NAVISITE INC
Form 10-K
October 26, 2006

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, 2006

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	*(I.R.S. Employer*
of incorporation or organization)	*Identification No.)*

400 Minuteman Road	**01810**
Andover, Massachusetts	*(zip code)*
(Address of principal executive offices)	

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, or a non-accelerated filer. See definition of   accelerated filer and large accelerated filer   in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer o   Accelerated filer o   Non-accelerated filer þ

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, 2006, based upon the closing price of a share of the Registrant s Common Stock on such date as reported by the Nasdaq Capital Market: $5,641,283.

On September 30, 2006, the Registrant had outstanding 29,059,977 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, 2006, 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.

**2006 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, Inc. provides Application Management, Hosting and Professional services for mid- to large-sized organizations. Leveraging our set of technologies and subject matter expertise, we deliver cost-effective, flexible solutions that provide responsive and predictable levels of service for our customers businesses. We provide services throughout the information technology lifecycle. We are dedicated to delivering quality services and meeting rigorous standards, including SAS 70, Microsoft Gold, and Oracle Certified Partner certifications.

We believe that by leveraging economies of scale utilizing our global delivery approach, industry best practices and process automation, our services enable our customers to achieve significant cost savings. In addition, we are able to leverage our application services platform, NaviView™, to enable software to be delivered on-demand over the Internet, providing an alternative delivery model to the traditional licensed software model. As the platform provider for an increasing number of independent software vendors (ISVs), we enable solutions and services to a wider and growing customer base.

Our services include:

Application Management

   Application management services   Defined services provided for specific packaged applications that are incremental to managed services. Services can include monitoring, diagnostics and problem resolution. Frequently sold as a follow-on to a professional services project.

   Software as a Service   Enablement of Software as a Service to the ISV community.

   Development Services   Services include eBusiness/Web solutions, enterprise integration, business intelligence, content management and user interface design.

   Custom Services   Services include custom application management and remote infrastructure management.

Hosting Services

Managed services   Support provided for hardware and software located in a data center. Services include business continuity and disaster recovery, connectivity, content distribution, database administration and performance tuning, desktop support, hardware management, monitoring, network management, security management, server and operating system management and storage management.

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Content Delivery   Includes the delivery of software electronically using NaviSite technology to manage version control and accelerated content distribution.

Colocation   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.

Professional Services

For leading enterprise software applications such as Oracle, PeopleSoft, JD Edwards and Siebel Systems, NaviSite Professional Services helps organizations plan, implement and maintain these applications.

Optimize scalable, business-driven software solutions. Specific services include planning, implementation, maintenance, optimization and compliance services.

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, public sector and software, through our direct sales force and sales channel relationships.

Our managed application services are facilitated by our proprietary NaviView^tm collaborative application management platform. Our NaviView^tm platform enables us to provide highly efficient, effective and customized management of enterprise applications and information technology. Comprised of a suite of third-party and proprietary products, NaviView^tm provides tools designed specifically to meet the needs of customers who outsource their IT needs. We also use this platform for electronic software distribution for software vendors and to enable software to be delivered on-demand over the Internet, providing an alternative delivery model to the traditional licensed software model.

We believe that the combination of NaviView^tm with our physical infrastructure and technical staff gives us a unique ability to provision on-demand application services for software providers for use by their customers. NaviView^tm is application and operating platform neutral as its on-demand provisioning capability is not dependent on the individual software application. Designed to enable enterprise software applications to be provisioned and used as an on-demand solution, the NaviView^tm technology allows us to offer new solutions to our software vendors and new products to our current customers.

We currently operate in 13 data centers in the United States and one data center in the United Kingdom. We believe that our data centers and infrastructure have the capacity necessary to expand our business for the foreseeable future. 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 are able to disrupt our customers   operations.

We currently service approximately 940 hosted customers. Our hosted customers typically enter into service agreements for a term of one to three years, which provide for monthly payment installments, providing us with a base of recurring revenue. Our revenue increases by adding new customers or providing additional services to existing customers. Our overall base of recurring revenue is affected by new customers, renewals and terminations of agreements with existing customers.

We were formed in 1996 within CMGI, Inc., our former majority stockholder, to support the networks and host Web sites of CMGI, 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 CMGI. 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 CMGI until September 2002, at which time ClearBlue Technologies, Inc., or CBT, became our majority stockholder.

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.

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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 colocation, 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.

We have made significant steps to improve the results of our operations. Due to improvements we have made in our overall business, the repayment of our maturing debt and our successful financing with Silver Point Finance and the availability to us of committed lines of credit, our audit report no longer contains the opinion of our independent registered public accounting firm, KPMG LLP, that our recurring losses as well as other factors raise substantial doubt about our ability to continue as a going concern.

Our Industry

The dramatic growth in Internet usage and the enhanced functionality, accessibility and security of Internet-enabled applications have made conducting business on the Internet increasingly attractive. Many businesses are using Internet-enabled information technology infrastructure and applications to enhance their core business operations, increase efficiencies and remain competitive. Internet-enabled information technology infrastructure and applications extend beyond Web sites to software such as financial, email, enterprise resource planning, supply chain management and customer relationship management applications. 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 software as a service model a viable one. 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 Internet-enabled applications and delivery models. Some of the potential benefits of these

applications and delivery models include the ability to:

increase operating efficiencies and reduce costs;

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;

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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 Internet-enabled 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;

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

the need to focus on core business operations;

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 three 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 outsourced IT services for mid-market companies and organizations. 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 to ensure that we are achieving this goal.

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 during the last twelve months. 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

NaviViewtm platform and our automated processes. Due to the fixed cost nature of our infrastructure, increased customer revenue results 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.

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Continue to Broaden Our Service Offerings. We intend to broaden our service offering to compete more effectively with the larger IT outsourcers. We believe that by growing our professional services, we will more effectively deliver to our customers a full range of services for Oracle, PeopleSoft, J.D. Edwards and Siebel Systems solutions. We believe that these services will help our customers achieve peak effectiveness with their systems. We believe that our ability to host applications in addition to providing professional services will distinguish us from our competitors, as companies look to use one vendor for both of these services.

Our Services

We offer our customers a broad range of managed IT services that can be deployed quickly and cost effectively. Our management expertise allows us to meet an expanding set of needs as our customers applications become more 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.

Application Management Services

Application Management

We provide implementation and operational services for packaged applications, including PeopleSoft Enterprise, JDE Enterprise One, Oracle E-Business Suite and Siebel CRM. Application management services are available in one of our data centers or via remote management on a customer s premises. Our messaging services include the monitoring and management of messaging applications, such as Microsoft Exchange and Lotus Domino, allowing customers to outsource their critical messaging applications. Customers can host their applications in one of our data centers or keep their servers in their own facility, which we monitor and manage remotely. In addition, our customers can choose to use dedicated servers or shared servers. We provide expert services to assist our customers with the migration from legacy or proprietary messaging systems to Microsoft Exchange or Lotus Domino. We also have expertise to customize messaging and collaborative applications. We offer user provisioning, spam filtering, virus protection and enhanced monitoring and reporting.

Software-as-a-Service

Using our NaviView™ collaborative application management platform, we enable software vendors to provide their applications in an on-demand or subscription model.

Custom Services helps organizations plan, develop, and manage their complete portfolio of custom and web-based applications.

Development Services

eBusiness/Web Solutions

Enterprise Integration

Business Intelligence

Content Management

User Interface Design

Management Services

Application Management

Remote Infrastructure Management

Hosting Services

NaviSite Hosting Services, from application and managed services to colocation and software-as-a-service, provide highly-available and secure ongoing technology solutions for our customers critical IT resources.

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Managed Services

We provide fully managed application hosting services. We manage data centers, Internet connectivity, servers and networking, security (including firewalls, virtual private networks and intrusion detection), storage, load balancers, database clusters, operating systems, and Web and application servers. We also provide bundled offerings packaged as content delivery services. Specific services include:

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

Content Delivery Acceleration

Colocation

Our data centers provide our colocation customers with a secure place to gain rapid access to the Internet, without having to build their own physical infrastructure. Our data centers include multiple levels of security with camera surveillance, redundant uninterruptible power supply, heating, ventilation and air conditioning, monitored customer access 24 hours a day, seven days a week, and advanced fire suppression. Specific services include:

Connectivity

Equipment

Power

Remote Hands

Space

Security

Professional Services

For leading enterprise software applications such as Oracle, PeopleSoft, JD Edwards and Siebel, NaviSite Professional Services helps organizations plan, implement, maintain, and optimize scalable, business-driven software solutions.

Planning Services

Technical Architecture Design

Implementation Services

Project Health Check and Readiness Assessment

Mergers, Acquisitions and Spin-Offs

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Maintenance Services

Application Upgrades

Optimization Services

Application Optimization

Compliance/Government

Compliance and Governance for Enterprise Applications

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

NaviView™ Platform

Our proprietary NaviView™ platform is a critical element of each of our service offerings. Our NaviView™ platform allows us to work with our customers information technology teams, systems integrators and other third parties to provide our services to customers. Our NaviView™ 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™ 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™ platform allows us to proactively monitor, identify and fix common problems associated with the applications we manage on behalf of our customers. These automated fixes 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 communications with our customers.

Our Infrastructure

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

backed by high service level guarantees.

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 center performs 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 personnel. We have technical support personnel located in our facilities in San Jose, California; Syracuse, New York; Houston, Texas and India, who provide initial and escalated support, 24 hours a

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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 any technical issues that arise.

Data Centers   We currently operate in 13 data centers located in the United States and one data center located 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, EMC, Hewlett-Packard, Microsoft, Oracle and Sun Microsystems.

Internet Connectivity   We have redundant high-capacity Internet connections to providers such as Global Crossing, Level 3, Cogent, AT&T and XO Communications. We have deployed direct private transit and peering Internet connections to utilize the provider s peering capabilities and to enhance routes via their networks to 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

Direct Sales   Our direct sales professionals are located in the United States and the United Kingdom. Our sales teams meet with customers to understand and identify their individual business requirements, then to translate those requirements into tailored services. Our sales teams are also supported by customer relationship managers who are assigned to specific accounts to identify and take advantage of cross-selling opportunities. To date, most of our sales have been realized through our direct sales force.

Channel Relationships   We also 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 provide the reseller a discount of approximately 25% from our list price or require us to pay a referral fee, typically ranging from approximately 4% to 10% of the amounts we receive from the customer. Typically, these third parties resell our services to their customers under their private label brand or under the NaviSite brand. In addition, we jointly market and sell our services with the products of Progress Software. 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 managed service.

Marketing   Our marketing organization is responsible for defining our overall market strategy, generating qualified leads and increasing our brand awareness. Our demand generation team focuses on identifying key market opportunities and customer segments which will best match our service portfolio and creates marketing programs which target those segments. Our marketing programs include a variety of advertising, events, direct mail and email campaigns, partner marketing, and web-based seminar campaigns targeted at key executives and decision makers within organizations. We are actively building general awareness of our company and our strategy through public relations, marketing communications and product marketing. The marketing organization also supports direct and channel sales.

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, 2006, NaviSite serviced approximately 940 hosted customers.

We derived approximately 9%, 8% and 12% of our revenue from the New York State Department of Labor for the fiscal years ended July 31, 2006, 2005 and 2004, respectively.

Other than the New York State Department of Labor, no customer represented 10% or more of our revenue for the fiscal years ended July 31, 2006, 2005 and 2004. Substantially all of our revenues are derived from, and substantially all of our plants, property and equipment are located in, the United States.

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Competition

We compete in the outsourced IT 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 our breadth of service offerings, the strength of our NaviView™ platform, our existing infrastructure capacity and our pricing.

Our current and prospective competitors include:

hosting and related services providers, including Data Return, LLC, Globix Corp., SAVVIS (which acquired the Cable & Wireless business including the Exodus and Digital Island businesses), IBM, AT&T and local and regional hosting providers;

application services providers, such as IBM, Infocrossing, Inc., Electronic Data Systems Corp. and Computer Sciences Corporation;

content and electronic software distribution providers, such as Akamai, Inc., Limelight Networks Inc., Digital River, Inc. and Intraware, Inc.;

colocation providers, including SAVVIS, Equinix and Switch & Data Facilities Company, Inc.;

messaging providers, including Mi8, Critical Path, Inc., Internoded, Inc. and USA.net, Inc., 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 assure you 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.

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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 assure you 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 or 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 operating results.

Employees

As of July 31, 2006, we had 564 employees. Of these employees, 426 were principally engaged in operations, 50 were principally engaged in sales and marketing and 88 were principally engaged in general and administration. 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. 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

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statements. If any of the following risks actually occurs, our business, financial condition and operating results could be materially adversely affected.