity of enterprise hosting and ERP applications, the costs of operating them and reduced resources and budget, companies are increasingly looking for cost effective alternatives. We believe a fast growing trend in the mid-market is the increased use of managed IT infrastructure and applications by companies to allow them to focus and enhance their core business operations, increase efficiencies and remain competitive. Enterprise hosting and related applications extend beyond traditional Web sites to business process software applications such as financial, email, enterprise resource planning, supply chain management and customer relationship management. Organizations have become increasingly dependent on these applications and they have evolved into important components of their businesses. In addition, we believe that the pervasiveness of the Internet and quality of network infrastructure, along with the dramatic decline in the pricing of computing technology and network bandwidth, have made the outsourced delivery model an attractive choice for mid-market companies. We believe that the recent adoption of alternative software licensing models by software industry market leaders is driving other software vendors in this direction and, consequently, generating strong industry growth.

As enterprises seek to remain competitive and improve profitability, we believe they will continue to implement increasingly sophisticated applications and delivery models. Some of the potential benefits of these applications and delivery models include the ability to:

- Increase business operating efficiencies and reduce costs by using best of breed applications;
- Build and enhance customer relationships by providing Internet-enabled customer service and technical support;
- Manage vendor and supplier relationships through Internet-enabled technologies, such as online training and online sales and marketing;
- Communicate and conduct business more rapidly and cost-effectively with customers, suppliers and employees worldwide; and
- Improve service and lower the cost of software ownership by the adoption of new Internet-enabled software delivery models.

These benefits have driven increased use of information technology infrastructure and applications, which in turn has created a strong demand for specialized information technology support and applications expertise. An increasing number of businesses are choosing to outsource the hosting and management of these applications.

The trend towards outsourced hosting and management of information technology infrastructure and applications by mid-market companies and organizations is driven by a number of factors, including:

Developments by major hardware and software vendors that facilitate outsourcing;

Advances in virtualization and high density computing that is beyond the skill and cost ability of the typical mid-market enterprise;

The need to improve the reliability, availability and overall performance of applications as they increase in importance and complexity;

The need to focus on core business operations;

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Challenges and costs of hiring, training and retaining application engineers and information technology employees with the requisite range of information technology expertise; and

The increasing complexity of managing the operations of Internet-enabled applications.

Notwithstanding increasing demand for these services, we believe the number of providers has decreased over the past five years, primarily as a result of industry consolidation. We believe this consolidation trend will continue and will benefit a small number of service providers that have the resources and infrastructure to cost-effectively provide the scalability, performance, reliability and business continuity that customers expect.

Our Strategy

Our goal is to become the leading provider of enterprise hosting and managed application services for middle market companies and organizations. Further, our financial business objective is to market and deliver high value services to generate the highest revenue per square foot of available capacity in our data centers. Key elements of our strategy are to:

Provide Excellent Customer Service. We are committed to providing all of our customers with a high level of customer support. We believe that through the acquisition of several businesses we have had the benefit of consolidating best of breed account management and customer support practices that ensure that we are achieving this goal.

Innovate and Leverage our Technology Platform. We will continue to expand our platform leverage by continued use of virtualization and utility type services. We believe the typical middle market organization is not able to take advantage of these technology developments because of their complexity and cost. By continually updating our platform, we will continue to drive our competitiveness with higher value services at competitive prices.

Expand Our Global Delivery Capabilities. We believe that global delivery is an integral piece of our long-term strategy in that it directly maps to our overall goal of service and operational excellence for our customers. By leveraging a global delivery solution, we believe that we will be able to continue to deliver superior services and technical expertise at a competitive cost and enhance the value proposition for our customers.

Improve Operating Margins Through Efficiencies. We have made significant improvements to our overall cost structure. We intend to continue to improve operating margins as we grow revenue and improve the efficiency of our operations. As we grow, we will take advantage of our infrastructure capacity, our NaviView^{tm} platform and our automated processes. Due to the fixed cost nature of our infrastructure, we believe that increased customer revenue will result in incremental improvements in our operating margins.

Grow Through Disciplined Acquisitions. We intend to derive a portion of our future growth through acquisitions of technologies, products and companies that improve our services and strengthen our position in our target markets. By utilizing our experience in acquiring and effectively integrating complementary companies, we can eliminate duplicative operations, reduce costs and improve our operating margins. We intend to acquire companies that provide valuable technical capabilities and entry into target markets, and allow us to take advantage of our existing technical and physical infrastructure.

Continue to Broaden Our Service Offerings. We continue to broaden our service offerings to compete more effectively in the middle market by offering a range of packaged solutions. With our professional services and deep operational expertise, we effectively deliver to our customers a full range of services for Oracle, PeopleSoft,

J. D. Edwards, Siebel, Lawson, Kronos and Microsoft Dynamics solutions. We believe that these services will help our customers achieve peak effectiveness with their systems. As a full service provider for a broad range of applications, we are able to create leverage and cross and up sell opportunities in a manner that is unparalleled in the marketplace.

Our Services

We offer our customers a broad range of enterprise hosting and ERP application services that can be deployed quickly and cost effectively. Our expertise allows us to meet an expanding set of needs as our customers needs

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become increasingly complex. Our experience and capabilities save our customers the time and cost of developing expertise in-house and we increasingly serve as the sole manager of our customers outsourced applications.

Enterprise Hosting Services

NaviSite s hosting services provide highly available and secure ongoing technology solutions for our customers critical IT needs.

Platform as a Service Support provided for hardware and software located in one of our 16 data centers. We also provide bundled offerings packaged as content delivery services. Specific services include:

- Dedicated and Virtualized Servers
- Business Continuity and Disaster Recovery
- Connectivity
- Content Distribution
- Database Administration and Performance Tuning
- Desktop Support
- Hardware Management
- Monitoring
- Network Management
- Security
- Server and Operating Management
- Storage Management

Software as a Service Enablement of SaaS to the ISV community. Services include SaaS starter kits and services specific to the needs of ISVs wanting to offer their software in an on-demand or subscription mode.

Content Delivery Includes the delivery of software electronically using NaviSite technology accelerated content distribution.

Co-location Physical space offered in a data center. In addition to providing the physical space, NaviSite offers environmental support, specified power with back-up power generation and network connectivity options.

Application Management

We provide implementation and operational services for packaged applications, which are listed below. In addition to packaged ERP applications we also offer outsourced messaging, including the monitoring and management of Microsoft Exchange and Lotus Domino, allowing customers to outsource their critical messaging applications.

Application management services are available either in a NaviSite data center or via remote management on customers premises. In addition, our customers can choose to use dedicated or shared servers. We also provide specific services to assist our customers with the migration from legacy or proprietary messaging systems to Microsoft Exchange or Lotus Domino and we have expertise to customize messaging and collaborative applications. We offer user provisioning, spam filtering, virus protection and enhanced monitoring and reporting.

ERP Application management services Defined services provided for specific packaged applications. Services include implementation, upgrade assistance, monitoring, diagnostics, problem resolution and functional end user support.

Applications include:

Oracle e-Business Suite

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- PeopleSoft Enterprise
- Siebel
- JD Edwards
- Hyperion
- Lawson
- Kronos
- Microsoft Dynamics
- Microsoft Exchange
- Lotus Notes

ERP Professional Services Planning, implementation, optimization, enhancement and upgrades for the supported third party ERP application.

Custom Development Professional Services Planning, implementation, optimization and enhancement for custom applications that we or our customers have developed.

All of our service offerings can be customized to meet our customers particular needs. Our proprietary NaviView^{tm} platform enables us to offer valuable flexibility without the significant costs associated with traditional customization.

NaviView^{tm} Platform

Our proprietary NaviView^{tm} platform is a critical element of each of our service offerings. Our NaviView^{tm} platform allows us to work with our customers information technology teams, systems integrators and other third parties to deliver services to customers. Our NaviView^{tm} platform and its user interface help ensure full transparency to the customer and seamless operation of outsourced applications and infrastructure, including: i) hardware, operating system, database and application monitoring; ii) event management; iii) problem resolution management; and iv) integrated change and configuration management tools. Our NaviView^{tm} platform includes:

Event Detection System Our proprietary technology allows our operations personnel to efficiently process alerts across heterogeneous computing environments. This system collects and aggregates data from all of the relevant systems management software packages utilized by an information technology organization.

Synthetic Transaction Monitoring Our proprietary synthetic transaction methods emulate the end-user experience and monitor for application latency or malfunctions that affect user productivity.

Automated Remediation Our NaviView^{tm} platform allows us to proactively monitor, identify and correct common problems associated with the applications we manage on behalf of our customers. These automated corrections help ensure availability and reliability by remediating known issues in real time, and keeping applications up and running while underlying problems or potential problems are diagnosed.

Component Information Manager This central repository provides a unified view of disparate network, database, application and hardware information.

Escalation Manager This workflow automation technology allows us to streamline routine tasks and escalate critical issues in a fraction of the time that manual procedures require. Escalation manager initiates specific orders and tasks based on pre-defined conditions, ensuring clear, consistent communication with our customers.

Our Infrastructure

Our infrastructure has been designed specifically to meet the demanding technical requirements of delivering our services to our customers. We securely deliver our services across Windows, Unix and Linux platforms. We believe that our infrastructure, together with our trained and experienced staff, enable us to offer market-leading levels of service backed by high service level guarantees.

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Network Operations Centers We monitor the operations of our infrastructure and customer applications from our own state-of-the-art network operations centers. Network and system management and monitoring tools continuously monitor our network and server performance. Our network operations centers perform first-level problem identification, validation and resolution. We have redundant network operations centers in New Delhi, India and in Andover, Massachusetts that are staffed 24 hours a day, seven days a week with network, security, Windows, Unix and Linux Database and Application personnel. We have technical and functional application support personnel located in our facilities in San Jose, California, Syracuse, New York, Houston, Texas, Minneapolis, Minnesota, Atlanta, Georgia, Andover , Massachusetts and New Delhi, India, who provide initial and escalated support 24 hours a day, seven days a week for our customers. Our engineers and support personnel are promptly alerted to problems, and we have established procedures for rapidly resolving technical issues that may arise.

Data Centers We currently operate in 14 data centers in the United States and two data centers in the United Kingdom. Our data centers incorporate technically sophisticated components which are designed to be fault-tolerant. The components used in our data centers include redundant core routers, redundant core switching hubs and secure virtual local area networks. We utilize the equipment and tools necessary for our data center operations, including our infrastructure hardware, networking and software products, from industry leaders such as BMC, Cisco, Dell, IBM, EMC, Hewlett-Packard, Microsoft, Oracle and Sun Microsystems.

Virtualization We employ virtualization technologies for processing, storage and networking. By using this approach we are able to maximize the benefit of our capital expenditures, minimize the amount of valuable data center space used and create additional operating efficiencies that lower our cost. Virtualization decreases our time to provision thereby accelerating our ability to recognize revenue. With inherent redundancy and scalability virtualizations adds de facto business continuity and assurances for internet based applications and hosting. In addition, these progressive developments in computing are typically out of the reach of the middle market customer due to cost and inexperience.

Internet Connectivity We have redundant high-capacity internet connections with providers such as Global Crossing, Level 3, Cogent, AT&T and XO Communications and others. We have deployed direct private transit and peering internet connections to utilize the provider s peering capabilities and to enhance routes via their networks that improve global performance. Our private transit system enables us to provide fast, reliable access for our customers information technology infrastructure and applications.

Sales and Marketing

Sales Our sales teams are located in the United States, the United Kingdom and India and focus on the identification, quoting and sale of solutions to new customers. Our sales professionals meet with these new prospective customers to understand and identify their individual business requirements and to translate those requirements into tailored services. The sales teams are focused on Application Management and Professional Services in which domain knowledge and expertise are a significant differentiator and Enterprise Hosting Solutions. Our sales teams are supported by Solution Architects who assess the infrastructure and application requirements to develop an optimal design and cost analysis. The quoting for prospective opportunities with less complex requirements was automated during the fiscal year and is now provided on line directly to our sales professionals.

The sales teams are augmented by Account Managers who are assigned to specific accounts to identify and manage the cross-selling opportunities of additional services. To date, most of our sales have been realized through our direct sales force teams. In 2007, we hired inside sales representatives to call potential customers from our offices in the United States and India to provide new opportunity development and consultative sales to smaller mid-market companies.

Automation and Platform Based Sales We launched an automated platform to allow new customers to purchase and provision hosted Microsoft Exchange during 2008. This automated system allows customers to buy services immediately without interaction with NaviSite staff. We plan to expand this platform for automated sales and provisioning to include other services targeted to the small and medium business market segment such as dedicated hosting and back ups. This will allow us to leverage our platform into another market segment with minimal additional costs.

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Channel Relationships We sell our services through third parties, pursuant to reseller or referral contracts with such third parties. These contracts are generally one to three years in length and either provide the reseller a discount of approximately 25% from our list price or require us to pay a referral fee, typically ranging from approximately 5% to 10% of the amounts we receive from the customer. Our channel partners resell our services to their customers under their private label brand or under the NaviSite brand. For systems integrators, our flexibility and cost-effectiveness bolsters their application development and management services. For independent software vendors, we provide the opportunity to offer their software as a service.

Marketing Our marketing organization is responsible for defining our overall market strategy, generating qualified leads for our field and inside sales forces, and increasing our overall brand awareness. Our lead generation programs include comprehensive on-line and off-line marketing programs with emphasis on on-line search, email, banner advertising, outbound telemarketing efforts as well as trade conferences and webinars. In 2008, we continued to expand the brand positioning campaign named Run With Us to reflect our emerging role as a business partner to our customers to design, implement and manage their business critical applications. We maintain a data driven rigorous measurement and monitoring approach to ensure that marketing investments are optimized and deliver the highest possible return on investment.

Customers

Our customers include mid-sized companies, divisions of large multi-national companies and government agencies. Our customers operate in a wide variety of industries, such as technology, manufacturing and distribution, healthcare and pharmaceutical, publishing, media and communications, financial services, retail, business services and government agencies.

As of July 31, 2008, NaviSite serviced over 1,400 hosted customers.

No customer represented 10% or more of our revenue for the fiscal years ended July 31, 2008, 2007 and 2006. Substantially all of our revenues are derived from, and over 90% of our plant, property and equipment is located in, the United States.

Competition

We compete in the outsourced information technology and professional services markets. These markets are fragmented, highly competitive and likely to be characterized by industry consolidation.

We believe that participants in these markets must grow rapidly and achieve a significant presence to compete effectively. We believe that the primary competitive factors determining success in our markets include:

- quality of services delivered;
- ability to consistently measure, track and report operational metrics;
- application hosting, infrastructure and messaging management expertise;
- fast, redundant and reliable Internet connectivity;
- a robust infrastructure providing availability, speed, scalability and security;
- comprehensive and diverse service offerings and timely addition of value-add services;

- brand recognition;
- strategic relationships;
- competitive pricing; and
- adequate capital to permit continued investment in infrastructure, customer service and support, and sales and marketing.

We believe that we compete effectively based on the breadth of our service offerings, the strength of our NaviView™ platform, our existing infrastructure capacity and our pricing.

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Our current and prospective competitors include:

- hosting and related services providers, including Terremark, Inc., Rackspace Hosting, Inc., SAVVIS, IBM, AT&T and other local and regional hosting providers;
- application services providers, such as IBM, AT&T, Electronic Data Systems Corp., Cedar Crestone, Oracle On Demand and Computer Sciences Corporation;
- co-location providers, including SAVVIS, Equinix and Switch & Data Facilities Company, Inc.;
- messaging providers, including Apptix Intermedia; and
- professional services providers, including Oracle Consulting Services, Accenture, Ciber, CSC, CedarCrestone, Deloitte Consulting, IBM and Rapidigm.

Intellectual Property

We rely on a combination of trademark, service mark, copyright, patent and trade secret laws and contractual restrictions to establish and protect our proprietary rights and promote our reputation and the growth of our business. While it is our practice to require our employees, consultants and independent contractors to enter into agreements containing non-disclosure, non-competition (for employees only) and non-solicitation restrictions and covenants, and while our agreements with some of our customers and suppliers include provisions prohibiting or restricting the disclosure of proprietary information, we cannot ensure that these contractual arrangements or the other steps taken by us to protect our proprietary rights will prove sufficient to prevent misappropriation of our proprietary rights or to deter independent, third-party development of similar proprietary assets. In addition, we offer our services in other countries where the laws may not afford adequate protection for our proprietary rights.

We license or lease most technologies used in our hosting and application management services. Our technology suppliers may become subject to third-party infringement claims, or other claims or assertions, which could result in their inability or unwillingness to continue to license their technology to us. The loss of certain of our technologies could impair our ability to provide services to our customers or require us to obtain substitute technologies that may be of lower quality or performance standards or at greater cost. We expect that we and our customers increasingly will be subject to third-party infringement claims as the number of Web sites and third-party service providers for internet-based businesses grows. We cannot ensure that third parties will not assert claims alleging the infringement of service marks and trademarks against us in the future or that these claims will not be successful. Any infringement claim as to our technologies or services, regardless of its merit, could be time-consuming, result in costly litigation, cause delays in service, installation or upgrades, adversely impact our relationships with suppliers or customers or require us to enter into costly royalty or licensing agreements.

Government Regulation

While there currently are few laws or regulations directly applicable to the Internet or to managed application hosting service providers, due to the increasing popularity of the Internet and Internet-based applications, such laws and regulations are being considered and may be adopted. These laws may cover a variety of issues including, for example, user privacy and the pricing, characteristics and quality of products and services. The adoption or modification of laws or regulations relating to commerce over the Internet could substantially impair the future growth of our business or expose us to unanticipated liabilities. Moreover, the applicability of existing laws to the Internet and managed application hosting service providers is uncertain. These existing laws could expose us to substantial liability if they are found to be applicable to our business. For example, we offer services over the Internet in many states in the United States and internationally and we facilitate the activities of our customers in those jurisdictions. As a result, we may be required to qualify to do business, be subject to taxation or be subject to other laws and regulations in these jurisdictions, even if we do not have a physical presence, employees or property there. The application of existing laws and regulations to the internet or our business, or the adoption of any new legislation or regulations applicable to the Internet or our business, could materially adversely affect our financial condition and results of operations.

Employees

As of July 31, 2008, we had 694 employees. Of these employees, 484 were principally engaged in operations, 111 were principally engaged in sales and marketing and 99 were principally engaged in general and administrative functions. None of our employees is party to a collective bargaining agreement, and we believe our relationship with our employees is good. We also retain consultants and independent contractors on a regular basis to assist in the completion of projects.

Available Information

We make our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports available through our Web site under Investors , free of charge, as soon as reasonably practicable after we file such material with, or furnish it to, the Securities and Exchange Commission (SEC). Our internet address is http://www.navisite.com. The contents of our web site are not incorporated by reference in this annual report on Form 10-K or any other report filed with or furnished to the SEC.

Item 1A. *Risk Factors*

We operate in a rapidly changing environment that involves a number of risks, some of which are beyond our control. Forward-looking statements in this report and those made from time to time by us through our senior management are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements concerning the expected future revenues, earnings or financial results or concerning project plans, performance, or development of products and services, as well as other estimates related to future operations are necessarily only estimates of future results and we cannot assure you that actual results will not materially differ from expectations. Forward-looking statements represent management s current expectations and are inherently uncertain. We do not undertake any obligation to update forward-looking statements. If any of the following risks actually occurs, our business, financial condition and operating results could be materially adversely affected.

We have a history of losses and may never achieve or sustain profitability. We have never been profitable and may never become profitable. As of July 31, 2008, we had incurred losses since our incorporation resulting in an accumulated deficit of approximately $504.5 million. During the fiscal year ended July 31, 2008, we had a net loss attributable to common shareholders of approximately $11.3 million. We may continue to incur losses in the future. As a result, we can give no assurance that we will achieve profitability or be capable of sustaining profitable operations.

Our financing agreement with a syndicated group of lenders includes various covenants and restrictions that may negatively affect our liquidity and our ability to operate and manage our business. As of September 30, 2008, we owed approximately $111.7 million under a credit agreement with a syndicated group of lenders. The credit agreement:

- restricts our ability to create, incur, assume, or permit to exist any additional indebtedness, excluding certain limited exemptions;
- restricts our ability to create, incur, assume or permit to exist any lien on any of our assets, excluding certain limited exemptions;
- restricts our ability to make investments, with certain limited exemptions;
- requires that we meet financial covenants for leverage, fixed charges and capital expenditures;

restricts our ability to enter into any transaction of merger or consolidation, excluding certain limited exemptions;

restricts our ability to sell assets or purchase or otherwise acquire the property of any person, excluding certain limited exemptions;

restricts our ability to authorize, declare or pay dividends, excluding certain limited exemptions;

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restricts our ability to enter into any transaction with any affiliate except on terms and conditions that are at least as favorable to us as those that could reasonably be obtained in a comparable arm s-length transaction with a person who is not an affiliate; and

restricts our ability to amend our organizational documents.

If we breach the credit agreement, a default could result. A default, if not waived, could result in, among other things, our not being able to borrow additional amounts under the credit agreement. In addition, all or a portion of our outstanding amounts may become due and payable on an accelerated basis, which would adversely affect our liquidity and our ability to manage our business. The maturity date of the Term Loan is June 8, 2013 and the revolving credit facility terminates on June 8, 2012. Interest on the Term Loan is payable in arrears on the first business day of August, November, February and May for ABR Loans, and the last day of the chosen interest period (which period can be one, two, three, six, nine or twelve months) or every three months, if the chosen interest period is greater than three months, for LIBOR Loans.

The Term Loan will amortize on the first day of each fiscal quarter (commencing on August 1, 2007) in equal quarterly installments over such period in the aggregate amounts as set forth below:

Year	**Percentage of Term Loan**
1	1.0%
2	1.0%
3	1.0%
4	1.0%
5	1.0%
6	95.0%

In addition, the credit agreement exposes us to interest rate fluctuations which could significantly increase the interest we pay the lenders. We are required, under the credit agreement, to maintain interest rate protection that shall result in at least 50% of the aggregate principal amount of the consolidated indebtedness of the Company and its subsidiaries, other than the revolving loans under the credit agreement, being subject to a fixed or maximum interest rate.

We may need to obtain additional debt or equity financing in order to satisfy any mandatory redemption requirement of our Preferred Stock. Our Series A Convertible Preferred Stock has redemption rights which could require us to redeem any or all of the issued and outstanding Preferred Stock. We may need to obtain additional debt or equity financing in order to satisfy any mandatory redemption requirement, which financing may not be available on favorable terms or at all. In addition, our financing agreement with a syndicated group of lenders restricts our ability to incur additional indebtedness, which could negatively affect our ability to fulfill our obligations to the holders of the Preferred Stock.

Disruption in financial and currency markets could have a negative effect on our business. As has been widely reported, financial markets in the United States, Europe and Asia have been experiencing extreme disruption in recent months, including, among other things, extreme volatility in security prices, severely diminished liquidity and credit availability, rating downgrades of certain investments and declining valuations of others. Governments have taken unprecedented actions intended to address extreme market conditions that include severely restricted credit and declines in real estate values. While currently these conditions have not impaired our ability to operate our business, there can be no assurance that there will not be a further deterioration in financial markets and confidence in major economies, which can then lead to challenges in the operation of our business. These economic developments affect businesses such as ours in a number of ways. The current tightening of credit in financial markets adversely affects the ability of customers and suppliers to obtain financing for significant purchases and operations and could result in a decrease in orders and spending for our products and services. We are unable to predict the likely duration and severity of the current disruption in financial markets and adverse economic conditions and the effects they will have on our business and financial condition.

Atlantic Investors, LLC, Unicorn Worldwide Holdings Limited and Madison Technology LLC may have interests that conflict with the interests of our other stockholders and have significant influence over corporate decisions. Unicorn Worldwide Holdings Limited and Madison Technology LLC, Atlantic Investors, LLC s two managing members, together with Atlantic Investors, LLC owned approximately 31% of our outstanding capital stock as of July 31, 2008 on a fully diluted basis. As of July 31, 2008, Atlantic Investors, LLC s ownership alone was approximately 27% on a fully diluted basis. Atlantic Investors, LLC, Unicorn Worldwide Holdings Limited and Madison Technology LLC, together have significant power in the election of our Board of Directors. Regardless of how our other stockholders may vote, Atlantic Investors, LLC, Unicorn Worldwide Holdings and Madison Technology acting together may have the ability to determine whether to engage in a merger, consolidation or sale of our assets and any other significant corporate transaction.

Members of our management group also have significant interests in Atlantic Investors, LLC, which may create conflicts of interest. Some of the members of our management group also serve as members of the management group of Atlantic Investors, LLC and its affiliates. Specifically, Andrew Ruhan, our Chairman of the Board, holds a 10% equity interest in Unicorn Worldwide Holdings Limited, a managing member of Atlantic Investors, LLC. Arthur P. Becker, our President and Chief Executive Officer and a member of our Board of Directors, is the managing member of Madison Technology LLC, a managing member of Atlantic Investors, LLC. As a result, these NaviSite officers and directors may face potential conflicts of interest with each other and with our stockholders. They may be presented with situations in their capacity as our officers or directors that conflict with their fiduciary obligations to Atlantic Investors, LLC, which in turn may have interests that conflict with the interests of our other stockholders.

Our common stockholders may suffer dilution in the future upon exercise of outstanding convertible securities or the issuance of additional securities in potential future acquisitions or financings. In connection with a financing agreement with Silver Point Finance, we issued warrants to SPCP Group, LLC and SPCP Group III LLC, two affiliates of Silver Point Finance, to purchase an aggregate of 3,930,136 shares of our common stock. If the warrants are exercised, Silver Point Finance may obtain a significant equity interest in NaviSite and other stockholders may experience significant and immediate dilution. As of September 30, 2008, SPCP Group, LLC and SPCP Group III LLC have exercised the warrants in part to acquire 2,730,005 shares of our Common Stock and warrants for the purchase of 1,200,131 shares of our Common Stock remain outstanding.

In connection with our acquisition of netASPx, Inc. we issued 3,125,000 shares of our Series A Convertible Preferred Stock to the stockholders of netASPx, Inc. Additional shares of the Preferred Stock have been and will be issued to the former shareholders of netASPx, Inc. as in-kind dividends that accrue on the outstanding Preferred Stock. The Preferred Stock may be converted into shares of common stock at a price of $8.00 per share by the holders after the earlier of (i) March 15, 2009 and (ii) any default date. No default has occurred and the Preferred Stock is not currently convertible into shares of our common stock. If converted, the shares of Preferred Stock convert into the number of shares of common stock determined by dividing the redemption price per share of the Preferred Stock by the conversion price applicable to such shares, which, as of October 31, 2008 would result in one share of common stock being issued upon the conversion of one share of Preferred Stock. The conversion price and the redemption price are subject to adjustment. However, in no event shall the number of shares of common stock to be issued upon the conversion of the Preferred Stock equal or exceed 6,692,856, (which represents 19.9% of the outstanding shares of our common stock on September 10, 2007) without the approval of our stockholders in accordance with the applicable rules and regulations of The Nasdaq Stock Market.

Our stockholders will also experience dilution to the extent that additional shares of our common stock are issued in potential future acquisitions or financings.

Acquisitions may result in disruptions to our business or distractions of our management due to difficulties in integrating acquired personnel and operations, and these integrations may not proceed as planned. Since

December 2002, we have acquired ClearBlue Technologies Management, Inc. (accounted for as an as if pooling), Avasta, Inc., Conxion Corporation, selected assets of Interliant, Inc., all of the shares of ten wholly-owned subsidiaries of ClearBlue Technologies, Inc. (accounted for as an as if pooling), substantially all of the assets and liabilities of Surebridge, Inc., substantially all of the assets of Alabanza, LLC and Hosting Ventures, LLC, and iCommerce, Inc. and all of the issued and outstanding stock of Jupiter Hosting, Inc., and netASPx, Inc. We intend to

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continue to expand our business through the acquisition of companies, technologies, products and services. Acquisitions involve a number of special problems and risks, including:

- difficulty integrating acquired technologies, products, services, operations and personnel with the existing businesses;
- difficulty maintaining relationships with important third parties, including those relating to marketing alliances and providing preferred partner status and favorable pricing;
- diversion of management s attention in connection with both negotiating the acquisitions and integrating the businesses;
- strain on managerial and operational resources as management tries to oversee larger operations;
- inability to retain and motivate management and other key personnel of the acquired businesses;
- exposure to unforeseen liabilities of acquired companies;
- potential costly and time-consuming litigation, including stockholder lawsuits;
- potential issuance of securities in connection with an acquisition with rights that are superior to the rights of holders of our common stock, or which may have a dilutive effect on our common stockholders;
- the need to incur additional debt or use cash; and
- the requirement to record potentially significant additional future operating costs for the amortization of intangible assets.

As a result of these problems and risks, businesses we acquire may not produce the revenues, earnings or business synergies that we anticipated, and acquired products, services or technologies might not perform as we expected. As a result, we may incur higher costs and realize lower revenues than we had anticipated. We may not be able to successfully address these problems and we cannot assure you that the acquisitions will be successfully identified and completed or that, if acquisitions are completed, the acquired businesses, products, services or technologies will generate sufficient revenue to offset the associated costs or other harmful effects on our business. In addition, our limited operating history with our current structure resulting from recent acquisitions makes it very difficult for us to evaluate or predict our ability to, among other things, retain customers, generate and sustain a revenue base sufficient to meet our operating expenses, and achieve and sustain profitability.

A failure to meet customer specifications or expectations could result in lost revenues, increased expenses, negative publicity, claims for damages and harm to our reputation and cause demand for our services to decline. Our agreements with customers require us to meet specified service levels for the services we provide. In addition, our customers may have additional expectations about our services. Any failure to meet customers specifications or expectations could result in:

- delayed or lost revenue;
- requirements to provide additional services to a customer at reduced charges or no charge;
- negative publicity about us, which could adversely affect our ability to attract or retain customers; and

claims by customers for substantial damages against us, regardless of our responsibility for the failure, which may not be covered by insurance policies and which may not be limited by contractual terms of our engagement.

Our ability to successfully market our services could be substantially impaired if we are unable to deploy new infrastructure systems and applications or if new infrastructure systems and applications deployed by us prove to be unreliable, defective or incompatible. We may experience difficulties that could delay or prevent the successful development, introduction or marketing of hosting and application management services in the future. If any newly introduced infrastructure systems and applications suffer from reliability, quality or compatibility problems, market acceptance of our services could be greatly hindered and our ability to attract new customers could be significantly reduced. We cannot assure you that new applications deployed by us will be free from any

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reliability, quality or compatibility problems. If we incur increased costs or are unable, for technical or other reasons, to host and manage new infrastructure systems and applications or enhancements of existing applications, our ability to successfully market our services could be substantially limited.

Any interruptions in, or degradation of, our private transit Internet connections could result in the loss of customers or hinder our ability to attract new customers. Our customers rely on our ability to move their digital content as efficiently as possible to the people accessing their websites and infrastructure systems and applications. We utilize our direct private transit Internet connections to major network providers, such as Level 3 Communications Inc. and Global Crossing, as a means of avoiding congestion and resulting performance degradation at public Internet exchange points. We rely on these telecommunications network suppliers to maintain the operational integrity of their networks so that our private transit Internet connections operate effectively. If our private transit Internet connections are interrupted or degraded, we may face claims by, or lose, customers, and our reputation in the industry may be harmed, which may cause demand for our services to decline.

If we are unable to maintain existing and develop additional relationships with software vendors, the sales and marketing of our service offerings may be unsuccessful. We believe that to penetrate the market for managed IT services we must maintain existing and develop additional relationships with industry-leading software vendors. We license or lease select software applications from software vendors, including IBM, Microsoft Corp., and Oracle Corp. Our relationships with Microsoft and Oracle are critical to the operations and success of our business. The loss of our ability to continue to obtain, utilize or depend on any of these applications or relationships could substantially weaken our ability to provide services to our customers. It may also require us to obtain substitute software applications that may be of lower quality or performance standards or at greater cost. In addition, because we generally license applications on a non-exclusive basis, our competitors may license and utilize the same software applications. In fact, many of the companies with which we have strategic relationships currently have, or could enter into, similar license agreements with our competitors or prospective competitors. We cannot assure you that software applications will continue to be available to us from software vendors on commercially reasonable terms. If we are unable to identify and license software applications that meet our targeted criteria for new application introductions, we may have to discontinue or delay introduction of services relating to these applications.

Our network infrastructure could fail which would impair our ability to provide guaranteed levels of service and could result in significant operating losses. To provide our customers with guaranteed levels of service, we must operate our network infrastructure 24 hours a day, seven days a week, without interruption. We must, therefore, protect our network infrastructure, equipment and customer files against damage from human error, natural disasters, unexpected equipment failure, power loss or telecommunications failures, terrorism, sabotage or other intentional acts of vandalism. Even if we take precautions, the occurrence of a natural disaster, equipment failure or other unanticipated problem at one or more of our data centers could result in interruptions in the services we provide to our customers. We cannot assure you that our disaster recovery plan will address all, or even most, of the problems we may encounter in the event of a disaster or other unanticipated problem. We have experienced service interruptions in the past, and any future service interruptions could:

- require us to spend substantial amounts of money to replace equipment or facilities;
- entitle customers to claim service credits or seek damages for losses under our service level guarantees;
- cause customers to seek alternate providers; or
- impede our ability to attract new customers, retain current customers or enter into additional strategic relationships.

Our dependence on third parties increases the risk that we will not be able to meet our customers needs for software, systems and services on a timely or cost-effective basis, which could result in the loss of customers. Our services and infrastructure rely on products and services of third-party providers. We purchase key components of our infrastructure, including networking equipment, from a limited number of suppliers, such as HP, Sun Microsystems, IBM, Cisco Systems, Inc., Microsoft, and Oracle. We cannot assure you that we will not experience operational problems attributable to the installation, implementation, integration, performance, features or functionality of third-party software, systems and services. We cannot assure you that we will have the necessary hardware or parts on hand or that our suppliers will be able to provide them in a timely manner in the event of equipment failure. Our inability to timely obtain and continue to maintain the necessary hardware or parts could result in sustained equipment failure and a loss of revenue due to customer loss or claims for service credits under our service level guarantees.

We could be subject to increased operating costs, as well as claims, litigation or other potential liability, in connection with risks associated with Internet security and the security of our systems. A significant barrier to the growth of e-commerce and communications over the Internet has been the need for secure transmission of confidential information. Several of our infrastructure systems and application services use encryption and authentication technology licensed from third parties to provide the protections necessary to ensure secure transmission of confidential information. We also rely on security systems designed by third parties and the personnel in our network operations centers to secure those data centers. Any unauthorized access, computer viruses, accidental or intentional actions and other disruptions could result in increased operating costs. For example, we may incur additional significant costs to protect against these interruptions and the threat of security breaches or to alleviate problems caused by these interruptions or breaches. If a third party were able to misappropriate a consumer s personal or proprietary information, including credit card information, during the use of an application solution provided by us, we could be subject to claims, litigation or other potential liability.

Third-party infringement claims against our technology suppliers, customers or us could result in disruptions in service, the loss of customers or costly and time-consuming litigation. We license or lease most technologies used in the infrastructure systems and application services that we offer. Our technology suppliers may become subject to third-party infringement or other claims and assertions, which could result in their inability or unwillingness to continue to license their technologies to us. We cannot assure you that third parties will not assert claims against us in the future or that these claims will not be successful. Any infringement claim as to our technologies or services, regardless of its merit, could result in delays in service, installation or upgrades, the loss of customers or costly and time-consuming litigation.

We may be subject to legal claims in connection with the information disseminated through our network, which could divert management s attention and require us to expend significant financial resources. We may face liability for claims of defamation, negligence, copyright, patent or trademark infringement and other claims based on the nature of the materials disseminated through our network. For example, lawsuits may be brought against us claiming that content distributed by some of our customers may be regulated or banned. In these and other instances, we may be required to engage in protracted and expensive litigation that could have the effect of diverting management s attention from our business and require us to expend significant financial resources. Our general liability insurance may not cover any of these claims or may not be adequate to protect us against all liability that may be imposed. In addition, on a limited number of occasions in the past, businesses, organizations and individuals have sent unsolicited commercial e-mails from servers hosted at our facilities to a number of people, typically to advertise products or services. This practice, known as spamming, can lead to statutory liability as well as complaints against service providers that enable these activities, particularly where recipients view the materials received as offensive. We have in the past received, and may in the future receive, letters from recipients of information transmitted by our customers objecting to the transmission. Although we prohibit our customers by contract from spamming, we cannot assure you that our customers will not engage in this practice, which could subject us to claims for damages.

Concerns relating to privacy and protection of customer and job seeker data on our America s Job Exchange website could damage our reputation and deter current and potential customers and job seekers from using our products and services. In fiscal year 2008 we launched America s Job Exchange, a successor to America s Job Bank. Concerns about our practices for America s Job Exchange with regard to the collection, use, disclosure or security of personal information or other privacy-related matters, even if unfounded, could damage our reputation, which in turn could significantly harm our business, financial condition and operating results. While we strive to comply with all applicable data protection laws and regulations, as well as our own posted privacy policies, any failure or perceived failure to comply may result in proceedings or actions against us by government entities or others, which could potentially have an adverse effect on our business. Moreover, failure or perceived failure to comply with our policies or applicable requirements related to the collection, use, sharing or security of personal information or other privacy-related matters could result in a loss of customer and job seeker confidence in us, which could adversely affect our business. Laws related to data protection continue to evolve. It is possible that certain jurisdictions may enact laws or regulations that impact our ability to offer our products and services and/or result in reduced traffic or contract terminations in those jurisdictions, which could harm our business.

Unauthorized access, phishing schemes and other disruptions could jeopardize the security of customer and job seeker information stored in our systems, and may result in significant liability to us and may cause existing customers and job seekers to refrain from doing business with us.

If we fail to attract or retain key officers, management and technical personnel, our ability to successfully execute our business strategy or to continue to provide services and technical support to our customers could be adversely affected and we may not be successful in attracting new customers. We believe that attracting, training, retaining and motivating technical and managerial personnel, including individuals with significant levels of infrastructure systems and application expertise, is a critical component of the future success of our business. Qualified technical personnel are likely to remain a limited resource for the foreseeable future and competition for these personnel is intense. The departure of any of our executive officers, particularly Arthur P. Becker, our Chief Executive Officer and President, or core members of our sales and marketing teams or technical service personnel, would have negative ramifications on our customer relations and operations. The departure of our executive officers could adversely affect the stability of our infrastructure and our ability to provide the guaranteed service levels our customers expect. Any officer or employee can terminate his or her relationship with us at any time. In addition, we do not carry life insurance on any of our personnel. Over the past three years, we have had reductions-in-force and departures of several members of senior management due to redundancies and restructurings resulting from the consolidation of our acquired companies. In the event of future reductions or departures of employees, our ability to successfully execute our business strategy, or to continue to provide services to our customers or attract new customers, could be adversely affected.

The unpredictability of our quarterly results may cause the trading price of our common stock to fluctuate or decline. Our quarterly operating results have previously varied, and may continue to vary significantly from quarter-to-quarter and period-to-period as a result of a number of factors, many of which are outside of our control and any one of which may cause our stock price to fluctuate. The primary factors that may affect our operating results include the following:

- a reduction of market demand and/or acceptance of our services;
- our ability to develop, market and introduce new services on a timely basis;
- the length of the sales cycle for our services;
- the timing and size of sales of our services, which depends on the budgets of our customers;
- downward price adjustments by our competitors;
- changes in the mix of services provided by our competitors;
- technical difficulties or system downtime affecting the Internet or our hosting operations;
- our ability to meet any increased technological demands of our customers; and
- the amount and timing of costs related to our marketing efforts and service introductions.

Due to the above factors, we believe that quarter-to-quarter or period-to-period comparisons of our operating results may not be a good indicator of our future performance. Our operating results for any particular quarter may fall short of our expectations or those of stockholders or securities analysts. In this event, the trading price of our common stock would likely fall.

If we are unsuccessful in pending and potential litigation matters, our financial condition may be adversely affected. We are currently involved in various pending and potential legal proceedings, including a class action lawsuit related to our initial public offering and a class action lawsuit related to an outage experienced by certain acquired customers of Alabanza. If we are ultimately unsuccessful in any of these matters, we could be required to pay substantial amounts of cash to the other parties. The amount and timing of any of these payments could adversely affect our financial condition.

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If the markets for outsourced information technology infrastructure and applications, Internet commerce and communication decline, there may be insufficient demand for our services and, as a result, our business strategy and objectives may fail. The increased use of the Internet for retrieving, sharing and transferring information among businesses and consumers is developing, and the market for the purchase of products and services over the Internet is still relatively new and emerging. Our industry has experienced periods of rapid growth, followed by a sharp decline in demand for products and services, which led to the failure in the last few years of many companies focused on developing Internet-related businesses. If acceptance and growth of the Internet as a medium for commerce and communication declines, our business strategy and objectives may fail because there may not be sufficient market demand for our managed IT services.

If we do not respond to rapid changes in the technology sector, we will lose customers. The markets for the technology-related services we offer are characterized by rapidly changing technology, evolving industry standards, frequent new service introductions, shifting distribution channels and changing customer demands. We may not be able to adequately adapt our services or to acquire new services that can compete successfully. In addition, we may not be able to establish and maintain effective distribution channels. We risk losing customers to our competitors if we are unable to adapt to this rapidly evolving marketplace.

The market in which we operate is highly competitive and is likely to consolidate, and we may lack the financial and other resources, expertise or capability necessary to capture increased market share or maintain our market share. We compete in the managed IT services market. This market is rapidly evolving, highly competitive and likely to be characterized by over-capacity and industry consolidation. Our competitors may consolidate with one another or acquire software application vendors or technology providers, enabling them to more effectively compete with us. Many participants in this market have suffered significantly in the last several years. We believe that participants in this market must grow rapidly and achieve a significant presence to compete effectively. This consolidation could affect prices and other competitive factors in ways that would impede our ability to compete successfully in the managed IT services market.

Further, our business is not as developed as that of many of our competitors. Many of our competitors have substantially greater financial, technical and market resources, greater name recognition and more established relationships in the industry. Many of our competitors may be able to:

- develop and expand their network infrastructure and service offerings more rapidly;
- adapt to new or emerging technologies and changes in customer requirements more quickly;
- take advantage of acquisitions and other opportunities more readily; or
- devote greater resources to the marketing and sale of their services and adopt more aggressive pricing policies than we can.

We may lack the financial and other resources, expertise or capability necessary to maintain or capture increased market share in this environment in the future. Because of these competitive factors and due to our comparatively small size and our lack of financial resources, we may be unable to successfully compete in the managed IT services market.

Difficulties presented by international economic, political, legal, accounting and business factors could harm our business in international markets. We currently operate two data centers in the United Kingdom. Revenue from our foreign operations accounted for approximately 7.6% of our total revenue during the fiscal year ended July 31, 2008. In fiscal year 2006, we expanded our operations to India, which has broadened our customer service support.

Although we expect to focus most of our growth efforts in the United States, we may enter into joint ventures or outsourcing agreements with third parties, acquire complementary businesses or operations, or establish and maintain new operations outside of the United States. Some risks inherent in conducting business internationally include:

- unexpected changes in regulatory, tax and political environments;
- longer payment cycles and problems collecting accounts receivable;
- geopolitical risks such as political and economic instability and the possibility of hostilities among countries or terrorism;

reduced protection of intellectual property rights;

fluctuations in currency exchange rates or imposition of restrictive currency controls;

our ability to secure and maintain the necessary physical and telecommunications infrastructure;

challenges in staffing and managing foreign operations;

employment laws and practices in foreign countries;

laws and regulations on content distributed over the Internet that are more restrictive than those currently in place in the United States; and

significant changes in immigration policies or difficulties in obtaining required immigration approvals.

Any one or more of these factors could adversely affect our international operations and consequently, our business.

We may become subject to burdensome government regulation and legal uncertainties that could substantially harm our business or expose us to unanticipated liabilities. It is likely that laws and regulations directly applicable to the Internet or to hosting and managed application service providers may be adopted. These laws may cover a variety of issues, including user privacy and the pricing, characteristics and quality of products and services. The adoption or modification of laws or regulations relating to commerce over the Internet could substantially impair the growth of our business or expose us to unanticipated liabilities. Moreover, the applicability of existing laws to the Internet and hosting and managed application service providers is uncertain. These existing laws could expose us to substantial liability if they are found to be applicable to our business. For example, we provide services over the Internet in many states in the United States and elsewhere and facilitate the activities of our customers in these jurisdictions. As a result, we may be required to qualify to do business, be subject to taxation or be subject to other laws and regulations in these jurisdictions, even if we do not have a physical presence, employees or property in those states.

The price of our common stock has been volatile, and may continue to experience wide fluctuations. Since January 2007, our common stock has closed as low as $0.38 per share and as high as $11.09 per share. The trading price of our common stock has been and may continue to be subject to wide fluctuations due to the risk factors discussed in this section and elsewhere in this report. Fluctuations in the market price of our common stock may cause an investor in our common stock to lose some or all of his investment.

Our common stock may be delisted from the Nasdaq Stock Market. Nasdaq s continued listing standards for our common stock require, among other things, that (i) we maintain a closing bid price for our common stock of at least $1.00, and (ii) we maintain: (A) stockholders equity of $2.5 million; (B) market value of listed securities of $35 million; or (C) net income from continuing operations of $500,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years. Our common stock recently has closed with a bid price of less than $1.00. In addition, we do not satisfy the stockholders equity, market value of listed securities or net income requirements. Failure to satisfy the Nasdaq continued listing standards could lead to a delisting of our common stock from Nasdaq. However, on October 16, 2008, Nasdaq announced that it had temporarily suspended its minimum bid price and market value of public float requirements for continued listing through January 16, 2009. Nasdaq adopted this measure to help companies remain listed in view of the extraordinary market conditions following the recent turmoil in the global economy and stock markets. Under the temporary relief provided by the new rules, companies will not be cited for bid price or market value of public float deficiencies. Nevertheless, NaviSite s failure to satisfy other continued listing requirements could lead to the receipt of a deficiency notice from Nasdaq and ultimately to a delisting from trading of our common stock. If our common stock were delisted from Nasdaq, among other things, this could result in a number of negative implications, including reduced liquidity in our common stock as a result of the loss of market efficiencies associated with Nasdaq and the loss of federal preemption of state securities laws as well as the potential loss of confidence by suppliers, customers and employees, the loss of analyst coverage and institutional investor interest, fewer business development opportunities, greater difficulty in obtaining financing and breaches of certain contractual obligations.

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Anti-takeover provisions in our corporate documents may discourage or prevent a takeover. Provisions in our certificate of incorporation and our by-laws may have the effect of delaying or preventing an acquisition or merger in which we are acquired or a transaction that changes our Board of Directors. These provisions:

- authorize the board to issue preferred stock without stockholder approval;
- prohibit cumulative voting in the election of directors;
- limit the persons who may call special meetings of stockholders; and
- establish advance notice requirements for nominations for the election of directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

Item 1B. *Unresolved Staff Comments*

None.

Item 2. *Properties*

Facilities

Our executive offices are located at 400 Minuteman Road, Andover, Massachusetts. We lease offices and data centers in various cities across the United States and have an office and data centers in the United Kingdom and an office in India. The table below sets forth a list of our leased offices and data centers:

Location	Type	Square Footage Leased (Approximate)	Lease Expiration
San Jose, CA (1)	Data Center and Office	66,350	November 2016
Los Angeles, CA	Data Center	34,711	February 2009
San Francisco, CA	Data Center	20,576	January 2010
Santa Clara, CA	Data Center	3,655	August 2009
Atlanta, GA	Office	4,598	June 2009
Chicago, IL (1)	Office	4,453	June 2009
Chicago, IL	Data Center	6,800	November 2010
Chicago, IL	Office	2,121	April 2012
Oak Brook, IL	Data Center	16,780	September 2019
Andover, MA	Office	25,817	January 2018
Andover, MA	Data Center and Office	86,931	January 2018
Minneapolis, MN (1)	Data Center and Office	54,474	June 2010
Syracuse, NY	Data Center	21,374	November 2015
Syracuse, NY (1)	Office	5,016	May 2009
New York, NY	Office	1,500	August 2013
New York, NY	Data Center	33,286	May 2018
Las Vegas, NV (2)	Data Center	28,560	February 2010
Dallas, TX	Data Center	27,370	March 2020
Houston, TX (1)	Data Center and Office	29,545	November 2008

Herndon, VA (1)(3)	Office	5,515	June 2011
Vienna, VA (3)	Data Center and Office	23,715	December 2009
Gurgaon, Haryana, India	Office	12,706	Month-to-Month
Watford, England	Data Center	10,008	February 2018
London, England	Data Center	4,017	March 2010

(1) We have idle office space at this facility from which we derive no economic benefit.

(2) We have entered into a sublease with a third party for this facility; however we retain the use of approximately 2,000 square feet.

(3) We have a subtenant for a portion of this space.

We believe that these offices and data centers are adequate to meet our foreseeable requirements and that suitable additional or substitute space will be available on commercially reasonable terms, if needed.

Item 3. ***Legal Proceedings***

IPO Securities Litigation

In 2001, lawsuits naming more than 300 issuers and over 50 investment banks were filed in the United States District Court for the Southern District of New York and assigned to the Honorable Shira A. Scheindlin (the Court) for all pretrial purposes (the IPO Securities Litigation). Between June 13, 2001 and July 10, 2001 five purported class action lawsuits seeking monetary damages were filed against us, Joel B. Rosen, our then chief executive officer, Kenneth W. Hale, our then chief financial officer, Robert E. Eisenberg, our then president, and the underwriters of our initial public offering of October 22, 1999. On September 6, 2001, the Court consolidated the five similar cases and a consolidated, amended complaint was filed on April 19, 2002 (the Class Action Litigation) against us and Messrs. Rosen, Hale and Eisenberg (collectively, the NaviSite Defendants) and against underwriter defendants Robertson Stephens (as successor-in-interest to BancBoston), BancBoston, J.P. Morgan (as successor-in-interest to Hambrecht & Quist), Hambrecht & Quist and First Albany. The plaintiffs uniformly alleged that all defendants, including the NaviSite Defendants, violated Sections 11 and 15 of the Securities Act of 1933, Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 by issuing and selling our common stock in the offering, without disclosing to investors that some of the underwriters, including the lead underwriters, allegedly had solicited and received undisclosed agreements from certain investors to purchase aftermarket shares at pre-arranged, escalating prices and also to receive additional commissions and/or other compensation from those investors. The Class Action Litigation seeks certification of a plaintiff class consisting of all persons who acquired shares of our common stock between October 22, 1999 and December 6, 2000. The claims against Messrs. Rosen, Hale and Eisenberg were dismissed without prejudice on November 18, 2002, in return for their agreement to toll any statute of limitations applicable to those claims. At this time, plaintiffs have not specified the amount of damages they are seeking in the Class Action Litigation. On October 13, 2004, the Court certified a class in a sub-group of cases (the Focus Cases) in the IPO Securities Litigation, which was vacated on December 5, 2006 by the United States Court of Appeals for the Second Circuit (the Second Circuit). The Class Action Litigation is not one of the Focus Cases. Plaintiffs-appellees January 5, 2007 petition with the Second Circuit for rehearing and rehearing en banc was denied by the Second Circuit on April 6, 2007. Plaintiffs renewed their certification motion in the Focus Cases on September 27, 2007 as to redefined classes pursuant to Fed. R. Civ. P. 23(b)(3) and 23(c)(4). On October 3, 2008, after briefing, in connection with the renewed class certification proceedings was completed, plaintiffs withdrew without prejudice the renewed certification motion in the Focus Cases. On October 10, 2008, the Court confirmed plaintiffs request and directed the clerk to close the renewed certification motion. Additionally, on August 14, 2007, plaintiffs filed amended class action complaints in the Focus Cases, along with an accompanying set of Amended Master Allegations (collectively, the Amended Complaints). Plaintiffs therein (i) revise their allegations with respect to (1) the issue of investor knowledge of the alleged undisclosed agreements with the underwriter defendants and (2) the issue of loss causation; (ii) include new pleadings concerning alleged governmental investigations of certain underwriters; and (iii) add additional plaintiffs to certain of the Amended Complaints. On March 26, 2008, the Court entered an order granting in part and denying in part the motions to dismiss filed by the defendants named in the Focus Cases. Specifically, the Court dismissed the Section 11 claims brought by plaintiffs (1) who lacked recoverable Section 11 damages and (2) whose claims were time barred, but otherwise denied the motions as to the other claims alleged in the Amended Complaints.

On October 12, 2007, a purported shareholder of the Company filed a complaint for violation of Section 16(b) of the Securities Exchange Act of 1934, which prohibits short-swing trading, against two of the underwriters of the public offering at issue in the Class Action Litigation. The complaint is pending in the United States District Court for the Western District of Washington and is captioned Vanessa Simmonds v. Bank of America Corp., et al. An

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amended complaint was filed on February 28, 2008. Plaintiff seeks the recovery of short-swing profits from the underwriters on behalf of the Company, which is named only as a nominal defendant and from whom no recovery is sought. Similar complaints have been filed against the underwriters of the public offerings of approximately 55 other issuers also involved in the IPO Securities Litigation. A joint status conference was held on April 28, 2008, at which the Court stayed discovery and ordered the parties to file motions to dismiss by July 25, 2008. On July 25, 2008, the Company joined 29 other nominal defendant issuers and filed Issuer Defendants Joint Motion to Dismiss the Amended Complaint. On the same date, the Underwriter Defendants also filed a Joint Motion to Dismiss. On September 8, 2008, plaintiff filed her oppositions to the motions. The replies in support of the motions to dismiss were filed on October 23, 2008.

We believe that the allegations against us are without merit and we intend to vigorously defend against the plaintiffs claims. Due to the inherent uncertainty of litigation, we are not able to predict the possible outcome of the suits and their ultimate effect, if any, on our business, financial condition, results of operations or cash flows.

Other litigation

In October 2007, the Company, pursuant to its integration plans, closed the former Alabanza data center in Baltimore, Maryland and moved all equipment to the Company s data center in Andover, Massachusetts (the Data Migration). In connection with the Data Migration, the Company encountered unforeseen circumstances which led to extended down-time for certain of its customers.

On November 14, 2007, Pam Kagan Marketing, Inc., d/b/a Earthplaza, filed a complaint in the United States District Court for the District of Maryland (the Court) against the Company and Alabanza Corporation seeking a class status for the customers who experienced web hosting service interruptions as a result of the Data Migration (the November Class Action Litigation). The total damages claimed approximate $5.0 million. On January 4, 2008, Palmatec, LLC, NYC Merchandise amd Taglogic RFID, Ltd. filed a complaint in the Maryland State Court, Circuit Court for Baltimore against the Company seeking a class status for the direct customers (the Direct Subclass) and the entities that purchased hosting services from those direct customers (the Non-Privity Subclass) (the January Class Action Litigation). The total damages claimed approximate $10.0 million. The January Class Action Litigation was removed to the Court by the Company. On May 11, 2008, the Court issued an order consolidating the two cases. On August 5, 2008, the plaintiffs in the January Class Action Litigation voluntarily withdrew their case, without prejudice, because of the inadequacy of their class representative. The claims of the Direct Subclass continue to be litigated in the November Class Action Litigation. The Company believes that the potential plaintiffs in the combined class action may be denied class status and further, that the plaintiffs claims are without merit. The Company plans to defend itself vigorously; however, at this time, due to the inherent uncertainty of litigation, we are not able to predict the possible outcome of the suit and its ultimate effect, if any, on our business, financial condition, results of operations or cash flows.

Item 4. ***Submission of Matters to a Vote of Security Holders***

None.

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PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Price Range of Common Stock

Our common stock is currently traded on the NASDAQ Capital Market under the symbol NAVI. As of October 24, 2008, there were 209 holders of record of our common stock. Because brokers and other institutions on behalf of stockholders hold many of such shares, we are unable to estimate the total number of stockholders represented by these record holders. The following table sets forth for the periods indicated the high and low sales prices for our common stock as reported on the NASDAQ Capital Market.

	High	Low
Fiscal Year Ended July 31, 2008		
May 1, 2008 through July 31, 2008	$ 4.95	$ 3.08
February 1, 2008 through April 30, 2008	$ 4.75	$ 2.05
November 1, 2007 through January 31, 2008	$ 11.29	$ 3.53
August 1, 2007 through October 31, 2007	$ 11.24	$ 6.18
Fiscal Year Ended July 31, 2007		
May 1, 2007 through July 31, 2007	$ 9.36	$ 6.06
February 1, 2007 through April 30, 2007	$ 7.08	$ 5.25
November 1, 2006 through January 31, 2007	$ 7.22	$ 3.44
August 1, 2006 through October 31, 2006	$ 4.30	$ 3.33

We believe that a number of factors may cause the market price of our common stock to fluctuate significantly. See Item 1A. Risk Factors.

We have never paid cash dividends on our common stock. We currently anticipate retaining all available earnings, if any, to finance internal growth and product and service development. Payment of dividends in the future will depend upon our earnings, financial condition, anticipated cash needs and such other factors as the directors may consider or deem appropriate at the time. In addition, the terms of our credit agreement with a syndicated group of lenders restrict the payment of cash dividends on our common stock. Additionally, on September 12, 2007, we issued 3,125,000 shares of Preferred Stock and additional shares of the Preferred Stock have been and will be issued as in-kind dividends that accrue on the outstanding Preferred Stock. The holders of the Preferred Stock are entitled to receive dividends prior and in preference to any declaration or payment of any dividend to a common stockholder.

We did not repurchase any shares of common stock during fiscal year 2008.

Information regarding our equity compensation plans and the securities authorized for issuance thereunder is set forth in Item 12 below.

On September 12, 2007, the Company acquired the outstanding capital stock of netASPx, Inc. for total consideration of $40.8 million. The consideration consisted of $15.5 million in cash, subject to adjustment based on netASPx s cash at the closing date, and the issuance of 3,125,000 shares of the Preferred Stock with a fair value of $24.9 million at the time of issuance. The Preferred Stock accrues payment-in-kind (PIK) dividends at 8% per annum, payable quarterly, increasing to 10% per annum in September 2008 and 12% per annum in March 2009.

Pursuant to the obligation described above, on September 15, 2008, the Company issued a PIK dividend of an aggregate of 66,397.75 shares of the Preferred Stock to its holders of Preferred Stock.

The shares issued as described in this Item 5 were not registered under the Securities Act of 1933, as amended (the Securities Act). The Company relied on the exemption from registration provided by Section 4(2) of the Securities Act as an issuance by the Company not involving a public offering. No underwriters were involved in the issuance of the Preferred Stock.

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Item 6. ***Selected Financial Data***

The following selected consolidated financial data should be read in conjunction with our consolidated financial statements and related notes and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this annual report on Form 10-K. Historical results are not necessarily indicative of results of any future period.

	Year Ended July 31,				
	2008	2007	2006	2005	2004
	(In thousands, except per share data)				
Revenue, net	$ 154,194	$ 125,860	$ 108,844	$ 109,731	$ 91,126
Revenue, related parties	372	322	243	132	46
Total revenue	154,566	126,182	109,087	109,863	91,172
Cost of revenue	106,897	85,196	75,064	80,227	68,379
Impairment, restructuring and other				383	917
Total cost of revenue	106,897	85,196	75,064	80,610	69,296
Gross profit	47,669	40,986	34,023	29,253	21,876
Operating expenses:					
Selling and marketing	19,909	16,924	14,756	12,993	10,642
General and administrative	22,773	22,043	21,787	23,600	24,714
Impairment, restructuring and other		(231)	1,373	2,662	5,286
Total operating expenses	42,682	38,736	37,916	39,255	40,642
Income (loss) from operations	4,987	2,250	(3,893)	(10,002)	(18,766)
Other income (expense):					
Interest income	264	337	283	61	126
Interest expense	(12,033)	(12,476)	(9,585)	(7,590)	(3,181)
Loss on debt extinguishment	(1,651)	(15,712)			
Other income (expense), net	2,295	864	437	2,785	468
Loss before income tax expense	(6,138)	(24,737)	(12,758)	(14,746)	(21,355)
Income tax expense	(1,834)	(1,173)	(1,173)	(1,338)	(1)
Net loss from continuing operations	(7,972)	(25,910)	(13,931)	(16,084)	(21,354)
Loss from discontinued operations net of income taxes	(712)				
Net loss	(8,684)	(25,910)	(13,931)	(16,084)	(21,354)
Accretion of preferred stock dividends	(2,656)				
	$ (11,340)	$ (25,910)	$ (13,931)	$ (16,084)	$ (21,354)

Net loss attributable to common shareholders					
Basic and diluted net loss per common share					
Loss from continuing operations before discontinued operations attributable to common stockholders	$ (0.31)	$ (0.85)	$ (0.49)	$ (0.57)	$ (0.85)
Loss from discontinued operations, net of income taxes	(0.02)				
Net loss attributable to common stockholders	$ (0.33)	$ (0.85)	$ (0.49)	$ (0.57)	$ (0.85)
Basic and diluted weighted average number of common shares outstanding	34,731	30,512	28,601	28,202	25,160
BALANCE SHEET DATA:					
Working capital (deficit)	$ 1,658	$ 10,611	$ (9,072)	$ (77,560)	$ (36,711)
Total assets	$ 175,713	$ 116,244	$ 102,409	$ 101,177	$ 123,864
Long-term obligations	$ 133,158	$ 97,072	$ 70,817	$ 5,515	$ 50,224
Stockholders equity (deficit)	$ (18,772)	$ (13,864)	$ (1,976)	$ (2,672)	$ 11,082

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Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations*

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended, that involve risks and uncertainties. All statements other than statements of historical information provided herein are forward-looking statements and may contain information about financial results, economic conditions, trends and known uncertainties. Our actual results could differ materially from those discussed in the forward-looking statements as a result of a number of factors, which include those discussed in this section and elsewhere in this report under Item 1A. Risk Factors and the risks discussed in our other filings with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management s analysis, judgment, belief or expectation only as of the date hereof. We undertake no obligation to publicly revise these forward-looking statements to reflect events or circumstances that arise after the date hereof.

Overview

We provide our services to customers typically pursuant to agreements with a term of one to five years with monthly payment installments. As a result, these agreements provide us with a base of recurring revenue. Our revenue increases by adding new customers or selling additional services to existing customers. Our overall base of recurring revenue is affected by new customers, renewals or terminations of agreements with existing customers.

A large portion of the costs to operate our data centers, such as rent, product development and general and administrative expenses, does not depend strictly on the number of customers or the amount of services we provide. As we add new customers or new services to existing customers, we generally incur limited incremental costs relating to telecommunications, utilities, hardware and software costs and payroll expenses. We have substantial capacity to add customers to our data centers. Our relatively fixed cost base, sufficient capacity for expansion and limited incremental variable costs provide us with the opportunity to grow profitably. However, these same fixed costs present us with the risk that we may incur losses if we are unable to generate sufficient revenue.

In recent years, we have grown through acquisitions of new businesses and have restructured our historical operations. Specifically, in December 2002, we acquired ClearBlue Technologies Management, Inc. (a wholly-owned subsidiary of our majority stockholder at the time of the acquisition and therefore was accounted for as a common control merger) (CBTM), adding application management and development capabilities to our managed application services. In February 2003, we acquired Avasta, Inc. (Avasta), adding capabilities to our managed application services. In April 2003, we acquired Conxion Corporation (Conxion), providing key services to our managed application services and managed infrastructure services. In May 2003, we acquired assets of Interliant, Inc., forming the core of our managed messaging services. In August 2003 and April 2004, we acquired assets of CBT (which was our majority stockholder at that time and therefore was accounted for as a common control merger) related to co-location, bandwidth, security and disaster recovery services, enhancing our managed infrastructure services. In June 2004, we acquired substantially all of the assets and liabilities of Surebridge, Inc. (Surebridge), adding significant capabilities to our managed application and professional services businesses. Prior to September 2002, substantially all of our services were managed application services. We have added managed infrastructure and managed messaging services and increased managed applications and professional services since that time. This transformation in our business will result in our recent results being more relevant to an understanding of our business than our historical results. We also expect to make additional acquisitions to take advantage of our available capacity, which will have significant effects on our future financial condition and results of operations.

Our acquisitions of CBTM and the assets and certain liabilities of CBT were accounted for in a manner similar to a pooling-of-interest due to common control ownership. The assets and the liabilities of CBT, CBTM and NaviSite were combined at their historical amounts beginning on September 11, 2002, the date on which CBT obtained a majority ownership of NaviSite. Our acquisitions of Avasta and Conxion, selected assets of Interliant, Inc. and our acquisition of substantially all of the assets and liabilities of Surebridge, Inc. were accounted for using the purchase method of accounting and as such, the results of operations and cash flows relating to these acquisitions were included in our Consolidated Statements of Operations and Consolidated Statements of Cash Flows from their respective dates of acquisition of February 5, 2003, April 2, 2003, May 16, 2003 and June 10, 2004.

During the first quarter of fiscal year 2008, the Company completed four acquisitions. In August 2007 we acquired the outstanding capital stock of Jupiter Hosting, Inc. (Jupiter), a privately held company based in Santa Clara, CA that provides managed hosting services and acquired the assets and assumed certain liabilities of Alabanza, LLC and Hosting Ventures, LLC (collectively Alabanza). Alabanza was a provider of dedicated and shared managed hosting services. In September 2007 the Company acquired the outstanding capital stock of netASPx, Inc. (netASPx), an application management service provider and in October 2007 we acquired the assets of iCommerce, Inc., a reseller of dedicated hosting services. All of the acquisitions during fiscal year 2008 were accounted for using the purchase method of accounting and as such, the results of operations and cash flow related to these acquisitions were included in the Consolidated Statement of Operations and Consolidated Statement of Cash Flows from their respective dates of acquisition.

Results of Operations for the Three Years Ended July 31, 2008, 2007 and 2006

The following table sets forth the percentage relationships of certain items from our Consolidated Statements of Operations as a percentage of total revenue for the periods indicated.

	Year Ended July 31,		
	2008	**2007**	**2006**
Revenue, net	99.8%	99.7%	99.8%
Revenue, related parties	0.2%	0.3%	0.2%
Total revenue	100.0%	100.0%	100.0%
Total Cost of revenue	69.2%	67.5%	68.8%
Gross profit	30.8%	32.5%	31.2%
Operating expenses:			
Selling and marketing	12.9%	13.4%	13.5%
General and administrative	14.7%	17.5%	20.0%
Impairment, restructuring and other	%	(0.2)%	1.3%
Total operating expenses	27.6%	30.7%	34.8%
Income (loss) from operations	3.2%	1.8%	(3.6)%
Other income (expense):			
Interest income	0.2%	0.3%	0.3%
Interest expense	(7.8)%	(9.9)%	(8.8)%
Loss on debt extinguishment	(1.1)%	(12.5)%	%
Other income (expense), net	1.5%	0.7%	0.4%
Loss from continuing operations before income taxes and discontinued operations	(4.0)%	(19.6)%	(11.7)%
Income taxes	(1.2)%	(0.9)%	(1.1)%
Loss from continuing operations before discontinued operations	(5.2)%	(20.5)%	(12.8)%
Discontinued operation, net of income taxes	(0.4)%		

Net loss	(5.6)%	(20.5)%	(12.8)%
Accretion of preferred stock dividends	(1.7)%	%	%
Net loss attributable to common shareholders	(7.3)%	(20.5)%	(12.8)%

Comparison of the Years 2008, 2007 and 2006

Revenue

We derive our revenue from managed IT services, including hosting, co-location and application services comprised of a variety of service offerings and professional services, to mid-market companies and organizations, including mid-sized companies, divisions of large multi-national companies and government agencies.

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Total revenue for the fiscal year ended July 31, 2008 increased 22.5% to approximately $154.6 million from approximately $126.2 million for the fiscal year ended July 31, 2007. The overall growth of approximately $28.4 million in revenue was mainly due to the addition of revenue from the companies acquired in August, September and October of 2007. Revenue from related parties increased 16% during the year ended July 31, 2008 to approximately $372,000 from approximately $322,000 during the year ended July 31, 2007.

Total revenue for the fiscal year ended July 31, 2007 increased 15.7% to approximately $126.2 million from approximately $109.1 million for the fiscal year ended July 31, 2006. The increase in revenue is primarily related to overall growth of our business. Specifically, we experienced continued growth in our hosting business derived from increased revenue from managed application services, application management and co-location services along with increased revenue from professional services. Revenue from related parties increased 33% during the year ended July 31, 2007 to approximately $322,000 from approximately $243,000 during the year ended July 31, 2006.

One unrelated customer accounted for 8% and 9% of our total revenue in fiscal years 2007 and 2006, respectively. No customer accounted for more than 5% of total revenues in fiscal year 2008.

Cost of Revenue and Gross Profit

Cost of revenue consists primarily of salaries and benefits for operations personnel, bandwidth fees and related internet connectivity charges, equipment costs and related depreciation and costs to run our data centers, such as rent and utilities.

Total cost of revenue of $106.9 million for the fiscal year ended July 31, 2008 increased approximately $21.7 million, or 25.5% from the cost of revenue of approximately $85.2 million for the fiscal year ended July 31, 2007. As a percentage of revenue, total cost of revenue for the fiscal year ended July 31, 2008 increased to 69.2% from 67.5% for the fiscal year ended July 31, 2007. The overall increase of approximately $21.7 million was primarily due to higher costs necessary to support the increase in revenues of $28.4 million. Incremental costs of revenue consisted of higher salaries and related costs (including stock based compensation and travel expenses) of approximately $7.8 million, increased intangible asset amortization expense of approximately $3.8 million resulting from the acquisitions of Alabanza, Jupiter, netASPx and iCommerce, Inc. during fiscal year 2008, increased depreciation expense of approximately $3.9 million, increased facility related expenses including rent and utilities of approximately $4.1 million, increased telecommunication related expenses of approximately $2.1 million and increased third party hardware and software pass-through charges and hardware and software maintenance and licensing costs of approximately $1.3 million and a one time datacenter migration charge of $0.4 million. These incremental expenses were partially offset by lower costs of outside consultants and billable expenses related to professional services revenue delivery of approximately $1.7 million during the period.

Total cost of revenue increased approximately 13.5% to approximately $85.2 million during the fiscal year ended July 31, 2007 from approximately $75.1 million for the fiscal year ended July 31, 2006. As a percentage of total revenue, total cost of revenue decreased from 68.8% of revenue in fiscal year 2006 to 67.5% of revenue in fiscal year 2007. The increase in total cost of revenue of approximately $10.1 million resulted primarily from $6.6 million of increased costs necessary to support the growth in professional services revenue and increased equipment and operating costs totaling approximately $3.7 million necessary to support the growth experienced in our hosting business, increased stock compensation expense of $0.3 million, all offset by lower amortization costs related to intangible assets of $0.9 million.

Gross profit of $47.7 million for the fiscal year ended July 31, 2008 increased approximately $6.7 million, or 16.3%, from a gross profit of approximately $41.0 million for the fiscal year ended July 31, 2007. Gross profit for the fiscal year ended July 31, 2008 represented 30.8% of total revenue, as compared to 32.5% of total revenue for the fiscal year ended July 31, 2007. Gross profit percentage was negatively impacted during fiscal year 2008 as compared to fiscal 2007 mainly due higher intangible amortization costs and higher levels of professional services business which carries overall lower gross profit.

Gross profit of $41.0 million for the fiscal year ended July 31, 2007 increased approximately $7.0 million, or 21%, from a gross profit of approximately $34.0 million for the fiscal year ended July 31, 2006. Gross profit for the fiscal year ended July 31, 2007 represented 32.5% of total revenue, as compared to 31.2% of total revenue for the fiscal year ended July 31, 2006. The improvement in gross profit as a percentage of total revenue was primarily attributable to our continued focus on cost containment and increased reliance on our operations in India.

Operating Expenses

Selling and Marketing Selling and marketing expense consists primarily of salaries and related benefits, commissions and marketing expenses such as advertising, product literature, trade show costs and marketing and direct mail programs.

Selling and marketing expense increased 17.8% to approximately $19.9 million, or 12.9% of total revenue for the fiscal year ended July 31, 2008 from approximately $16.9 million, or 13.4% of total revenue for the fiscal year ended July 31, 2007. The increase of approximately $3.0 million resulted primarily from increased salary and headcount related costs of $3.5 million (including stock based compensation) supporting the growth in total revenue during the fiscal year ended July 31, 2008, and increased lead referral fees of $0.3 million. These cost increases were partially offset by decreased commission related expenses of $0.5 million and decreased sales related marketing expenses of $0.3 million.

Selling and marketing expense increased 14.2% to approximately $16.9 million, or 13.4% of total revenue for the fiscal year ended July 31, 2007 from approximately $14.8 million, or 13.5% of total revenue for the fiscal year ended July 31, 2006. The increase of approximately $2.3 million resulted primarily from increased salary and related costs of $0.6 million (including stock based compensation) supporting the growth in total revenue during the fiscal year ended July 31, 2007, increased commission expenses and partner fees associated with higher bookings realized during the fiscal year ended July 31, 2007 of $1.0 million, and $0.3 million of increased spending on sales related marketing programs.

General and Administrative General and administrative expense includes the costs of financial, human resources, IT and administrative personnel, professional services, bad debt and corporate overhead.

General and administrative expense increased 4% to approximately $22.8 million, for the fiscal year ended July 31, 2008 from approximately $22.0 million, for the fiscal year ended July 31, 2007. General and administrative expense decreased to 14.7% of total revenue for the fiscal year ended July 31, 2008 from 17.5% of total revenue for the fiscal year ended July 31, 2007. The total increased expenses of $0.8 million were attributable to an increase of $1.1 million in facilities related costs including rent and utilities, increased consulting and professional services of $1.0 million, increased bad debt expense of $0.5 million, and increased miscellaneous fees including non-income tax expenses and administrative service charges of $0.7 million. The increased expenses were offset by lower transaction related costs of $1.8 million, lower salary costs (including stock based compensation) of $0.4 million and a net decrease in depreciation and amortization of $0.3 million.

General and administrative expense increased 0.9% to approximately $22.0 million, for the fiscal year ended July 31, 2007 from approximately $21.8 million, for the fiscal year ended July 31, 2006. General and administrative expense decreased to 17.5% of total revenue for the fiscal year ended July 31, 2007 from 20.0% of total revenue for the fiscal year ended July 31, 2006. The increase of approximately $0.2 million is due to an increase of approximately $1.0 million in facilities related costs, and $1.1 million in amortization of transaction costs, offset by a decrease of $1.2 million of stock compensation expense, $0.3 million in professional fees and $0.4 million related to decreased miscellaneous costs and administrative service charges.

Operating Expenses Impairment, Restructuring and Other

No impairment, restructuring, or other charges were recorded in fiscal year 2008.

The Company recorded a net impairment recovery of $0.2 million in fiscal 2007 primarily due to an impairment recovery of approximately $0.3 million related to revised assumptions due to securing a sublease of an impaired facility during the fiscal year ended July 31, 2007, offset by an approximate $0.1 million impairment charge related to the abandonment of additional space in our Syracuse, New York facility.

The Company recorded $1.4 million of net lease impairment charges during fiscal year 2006, resulting primarily from an adjustment to a lease modification for our impaired Chicago facility and revisions in assumptions associated with impaired facilities in Houston, Texas, Syracuse, New York, and San Jose, California partially offset by a $0.2 million impairment credit to operating expense, resulting from a settlement with the landlord of the Company s abandoned property in Lexington, Massachusetts.

Interest Income

Interest income decreased 21.7% to approximately $264,000, or 0.2% of total revenue, for the fiscal year ended July 31, 2008 from approximately $337,000, or 0.3% of total revenue, for the fiscal year ended July 31, 2007. The decrease of $73,000 is mainly due to lower levels of average cash balances during the year ended July 31, 2008 as compared to the fiscal year ended July 31, 2007, as a result of the Company s use of cash for acquisitions during fiscal year 2008.

Interest income increased 19.1% to approximately $337,000, or 0.3% of total revenue, for the fiscal year ended July 31, 2007 from approximately $283,000, or 0.3% of total revenue, for the fiscal year ended July 31, 2006. The increase of $54,000 is mainly due to an increase in the rate of interest on our security deposits, and a higher average cash balances during the year ended July 31, 2007 as compared to the fiscal year ended July 31, 2006.

Interest Expense

Interest expense decreased 4.0% to approximately $12.0 million, or 7.8% of total revenue, for the fiscal year ended July 31, 2008 from approximately $12.5 million, or 9.9% of total revenue, for the fiscal year ended July 31, 2007. The decrease of $0.5 million is primarily related to a lower rate of interest on our outstanding long-term debt during the fiscal year ended July 31, 2008. The average long-term debt balance during the fiscal year ended July 31, 2008 compared to the fiscal year ended July 31, 2007 was higher due to an increase in the term loan balance as a result of the debt refinancing in June 2007 and the acquisitions done in first quarter of fiscal year 2008.

Interest expense increased 30.2% to approximately $12.5 million, or 9.9% of total revenue, for the fiscal year ended July 31, 2007 from approximately $9.6 million, or 8.8% of total revenue, for the fiscal year ended July 31, 2006. The increase of $2.9 million is primarily related to an increased rate of interest on our outstanding long-term debt during the fiscal year ended July 31, 2007 and a higher average long-term debt balance during the fiscal year ended July 31, 2007 compared to the fiscal year ended July 31, 2006.

Loss on debt extinguishment

During the year ended July 31, 2008, the Company recorded a loss on debt extinguishment of $1.7 million in connection with the refinancing of its credit agreement completed in September 2007. The total amount of the loss on debt extinguishment consisted of the write-off of unamortized transaction fees and expenses related to the prior refinancing of the Company s long-term debt in June 2007.

During the year ended July 31, 2007, the Company recorded a loss on debt extinguishment of approximately $15.7 million in connection with the refinancing of the Company s long-term debt in June 2007. The loss on debt extinguishment consisted of an approximate $3.0 million pre-payment penalty due to Silver Point Finance LLC in connection with the refinancing of outstanding debt, approximately $8.6 million of unamortized value ascribed to warrants issued in connection with the outstanding debt, approximately $0.8 million related to the write-off of the unamortized debt discount (recorded in connection with the embedded derivative) related to the original debt and approximately $4.1 million of unamortized transaction fees and expenses.

Other Income (Expense), Net

Other income was approximately $2.3 million for the fiscal year ended July 31, 2008, as compared to other income of approximately $0.9 million for the fiscal year ended July 31, 2007. Other income consists of a $1.6 million gain attributed to the settlement of the AppliedTheory litigation coupled with $0.7 million for sub-lease rental income and other miscellaneous income.

Other income was approximately $0.9 million for the fiscal year ended July 31, 2007, as compared to other income of approximately $0.4 million for the fiscal year ended July 31, 2006. Other income consists of sub-lease rental income and other miscellaneous income.

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Income Tax Expense

The Company recorded $1.8 million of deferred income tax expense for the fiscal year ended July 31, 2008, $0.7 million more that the amounts recorded for the years ended July 31, 2007 and July 31, 2006. No income tax benefit was recorded for the losses incurred due to a valuation allowance recognized against deferred tax assets. The deferred tax expense resulted from tax goodwill amortization related to the Surebridge asset acquisition in June 2004, the acquisition of certain AppliedTheory Corporation assets by CBTM prior to the pooling of interests in December 2002, the asset acquisition of Alabanza in September 2007, and the asset acquisition of iCommerce, Inc. in October 2007. Accordingly, the acquired goodwill and intangible assets for these acquisitions are amortizable for tax purposes over fifteen years. For financial statement purposes, goodwill is not amortized for any of these acquisitions but is tested for impairment annually. Tax amortization of goodwill results in a taxable temporary difference which will not reverse until the goodwill is impaired or written off. The resulting taxable temporary difference may not be offset by deductible temporary differences currently available, such as net operating loss carryforwards, which expire within a definite period.

Discontinued Operations

During the year ended July 31, 2008, the Company s loss from discontinued operations was $0.7 million. The discontinued operations relates to the Company s employment services operation called America s Job Exchange (AJE). During fiscal year 2008 the Company made the determination that AJE was not core to our business and is actively looking to dispose of this asset.

Liquidity and Capital Resources

As of July 31, 2008, our principal sources of liquidity included cash and cash equivalents of $3.3 million and a revolving credit facility of $10.0 million provided under our credit agreement ($5.0 million available at July 31, 2008) with a lending syndicate. Our current assets were substantially equal to our current liabilities at July 31, 2008, giving us a neutral working capital position including cash and cash equivalents of $3.3 million as compared to a working capital of $10.6 million, including cash and cash equivalents of $11.7 million, at July 31, 2007.

Cash and cash equivalents decreased approximately $8.4 million for the fiscal year ended July 31, 2008. The primary uses of cash for the fiscal year ended July 31, 2008 included $31.4 million used for acquisitions, net of cash acquired, $12.0 million for purchases of property, plant and equipment, $7.9 million of payments on notes payable and capital lease obligations, $6.0 million settlement of the AppliedTheory promissory notes, $1.5 million of payments for debt issuance costs and $0.6 million used for discontinued operations. Our primary sources of cash included approximately $6.6 million in cash provided by operations, $28.9 million in proceeds from borrowings on notes payable, $13.5 million related to the release of restricted cash and approximately $2.0 million in proceeds from the exercise of employee stock options and employee stock purchases. Net cash provided by operating activities of approximately $6.6 million for the fiscal year ended July 31, 2008 resulted from the funding of our net loss of $8.7 million, $13.5 million in net changes in operating assets and liabilities offset by a loss on debt extinguishment of $1.7 million, non-cash charges of $28.0 million and $1.6 million gain on settlement of the AppliedTheory litigation. At July 31, 2008, we had an accumulated deficit of $504.5 million.

During fiscal year 2008, the Company entered into a deposit agreement to secure additional data center space in the U.K., totaling $5.0 million (which is reflected as a $5.0 million use of cash and is included in the total use of cash related to net change in operating assets and liabilities of $13.5 million). Excluding the $5.0 million deposit, which was returned to the Company in September 2008, the Company generated $11.6 million in net cash flows from operating activities for the year ended July 31, 2008.

Our revolving credit facility with our lending group allows for maximum borrowing of $10.0 million and expires in June 2012. Outstanding amounts will bear interest at either the LIBOR rate plus 3.5% or the Base Rate, as defined in the credit agreement, plus the Federal Funds Effective Rate plus 0.5%, at the Company s option. Upon the attainment of a Consolidated Leverage Ratio, as defined in the credit agreement, of no greater than 3:1, the interest rate under the LIBOR option can decrease to LIBOR plus 3.0%. In June 2008 the credit agreement was modified to increase the applicable margin of the loan to either 5% for LIBOR or 4% for ABR loans and minimum LIBOR was fixed at 3.15%. Interest becomes due and is payable quarterly in arrears.

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The Company believes that our existing cash and cash equivalents, cash flow from operations and existing amounts available under our credit facility will be sufficient to meet our anticipated cash needs for at least the next twelve months.

Contractual Obligations and Commercial Commitments

We are obligated under various capital and operating leases for facilities and equipment. Future minimum annual rental commitments under capital and operating leases and other commitments, as of July 31, 2008, are as follows:

Description	Total	Less than 1 Year	1-3 Years (In thousands)	3-5 Years	More than 5 Years
Short/Long-term debt	$ 113,950	$ 6,100	$ 2,200	$ 105,650	$
Interest on debt (a)	43,144	9,051	17,685	16,408	
Capital leases	30,840	5,917	7,032	5,571	12,320
Bandwidth commitments	4,178	2,321	1,857		
Property leases (b)(c)(d)	83,946	12,578	19,442	17,983	33,943
Total	$ 276,058	$ 35,967			