

DIGITAL RIVER INC /DE
Form 10-K
February 19, 2009

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

Form 10-K

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2008.
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

Commission File Number: 000-24643

DIGITAL RIVER, INC.

(Exact name of registrant as specified in its charter)

DELAWARE

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

41-1901640

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

**9625 WEST 76TH STREET
EDEN PRAIRIE, MINNESOTA 55344**

(Address of principal executive offices)

(952) 253-1234

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:
Name of each Exchange on which registered:
Common Stock \$0.01 par value Nasdaq Global Select Market

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by checkmark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes No

Indicated by checkmark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 filing requirements for the past 90 days. Yes No

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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.

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

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

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

As of June 30, 2008, there were 36,959,613 shares of Digital River, Inc. common stock, issued and outstanding. As of such date, based on the closing sales price as quoted by The Nasdaq Global Select Market, 36,352,219 shares of common stock, having an aggregate market value of approximately \$1,402,469,000 were held by non-affiliates. For purposes of the above statement only, all directors and executive officers of the registrant are assumed to be affiliates.

The number of shares of common stock outstanding at February 2, 2009 was 37,034,913 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Certain sections of the Registrant's definitive Proxy Statement for the 2009 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K to the extent stated herein.

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CAUTIONARY STATEMENT PURSUANT TO THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Annual Report on Form 10-K contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical fact, regarding our strategy, future operations, financial position, estimated revenue, projected costs, projected savings, prospects, plans, opportunities and objectives constitute forward-looking statements. The words may, will, expect, plan, anticipate, believe, estimate, potential, similar types of expressions identify forward-looking statements, although not all such statements contain these identifying words. These forward-looking statements are based upon information that is currently available to us and/or management's current expectations, speak only as of the date hereof, and are subject to risks and uncertainties. We expressly disclaim any obligation, except as required by law, or undertaking to update or revise any forward-looking statements contained or incorporated by reference herein to reflect any change or expectations with regard thereto or to reflect any change in events, conditions, or circumstances on which any such forward-looking statement is based, in whole or in part. Our actual results may differ materially from the results discussed in or implied by such forward-looking statements. We are subject to a number of risks, some of which may be similar to those of other companies of similar size in our industry, including pre-tax losses, rapid technological changes, competition, limited number of suppliers, customer concentration, failure to successfully integrate acquisitions, adverse government regulations, failure to manage international activities, and loss of key individuals. Risks that may affect our operating results include, but are not limited to, those discussed in Part I Item 1A, titled Risk Factors. Readers should carefully review the risk factors described in this document and in other documents that we file from time to time with the Securities and Exchange Commission.

PART I

ITEM 1. BUSINESS.

Overview

We provide end-to-end global e-commerce solutions to a wide variety of companies in software, consumer electronics, computer games, video games, and other markets. We were incorporated in 1994 and began building and operating online stores for our clients in 1996. We offer our clients a broad range of services that enable them to quickly and cost effectively establish an online sales channel capability and to subsequently manage and grow online sales on a global basis while mitigating risks. Our services include design, development and hosting of online stores and shopping carts, store merchandising and optimization, order management, denied parties screening, export controls and management, tax compliance and management, fraud management, digital product delivery via download, physical product fulfillment, subscription management, multi-lingual customer service, online marketing including e-mail marketing, management of paid search programs, payment processing services, website optimization, web analytics and reporting, and CD production and delivery.

Our products and services allow our clients to focus on promoting and marketing their brands while leveraging our investments in technology and infrastructure to facilitate the purchase of products through their online websites. When shoppers visit one of our clients' branded websites and purchase goods, they are transferred to an e-commerce store and /or shopping cart operated by us on our e-commerce platforms. Once on our system, shoppers can browse for products and make purchases online. We typically are the seller of record for transactions through our client branded stores. After a purchase is made, we either deliver the product digitally via download over the Internet or transmit instructions to a third party for physical fulfillment of the order. We also process the buyer's payment as the merchant of record, including collection and remittance of applicable taxes, and can provide customer service in multiple languages to handle order-related questions. We believe we are an example of a trend known as Software as a Service

(SaaS). We have invested substantial resources to develop our e-commerce software platforms and we provide access and use of

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our platforms to our clients as a service as opposed to selling the software to be operated on their own in-house computer hardware.

In addition to the services we provide that facilitate the completion of an online transaction, we also offer services designed to increase traffic to our clients' websites and the associated online stores and to improve the sales productivity of those stores. Our services include paid search advertising, search engine optimization, affiliate marketing, store optimization, multi-variant testing, web analytic services and e-mail optimization. All of our services are designed to help our clients acquire customers more effectively, sell to those customers more often and more efficiently, and increase the lifetime value of each customer.

Our clients include many of the largest software, consumer electronics, computer and video game companies, including Absolute Software Corporation, Adobe Systems, Inc., Aspyr Media, Inc., Autodesk, Inc., Canon Europa N.V., Computer Associates, Cyber Patrol, LLC, Eastman Kodak Company, Electronic Arts, Inc., Lexmark, Inc., Microsoft Corporation, Nuance Communications Inc, SanDisk Corporation, Smith Micro Software, Inc., Symantec Corporation, and Trend Micro, Inc.

We were incorporated in Delaware in February 1994. Our headquarters are located at 9625 West 76th Street, Eden Prairie, Minnesota and our telephone number is 952-253-1234.

General information about us can be found at www.digitalriver.com under the Company/Investor Relations link. Our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as any amendments or exhibits to those reports, are available free of charge through our website as soon as reasonably practicable after we file them with the Securities and Exchange Commission.

Industry Background

Growth of the Internet and E-Commerce. E-Commerce sales continue to grow. The U.S. Commerce Department reported that e-commerce sales in 2008 rose 4.6% compared to 2007. We believe there are a number of factors that are contributing to the continued growth of e-commerce: (i) adoption of the Internet continues to increase globally; (ii) broadband technology is increasingly being used to deliver Internet service enabling the delivery of richer content as well as larger files to consumers; (iii) Internet users are becoming increasingly comfortable with the process of buying products online; (iv) the functionality of online stores continues to improve, offering a broader assortment of payment options with more promotion alternatives; (v) businesses are placing more emphasis on their online channel, reaching a larger audience at comparatively lower costs than other methods; and (vi) concerns about conflicts between online and traditional sales channels continue to subside. Additionally, we believe that current economic conditions have led to increased retail store closings which should drive more shoppers online as they shift to other channels, filling the void created by retail downsizings and bankruptcies.

Growing Interest in Direct Sales of Products to Consumers. Increasingly, companies are selling their products directly to consumers via online sales channels. This is due to increased competition for shelf space in the traditional retail channels as well as recognition that direct sales channels can co-exist with traditional sales channels. There is also a growing recognition of the value inherent in developing behavioral or personalized marketing campaigns relevant to a consumer's interests.

Opportunities for Outsourced E-Commerce. We believe the market for outsourced e-commerce will continue to grow as there are advantages to outsourced e-commerce that will continue to make it an attractive alternative to building and maintaining this capability in-house. These advantages include: (i) eliminating the substantial up-front and ongoing costs of computer hardware, network infrastructure, specialized application software and training and support costs; (ii) reducing the time it takes to get online stores live and productive; (iii) shifting the ongoing technology,

financial, personal information security protections, regulatory and compliance risks to a proven service provider; (iv) leveraging the direct marketing expertise of an e-commerce service provider to accelerate growth of an online business; and (v) allowing businesses to focus on their specific core competencies.

Once an online store is established, it is immediately accessible to Internet users around the world. Web pages must be presented and customer service inquiries handled in multiple languages, and a variety of

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currencies and payment options must be accepted. The appropriate taxes must be collected and paid, payment fraud risk mitigated, fulfillment provided, and assurances made that products are not shipped to banned locations. These and other requirements of a global e-commerce system make it an expensive and potentially risky undertaking for any business. These factors also make a comprehensive outsourced offering, such as that provided by Digital River, an attractive alternative.

Shift from Physical to Electronic Delivery of Software. Consumers have grown increasingly comfortable with the electronic delivery of digital products, such as software, e-books, computer games, video games, music, and video. This shift from physical to electronic delivery is being driven by benefits to both buyers and sellers of these products. For buyers, downloaded products are immediately available for use and a wider variety of products are available than can be found in most retail stores. For sellers, electronic delivery eliminates inventory-stocking requirements, shipping, handling, storage and inventory-carrying costs as well as the risk of product obsolescence.

The Digital River Solution

Our solution combines a robust e-commerce technology platform and a suite of services to help businesses worldwide grow their online revenues and avoid the costs and risks of running an integrated global e-commerce operation in-house. We offer a comprehensive e-commerce solution that operates seamlessly as part of a client's website. We provide services that facilitate e-commerce transactions and drive traffic to our clients' online stores. Our services include design, development and hosting of online stores, merchandising, order management, fraud prevention screening, popular online payment methods, export controls and management, denied parties screening, tax compliance and management, digital product delivery via download, physical product fulfillment, CD production, multi-lingual customer service, subscription management, online marketing services including email marketing, paid search program management, website optimization, web analytics and reporting. We also provide our clients with increased product visibility and sales opportunities through our large network of online channel partners, including retailers and affiliates. We generate a significant proportion of our revenue on a revenue-share basis, meaning that we are paid a percentage of the selling price of each product sold at a client's online store that is being managed by Digital River. We believe this revenue share model aligns our interests with those of our clients.

Benefits to Clients

Reduced Total Cost of Ownership and Risk

Utilizing the Digital River solution, businesses can dramatically reduce or eliminate upfront and ongoing hardware, software, maintenance and support costs associated with developing, customizing, deploying, maintaining and upgrading an in-house global e-commerce solution. They can have a global e-commerce presence without assuming the costs and risks of internal development and leverage the investments we make in our e-commerce system. In addition, we help mitigate the risks of global e-commerce, including risks associated with payment fraud, data security, tax compliance, and regulatory compliance. Our ongoing investments in the latest technologies and e-commerce functionality help ensure our clients maintain pace with industry advances.

Revenue Growth

We can assist our clients in growing their online businesses by (i) facilitating the acquisition of new customers, improving the retention of existing customers, and increasing the lifetime value of each customer; (ii) extending their businesses into international markets; and (iii) expanding the visibility and sales of their products through new online sales channels. We have developed substantial expertise in online marketing and merchandising which we apply to help our clients increase traffic to their online stores, and improve order close ratios, average order sizes and repeat purchases, all of which result in higher revenues for our clients and Digital River.

We provide the technology and services required to establish, grow and support international sales, both for U.S.-based clients seeking to reach customers overseas, and non-U.S.-based clients looking to access the

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U.S. and other markets. Our technology platform enables transactions to be completed in numerous currencies using a variety of payment methods. In addition, we provide localized online content and payment methods, and offer customer service in a variety of languages, extending our clients' reach beyond their home markets.

Through our large online affiliate network marketplace, which we call oneNetworkDirect™, we provide our clients access to a new sales channel which can help grow their online businesses. Clients can offer any part of their product catalogs to our network of online channel partners, including online retailers and affiliates. This increases the exposure these products receive and can result in higher sales volumes. Our channel partners benefit because we eliminate the need for each of them to manage hundreds of relationships with product developers, while increasing the depth and breadth of products they can sell, all without requiring the management of physical product inventory.

Deployment Speed

Businesses can reduce the time required to develop an e-commerce presence by utilizing our outsourced business model. Typically, a new client can have an online store live in a matter of weeks compared with months or longer if they decide to build, test deploy and integrate the e-commerce capability in-house. Once they are operational on our platform, most clients can utilize our remote control toolset to make real-time changes to their online store, allowing them to take advantage of opportunities without technical assistance from Digital River.

Focus on Core Competency

By utilizing our outsourced e-commerce services, clients can focus on developing, marketing and selling their products rather than devoting time and resources to building and maintaining an e-commerce infrastructure. This allows client management time to focus on what they know best while ensuring they have access to the latest technologies, tools and expertise for running a successful e-commerce operation.

Benefits to Buyers

Our solution emphasizes convenience as it enables products to be purchased online at anytime from anywhere in the world via a connection to the Internet. In the case of software, video games and other digital products, buyers can immediately download their purchase and, depending on file size, begin using it in a matter of minutes. Search technology allows shoppers to browse our entire catalog to find the products they are looking for quickly and easily. Our extended download service, which guarantees replacement of products accidentally destroyed through computer error or malfunction, and our 24/7 customer service provided on behalf of our clients, offer shoppers additional assurance that their e-commerce experience will be a positive one. Our CD2Go service gives buyers the ability to obtain, for a fee, a copy of the product they have purchased and downloaded on a CD.

Strategy

Our objective is to be the global leader in outsourced e-commerce activities for software and digital products developers, high-tech product and computer manufacturers, and video game publishers. Our strategy for achieving this objective includes the following key components:

Attract New Clients and Expand Relationships with Existing Clients. We have focused our efforts on securing new clients and expanding our relationships with existing clients primarily in the software, consumer electronics, computer game and video game markets. Our clients include software publishers, other digital content providers, high-tech product manufacturers, and online channel partners. In 2008, we entered into more than 100 new contracts with new and existing clients.

We believe we can attract new clients and gain additional business with existing clients by expanding the range of services we offer. This includes services to enhance the e-commerce transaction as well as additional online marketing and payment services. We believe that by expanding the size and breadth of the catalog of products we offer, we will attract additional online retailers and affiliates seeking to offer

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their customers a wide range of quality products. We currently provide e-commerce services for thousands of software and digital products publishers, high-tech products manufacturers, game publishers and affiliates.

Expand International Sales. We believe there is a substantial opportunity to grow our business by enabling our clients to expand their sales through international online stores. Internet adoption and broadband deployment continue to increase rapidly, especially in the European and Asia Pacific regions. We have seen significant growth in sales for clients that have created international online stores. We intend to continue to enhance our technology platform, payment options and localized service offerings to increase sales in international markets.

Provide Clients with Strategic Marketing Services. We proactively develop and deliver new strategic marketing services that are designed to help our clients improve customer acquisition and retention and maximize the lifetime value of customers. These services currently include paid search advertising, search engine optimization, affiliate marketing, store optimization, web analytics, and e-mail marketing and optimization. In general, we manage these programs for our clients and have achieved significant increases in client revenue, return-on-investment or both, compared to what clients experienced when running these programs and supporting technologies in-house or through other service providers. We intend to continue to develop and/or acquire new value-added strategic marketing services and technologies to create additional sources of revenue for our clients and for Digital River.

Maintain Technology Leadership. We believe our technology platform and infrastructure afford us a competitive advantage in the market for outsourced e-commerce solutions. We intend to continue to invest in and enhance our platform to improve scalability, efficiency, reliability, security and performance. By leveraging our infrastructure, we can improve our ability to provide low-cost, high-value services while continuing to deploy the latest technologies. Additionally, we plan to continue investing in our infrastructure to enable our clients to further penetrate international markets, enhance their relationships with their customers, better manage the return-on-investment across all their online marketing activities, successfully adopt new selling models such as subscriptions, SaaS, trial programs and volume licensing programs.

Continue to Seek Strategic Acquisitions. Historically, we have been an active acquirer of businesses, and we expect to continue actively pursuing acquisitions that further our business strategy. Some of the strategic factors we consider when evaluating an acquisition opportunity include: expanding our base of clients, improving the breadth and depth of our product offering, improving the catalog of content, extending our strategic marketing and other services offerings, expanding our geographic reach and diversifying our revenue stream into complementary or adjacent market segments.

Services

We provide a broad range of services to our clients, including design, development and hosting of online stores, merchandising, order management, fraud prevention screening, popular localized online payment methods, export controls and management, denied parties screening, tax compliance and management, digital product delivery via download, physical product fulfillment, CD production, multi-lingual customer service, subscription management, online marketing services including email marketing, paid search program management, website optimization, web analytics and reporting. Most of these offerings can be managed through client-facing, remote control self-service tools that are easily used by business users without specialized training. Since clients utilize our centralized system and processes, we can consistently offer best practices across our entire client base.

Store Design, Development and Hosting. We offer our clients website design services utilizing our experience and expertise to create efficient and effective online stores. Our e-commerce solutions can be deployed quickly and implemented in a variety of ways from fully-functioning shopping carts through completely merchandised online stores. The online stores we operate for our clients often match their branding and website design to provide a

seamless experience for shoppers. When a shopper navigates from a client's website (operated by them) to their store (operated by us), the transition is seamless and the customer is unaware they are then being served by our technology platform. We manage the order process through

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payment processing, fraud screening, and fulfillment (either digital or physical) and notify the buyer via e-mail once the transaction is completed. Transaction information is captured and stored in our database systems, an increasingly valuable source of information used to create highly targeted merchandising programs, e-mail marketing campaigns, product offers and test marketing programs.

For many of our clients, the solution we provide is critical to their businesses and therefore we operate global data centers that perform and scale for continuous e-commerce operation in a high-demand environment. We operate multiple data centers globally, which feature fully redundant high-speed connections to the Internet, server capacity to handle unpredictable spikes in traffic and transactions, 24/7 security and monitoring, back-up electric generators and dedicated power supplies.

Store Merchandising. Our technology platforms support a wide range of merchandising activities. This enables our clients to effectively execute promotions, up-sell, and cross-sell activities and to feature specific products and services during any phase of the shopping process. From the home page of our clients' online stores through the checkout and thank you pages, our solution allows clients to deliver targeted offers designed to increase order close ratios and average order sizes.

Order Management and Fraud Screening. We manage all phases of a shopper's order on our clients' e-commerce stores. We process payment transactions for orders placed through our technology platform and support a wide variety of payment types, including credit cards, wire transfers, purchase orders, money orders, direct debit cards and many other payment methods popular both in the United States and around the world. As part of the payment process, we ensure that the correct taxes are displayed, collected, remitted and reported.

The fraud screening component of our platform uses both rules-based and heuristic scoring methods which use observations of known fraudulent activities to make a determination regarding the validity of the order, buyer and payment information. As the order is entered, hundreds of data reviews can be processed in real time. We also provide denied-parties screening and export controls, which are designed to ensure that persons and/or organizations appearing on government denied-parties lists are blocked from making purchases through our system. Once a transaction is approved and the digital product has been delivered via download or the physical product(s) has been shipped, we submit the transaction for payment.

Digital and Physical Fulfillment Services. We provide both digital and physical fulfillment services to our clients. We offer our clients a broad array of electronic delivery capabilities that enable delivery of digital products directly to customers' computers via the Internet. Delivery is completed when a copy of the purchased digital product is made from a master generally stored on our technology platform and then securely downloaded to the purchaser. Optionally, buyers can, for an additional fee, request that a CD be created and shipped as a backup for their order.

In addition to electronic fulfillment via download, we offer physical distribution services to our clients as well. We have contracted with third-party fulfillment agents that maintain inventories of physical products for shipment to buyers. These products are held by the fulfillment agent on consignment from our clients. We provide notification of product shipment to the buyer as well as shipment tracking, order status, and inventory information. We also provide a service called Physical on Demand (POD), which utilizes robotic systems to create a client-branded product CD and packaging materials after a POD order has been placed. This eliminates the requirement for inventory to be stored in a warehouse as physical product is created only when needed. We provide extended download services for digital products for an additional fee, which enables buyers to download the products they have purchased more than once in the event of a computer failure or other unexpected problem. We believe physical fulfillment services are important to providing a complete e-commerce solution to our clients, particularly for non-digital products market where digital fulfillment is not possible.

In connection with the sales of consumer electronic goods, we offer management services relating to regulatory matters such as the Waste Electronics and Electrical Equipment laws.

Customer Service. At our client's option and for an additional fee, we provide telephone and e-mail customer support for products sold through our platforms. We provide assistance to buyers regarding ordering

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and delivery questions on a 24/7 basis in multiple languages. We continue to invest in technology and infrastructure to provide fast and efficient responses to customer inquiries as well as provide online self-help options.

Advanced Reporting and Analytics. We capture and store detailed information about visitor traffic for sales in the online stores we manage for our clients. This information is stored in our database systems where it is available for analysis and reporting. We provide clients access to a large collection of standard and customizable reports via our web analytics technology. This enables our clients to track and analyze sales, products, transactions, customer behavior and the results of marketing campaigns so they can optimize their marketing efforts to increase traffic, order close ratios and average order values. We also believe this information is valuable in establishing a metric for the lifetime value of the customer.

Strategic Marketing Services. We offer a range of strategic marketing services designed to increase customer acquisition, improve customer retention and enhance the lifetime value of each customer. Through a combination of web analytics, analytics-based statistical testing, optimization and proven direct marketing practices, our team of strategic marketing experts develops, delivers and manages programs such as paid search advertising, search engine optimization, affiliate marketing, store optimization and e-mail optimization on behalf of our clients. We generally charge an incremental percentage of the selling price of merchandise for sales driven by our strategic marketing services activities. We believe our ability to capture and analyze integrated traffic and e-commerce sales data enhances the value of our strategic marketing services as we can precisely determine the effectiveness of specific marketing activities, website changes, and other actions taken by our clients.

Financial Services. We offer full service payment provider solutions for online merchants around the world. We connect businesses to the local payment methods that their customers prefer and support businesses to expand into new markets through enabling the acceptance and processing of a diverse range of payment methods and options. We offer a broad range of back office payment reconciliation services that result in a highly cost efficient and secure program for e-payments. We sell and market these services through a direct sales channel located in offices in the United States and Europe. Our technology platform provides for high transaction throughput in a highly secure and data sensitive environment. These services are provided either via a direct API interface between the client's commerce system and our payment services platform or via a PCI compliant wrapped secure web based payment page that is served to the client's commerce system on a transaction by transaction basis.

Clients

We serve distinct groups of clients: (1) software, consumer electronics, and computer and video game product manufacturers; and (2) online channel partners including retailers and affiliates. We believe that the breadth of our catalog of products is a competitive advantage in selling e-commerce services to online channel partners as they can access a huge volume of products to sell without negotiating contract terms with every product provider. At the same time, we believe the breadth of our channel partner group is attractive to product manufacturers since it provides access to distribution through a single source.

Sales and Marketing

We sell products and services primarily to consumers through the Internet. We sell and market our services for clients through a direct sales force located in offices in the United States, Europe and Asia Pacific. These offices include staff dedicated to pre-sales, sales and sales support activities. Our client sales organization sells to executives within software, consumer electronics, computer and game manufacturers and online channel partners who are looking to create or expand their online businesses. During the sales process, our sales staff deliver demonstrations, presentations, collateral material, return-on-investment analyses, proposals and contracts.

We also design, implement and manage marketing and merchandising programs to help our clients drive traffic to their online stores and increase order close ratios, average order values and repeat purchases at those stores. Our strategic e-marketing team delivers a range of marketing and merchandising programs such as paid

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search advertising, search engine optimization, affiliate marketing, site and store optimization, e-mail marketing and optimization and site merchandising, which includes promotions, cross-sells and up-sells. This team integrates their marketing domain expertise with our suite of technology, including reporting, analytics, optimization and e-mail to drive increased sales for our clients.

We market our products and services directly to clients and prospective clients. We focus our efforts on generating awareness of our brand and capabilities, establishing our position as a global leader in e-commerce outsourcing, generating leads in our target markets, and providing sales tools for our direct sales force. We conduct a variety of highly integrated marketing programs to achieve these objectives in an efficient and effective manner. We currently market our products and services to clients and prospects via direct marketing, print and electronic advertising, trade shows and events, public relations, media events and speaking engagements.

Technology

We deliver our outsourced e-commerce solutions on several platforms, each of which has been architected to solve our clients multi-faceted e-commerce needs. The following is a brief description of the technology standards utilized by the family of Digital River e-commerce platforms:

Architecture. Our platforms are highly scalable and designed to handle tens of thousands of individual e-commerce stores and millions of products available for sale within those stores. These platforms consist of Digital River developed proprietary software applications running on multiple pods of Sun Microsystems and Dell servers that serve dynamic web pages using Oracle, SQL server and MySQL databases, .net Microsoft IIS and Oracle 9iAS application servers. Our platforms are designed to support growth by adding servers, CPUs, memory and bandwidth without substantial changes to the software applications. We believe this level of scalability is a competitive advantage. The application software is written in modular layers, enabling us to quickly respond to industry changes, payment processing changes, changes to international requirements for taxes and export screening, banking procedures, encryption technologies, and new and emerging web technologies, including AJAX, Web Services, DHTML, and web Caches.

The platforms include search capabilities that allow shoppers to search for items across millions of products and thousands of categories based on specific product characteristics or specifications while maintaining page response times acceptable to the user. We use database indexing combined with a dynamic cache system to provide flexibility and speed. The platforms have been designed to index, retrieve and manage all transaction data that flows through the system, including detailed commerce transactions and consumer interaction data. This enables us to create proprietary market profiles of each shopper and groups of shoppers that can then be used to create merchandising campaigns that are relevant to the end consumer and more successful. We also use our platforms internally for fraud detection and prevention, management of physical shipping, return authorizations, backorder processing, transaction auditing and reporting.

E-Commerce System Maintenance. Our platforms have a centralized maintenance management system that we use to build and manage our clients e-commerce systems. Changes that affect all of our clients e-commerce sites or groups of e-commerce sites can be made centrally, dramatically reducing maintenance time and complexity. Most of our clients e-commerce sites include a central store and many have additional web pages where highly targeted traffic is routed. Clients also may choose to link specific locations on their e-commerce stores to detailed product or category information within their stores to more effectively address a shopper s specific areas of interest.

Security. We have security systems in place to control access to our internal systems and commerce data. Log-ins and passwords are required for all systems with additional levels of log-in, password and Internet Protocol security in place to control access on an individual basis. Access only is granted to commerce areas for which an individual is

responsible. Multiple levels of firewalls prevent unauthorized access from the outside or access to confidential data from the inside. Our security system does not allow direct access to any client or customer data. We license certain encryption and authentication technology

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from third parties to provide secure transmission of confidential information such as credit card data. The security system is designed not to interfere with the consumer's experience on our clients' e-commerce sites.

Data Center Operations. Continuous data center operations are crucial to our success. We currently maintain major data center operations in six facilities: California, Minnesota and Utah, USA; and Germany, Ireland and Sweden. All major data center locations are currently processing transactions and serving downloads.

All data centers currently utilize multiple levels of redundant systems, including load balancers managing traffic volumes across web and application server farms, database servers, and enterprise disk storage arrays. For the majority of these systems, we have automatic failover procedures in place such that when a fault is detected, a process automatically takes that portion of the system offline and processing continues on the remaining redundant portions of the system, or in an alternate datacenter. In the event of an electrical power failure, we have redundant power generators and uninterruptible power supplies that protect our facilities. Fire suppression systems are present in each data center.

Our network software constantly monitors our clients' e-commerce sites and internal system functions, and notifies systems engineers if any unexpected conditions arise. We lease multiple lines from diverse Internet service providers and maintain a policy of adding additional capacity if more than 40 percent of our capacity is consistently utilized. Accordingly, if one line fails, the other lines are able to assume the traffic load of the failed line. We also utilize content distribution networks operated by our vendors to serve appropriate types of traffic; currently, the majority of our image traffic and a substantial portion of our download traffic is served via the Akamai, Limelight and Mirror Image networks.

Product Research and Development

Our primary product research and development strategy is to maintain our technology and feature set for our commerce platforms and related technologies. To this end, we continually have numerous development projects in process, including ongoing enhancement of our commerce platforms, improvements in our remote control capabilities, enhanced international support, advanced product distribution capabilities, sophisticated reporting functionality and new marketing technologies.

We believe that the functionality and capabilities of our commerce platforms are a competitive advantage and that we must continue to invest in them to maintain our competitive position. The Internet and e-commerce, in particular, are subject to rapid technological change, changes in user and client requirements and expectations, new technologies and evolving industry standards. To remain successful, we must continually adapt to these and other changes. We rely on internally developed, acquired and licensed technologies to maintain the technological sufficiency of our e-commerce platforms.

Competition

The market for e-commerce solutions is highly competitive. We compete with e-commerce solutions that our customers develop internally or contract with third parties to develop on their behalf. We also compete with other outsourced e-commerce providers. The competition we encounter includes:

In-house development of e-commerce capabilities using tools or applications from companies such as Art Technology Group, Inc. and IBM Corporation;

E-Commerce capabilities custom-developed by companies such as IBM Global Services and Accenture, Inc.;

Other providers of outsourced e-commerce solutions, such as GSI Commerce, Inc., asknet Inc. and Arvato, a division of Bertelsmann AG;

Providers of technologies, services or products that support a portion of the e-commerce process, such as payment processing, including CyberSource Corporation and PayPal Corp.;

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Companies that offer various online marketing services, technologies and products, including ValueClick, Inc. and aQuantive, Inc.;

High-traffic branded websites that generate a substantial portion of their revenue from e-commerce and may offer or provide to others the means to offer products for sale, such as Amazon.com, Inc. and Buy.com, Inc.; and

Web hosting, web services and infrastructure companies that offer portions of our solution and are seeking to expand the range of their offerings, such as Network Solutions, LLC, Akamai Technologies, Inc., Yahoo! Inc. and eBay Inc.

We believe that the principal competitive factors in our market are the breadth of consumer products and services offered, the number of clients and online channel partnerships, brand recognition, system reliability and scalability, price, customer service, ease of use, speed to market, convenience, and quality of delivery. Some of the companies described above are clients or potential clients, but they may also choose to compete with us by adopting a similar business model.

Intellectual Property

We believe the protection of our trademarks, copyrights, trade secrets and other intellectual property is critical to our success. We rely on patent, copyright and trademark enforcement, contractual restrictions, service mark and trade secret laws to protect our proprietary rights. We have entered into confidentiality and invention assignment agreements with our employees and contractors, and nondisclosure agreements with certain parties with whom we conduct business in order to limit access to and disclosure of our proprietary information. We also seek to protect our proprietary position by filing U.S. and foreign patent applications related to our proprietary technology, inventions and improvements that are important to our business. We currently have seventeen U.S. patents issued with six to fifteen years remaining prior to expiration. We also have over seventy U.S. and foreign patent applications pending. We pursue the registration of our trademarks and service marks in the U.S. and internationally. We have a number of registered trademarks in the U.S., European Union and other countries.

Government Regulation

We are subject to a number of foreign and domestic laws and regulations that affect companies conducting business on the internet. In addition, laws and regulations relating to user privacy, information security and intellectual property rights are being debated and considered for adoption by many countries throughout the world. We face risks from some of the proposed legislation that could be passed in the future.

A range of laws and new interpretations of existing laws could have an impact on our business. For example, the Digital Millennium Copyright Act has provisions that limit, but do not necessarily eliminate, our liability for listing, linking or hosting third-party content that includes materials that infringe copyrights. The Child Online Protection Act and the Children's Online Privacy Protection Act restrict the distribution of materials considered harmful to children and impose additional restrictions on the ability of online services to collect information from children under 13. In the area of data protection, many states have passed laws requiring notification to users when there is a security breach for personal data, such as California's Information Practices Act. The costs of compliance with these laws may increase in the future as a result of changes in interpretation. Furthermore, any failure on our part to comply with these laws may subject us to significant liabilities.

We are also subject to federal, state and foreign laws regarding privacy and protection of user data. We post on our web site our privacy policies and practices concerning the use and disclosure of user data. Any failure by us to comply with our posted privacy policies or privacy-related laws and regulations could result in proceedings against us by governmental authorities or others, which could potentially harm our business. In addition, the interpretation of data protection laws, and their application to the internet, in Europe and other foreign jurisdictions is unclear and in a state of flux. There is a risk that these laws may be interpreted and applied in conflicting ways from country to country and in a manner that is not consistent with our current

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data protection practices. Complying with these varying international requirements could cause us to incur additional costs. Further, any failure by us to protect our users' privacy and data could result in a loss of user confidence in our services.

Employees

As of February 2, 2009, we employed 1,335 associates. We also employ independent contractors and other temporary employees. None of our employees are represented by a labor union, and we consider our employee relations to be good. Competition for qualified personnel in our industry is intense. We believe that our future success will continue to depend, in part, on our continued ability to attract, hire and retain qualified personnel.

Executive Officers

The following table sets forth information regarding our executive officers at February 2, 2009:

Name	Age	Position
Joel A. Ronning	52	Chief Executive Officer
Thomas M. Donnelly	44	Chief Financial Officer
Kevin L. Crudden	53	VP/General Counsel

Mr. Ronning founded Digital River in February 1994 and has been our Chief Executive Officer and a director since that time. From February 1994 to July 1998, Mr. Ronning served as President of Digital River.

Mr. Donnelly joined Digital River in February 2005 as Vice President of Finance and Treasurer and was named Chief Financial Officer and Secretary in July 2005. From March 1997 to May 2004, he held various positions, including President, Chief Operating Officer and Chief Financial Officer with Net Perceptions, Inc., a developer of software systems used to improve the effectiveness of various customer interaction systems.

Mr. Crudden joined Digital River in January 2006 as Vice President, General Counsel and Corporate Secretary. From 1987 until joining Digital River, Mr. Crudden was with the law firm of Robins, Kaplan, Miller & Ciresi L.L.P., Minneapolis, Minnesota, and served as a partner practicing in the areas of corporate finance, mergers and acquisitions, and corporate governance.

ITEM 1A. RISK FACTORS

The risks described below are not the only ones facing our company. Additional risks not presently known to us or that we currently deem immaterial also may impair our business operations. Our business, financial condition or results of operations could be materially adversely affected by any of these risks and the value of our common stock could decline due to any of these risks. This annual report also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks faced by us described below and elsewhere in this report.

We may experience significant fluctuations in our revenues, operating results, growth rate, and stock price.

Our quarterly and annual revenues, operating results, and growth rate have fluctuated significantly in the past and are likely to do so in the future due to a variety of factors, some of which are outside our control. As a result, we believe that quarter-to-quarter and year-to-year comparisons of our revenue and operating results are not necessarily

meaningful, and that these comparisons may not be accurate indicators of future performance. If our annual or quarterly operating results fail to meet the guidance we provide to securities analysts and investors or otherwise fail to meet their expectations the trading price of our common stock may be impacted.

The stock market as a whole and the trading prices of companies in the electronic commerce industry in particular, has been notably volatile. The operating results of companies in the electronic commerce industry

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have experienced significant quarter-to-quarter fluctuations. This broad market and industry volatility could significantly reduce the price of our common stock at any time, without regard to our own operating performance. In addition, our stock price may be impacted by the short sales and actions of other parties who may disseminate misleading information about us in an effort to profit from fluctuations in our stock price.

Factors that may affect our revenues, operating results, continued growth, and our stock price include the risks described elsewhere in this Item 1A, as well as the following:

Client Development and Retention. We generate revenue by providing services to a wide variety of companies, primarily in the software and high-tech products markets. Therefore, it is important to our ongoing success that we maintain our key client relationships and, at the same time, develop new client relationships. If we cannot develop and maintain satisfactory relationships with software and digital products publishers, manufacturers of consumer electronics and other goods, online retailers and online channel partners on acceptable commercial terms, we will likely experience a decline in revenue and operating profit. We also depend on our clients creating and supporting products that consumers will purchase. If we are unable to obtain sufficient quantities of products for any reason, or if the quality of service provided by these publishers and manufacturers falls below a satisfactory level, we could also experience a decline in revenue, operating profit and consumer satisfaction, and our reputation could be harmed. Our contracts with our clients are generally one to two years in duration, with an automatic renewal provision for additional one-year periods, unless we are provided with a written notice before the end of the contract. We have no material long-term or exclusive contracts or arrangements with any clients that guarantee the availability of products. Clients that currently supply products to us may not continue to do so, and we may be unable to establish new relationships with clients to supplement or replace existing relationships.

Sales of products for one client, Symantec Corporation, accounted for approximately 24.3% of our revenue in 2008. In addition, revenues derived from proprietary Digital River services sold to Symantec consumers and sales of Symantec products through our oneNetworkDirect™ retail and affiliate channel together accounted for approximately 9.4% of total Digital River revenue in 2008. In addition, a limited number of other software and physical goods clients contribute a large portion of our annual revenue. If any one of these key contracts is not renewed or otherwise terminates, or if revenues from these clients decline for any other reason (such as competitive developments), our revenue would decline and our ability to sustain profitability would be impaired. If our contract with Symantec is not renewed, renegotiated or otherwise terminated, or if revenues from Symantec and Symantec-related services decline for any other reason, our revenue and our ability to sustain profitability could be materially adversely impaired.

Fluctuations in Demand. Our quarterly and annual operating results are subject to fluctuations in demand for the products or services offered by us or our clients, such as anti-virus software and anti-spyware software and consumer electronics. In particular, sales of anti-virus software represented a significant portion of our revenues in recent years, and continue to be very important to our business. Demand for anti-virus software is subject to the unpredictable introduction of significant computer viruses. To the extent that software publishers successfully introduce products or services not sold through our platform that are competitive with the products and services offered by our current clients (including anti-virus products and services), our revenues could be materially adversely affected. In addition, revenue generated by our software and digital commerce services is likely to fluctuate on a seasonal basis that is typical for the software publishing market, consumer electronics market, and computer and video games markets. Softening or weakening of traditionally high-volume periods, such as the holiday season, can materially adversely affect our revenues and operating results.

Changes in the E-commerce Industry. The nature of our business and the e-commerce industry in which we operate has undergone, and continues to undergo, rapid development and change. Thus, our chances of financial and operational success should be evaluated in light of the risks, uncertainties, expenses, delays and

difficulties associated with operating a business in a relatively rapidly changing industry. If we are unable to address these issues, we may not be financially or operationally successful.

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Dependence on Key Personnel. Our future success significantly depends on our ability to continue to identify, attract, hire, train, retain and motivate highly skilled personnel, including the continued services and performance of our senior management. Competition for these personnel is intense, particularly in the Internet industry. Our performance also depends on our ability to retain and motivate our key technical employees who are skilled in maintaining our proprietary technology platforms. The loss of the services of any of our executive officers or key employees could harm our business if we are unable to effectively replace that officer or employee, or if that person should decide to join a competitor or otherwise directly or indirectly compete with us. Further, we may need to incur additional operating expenses and divert other management time in order to search for a replacement.

Operating Expenses. Our operating expenses are based on our expectations of future revenue. These expenses are relatively fixed in the short-term. If our revenue for a quarter falls below our expectations and we are unable to quickly reduce spending in response, our operating results for that quarter would be harmed.

Infrastructure. The introduction by us of new websites, web stores or services, and the continued upgrading, development and maintenance of our systems and infrastructure to meet emerging market needs, leverage technical innovations, and remain competitive in our service and product offerings, may require a substantial investment of our resources and result in significant capital expenditures and operating costs.

Other Factors. Additional factors that may affect our revenues, operating results, continued growth, and our stock price include:

Competitive developments, including the introduction of new products and services and the announcement of new client and strategic relationships by our competitors;

General macroeconomic conditions, including severe downturns or recessions in the United States and elsewhere, global unrest, terrorist activities, and particularly those economic conditions affecting the e-commerce and retailer industries;

Changes that affect our clients or the viability of their product lines, and client decisions to delay new product launches or to invest in e-commerce initiatives;

Conditions or trends in the Internet and online commerce industries in the United States and around the world, including slower-than-anticipated growth of the online market as a vehicle for the purchase of software products, changes in consumer confidence in the safety and security of online commerce, and changes in the usage of the Internet and e-commerce;

The cost of compliance with U.S. and foreign laws, rules and regulations relating to our business, including the potential effect of new laws, rules and regulations, or interpretations of existing laws, rules and regulations, that affect our business operations or otherwise restrict or affect online commerce and/or the Internet as a whole, as well as our compliance with the rules and policies of entities whose services are critical for our continued operations, such as banks and credit card associations;

Our announcement of significant acquisitions, strategic partnerships, joint ventures or capital commitments or results of operations or other developments related to those acquisitions, and our ability to successfully integrate and manage acquired businesses;

Required changes in generally accepted accounting principles and disclosures; and

Sales or other transactions involving our common stock or our convertible notes.

Failure to properly manage and sustain our expansion efforts could strain our management and other resources.

Through acquisitions and organic growth, we are rapidly and significantly expanding our operations, both domestically and internationally. We will continue to expand further to pursue growth of our service offerings

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and customer base. This expansion increases the complexity of our business and places a significant strain on our management, operations, technical performance, financial resources, and internal financial control and reporting functions, and there can be no assurance that we will be able to manage it effectively. Our personnel, systems, procedures and controls may not be adequate to effectively manage our future operations, especially as we employ personnel in multiple domestic and international locations. We may not be able to hire, train, retain and manage the personnel required to address our growth. Failure to effectively manage our growth opportunities could damage our reputation, limit our future growth, negatively affect our operating results and harm our business.

Our international expansion efforts may not be successful in generating additional revenue.

We sell products and services to consumers outside the United States and we intend to continue expanding our international presence. In 2008, our sales to international consumers represented approximately 42.8% of our total sales. Expansion into international markets, particularly the European and Asia-Pacific regions, requires significant resources that we may fail to recover through generating additional revenue. Conducting business outside of the United States is subject to risks, including:

Changes in regulatory requirements and tariffs;

Uncertainty of application of local commercial, tax, privacy and other laws and regulations;

Reduced protection of intellectual property rights;

Difficulties in physical distribution for international sales;

Higher incidences of credit card fraud and difficulties in accounts receivable collection;

The burden and cost of complying with a variety of foreign laws, rules and regulations;

The possibility of unionization of our workforce outside the United States, particularly in Europe;

Political, social and economic instability and constraints on international trade; and

Import and export license requirements and restrictions of the United States and every other country in which we operate.

Any of the factors described above, as well as other risks of doing business outside the United States, may have a material adverse effect on our ability to increase or maintain foreign sales.

We may be unable to successfully and cost-effectively market, sell and distribute our services in foreign markets. Doing so may be more difficult or take longer than anticipated especially due to international challenges, such as language barriers, currency exchange issues and the fact that the Internet infrastructure in some foreign countries may be less advanced than the U.S. Internet infrastructure. If we are unable to successfully expand our international operations, or manage this expansion, our operating results and financial condition could be harmed.

New obligations to collect or pay transaction taxes could substantially increase the cost to us of doing business.

Many of the laws and regulations regarding the application of sales, use, value added tax (VAT) or other similar transaction taxes predate the growth of the Internet and online commerce. The application of transaction taxes to interstate and international sales over the Internet is complex and evolving. We currently collect taxes with respect to

electronic software download and physical delivery of products in tax jurisdictions where we have taxable presence. A successful assertion by one or more tax jurisdictions that we should collect or were obligated to collect transaction taxes on the products we sell could harm our results of operations. The imposition by state and local governments of various taxes upon Internet commerce and related e-commerce activities could create administrative burdens for us, put us at a competitive disadvantage if they do not impose similar obligations on all of our online competitors, and decrease our future sales.

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We could be liable for fraudulent, improper or illegal uses of our platforms and services.

In recent years revenues from our remote control platforms have grown as a percentage of our overall business, and we plan to continue to emphasize our self service e-commerce solutions. These platforms typically have an automated structure that allows customers to sign up for and use our e-commerce services without significant participation from Digital River personnel. Despite our efforts to contractually prohibit the sale of inappropriate and illegal goods and services and our efforts to detect the same, the remote control nature of these platforms increases the risk that transactions involving the sale of unlawful goods or services or the violation of the proprietary rights of others may occur before we become aware of them. Furthermore, unscrupulous individuals may offer for sale, or attempt to purchase, illegal products via such platforms under innocuous names, further frustrating our attempts to prevent inappropriate use of our services. Failure to detect inappropriate or illegal uses of our platforms by third parties could expose us to a number of risks, including fines, increased fees or termination of services by payment processors or credit card associations, risks of lawsuits, and civil and criminal penalties.

Loss of our credit card acceptance privileges, or changes to payment networks, fees, rules or practices, would seriously hamper our ability to process the sale of merchandise.

The payment by consumers for the purchase of digital or physical goods that we process is typically made by credit card or similar payment method. As a result, we must rely on banks or payment processors to process transactions, and must pay a fee for this service. From time to time, credit card associations may increase the interchange fees that they charge for each transaction using one of their cards. Any such increased fees will increase our operating costs and reduce our profit margins. We also are required by our processors to comply with credit card association operating rules, and we have agreed to reimburse our processors for any fines they are assessed by credit card associations as a result of processing payments for us. The credit card associations and their member banks set and interpret the credit card rules. Visa, MasterCard, American Express, Discover, or other card associations could adopt new operating rules or re-interpret existing rules that we, or our processors, might find difficult to follow. We have had payment processing agreements with certain of our payment processors terminated due to violations of their rules, and although we have been able to successfully migrate to new processors, such migrations require significant attention from our personnel, and often result in higher fees and customer dissatisfaction. Any disputes or problems associated with our payment processors could impair our ability to give customers the option of using credit cards to fund their payments. If we were unable to accept credit cards or other widely accepted forms of payment, our business would be seriously damaged. We also could be subject to fines or increased fees from MasterCard and Visa if we fail to detect that merchants are engaging in activities that are illegal or activities that are considered high risk, primarily the sale of certain types of digital content. We may be required to expend significant capital and other resources to monitor these activities.

Implementing our acquisition strategy could result in dilution and operating difficulties leading to a decline in revenue and operating profit.

A key element of our business strategy involves expansion through the acquisitions of businesses, assets, products or technologies that allow us to complement our existing product offerings, expand our market coverage, increase our engineering workforce or enhance our technological capabilities. Between January 1, 1999 and December 31, 2008, we acquired 30 companies. We continually evaluate and explore strategic opportunities as they arise, including business combination transactions, strategic partnerships, and the purchase or sale of assets, including tangible and intangible assets such as intellectual property. We have acquired, and intend to continue engaging in strategic acquisitions of businesses, technologies, services and products. Since December 2007, we have acquired three businesses, IA Users Club d.b.a. CustomCD, Inc., DigitalSwift Corporation, and THINK Subscription, Inc.

Acquisitions may require significant capital infusions, typically entail many risks, and could result in unforeseen difficulties and expenditures in assimilating and integrating the operations, personnel, technologies, products and information systems of acquired companies or businesses. We have in the past and may in the future experience delays in the timing and successful integration of an acquired company s technologies and

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product development, unanticipated costs and expenditures, changing relationships with customers, suppliers and strategic partners, or contractual, intellectual property or employment issues. Integration of an acquired business also may disrupt our ongoing business, distract management and make it difficult to maintain standards, controls and procedures. These challenges are magnified as the size of the acquisition increases. Furthermore, these challenges would be even greater if we acquired a business or entered into a business combination transaction with a company that was larger and more difficult to integrate than the companies we have historically acquired. Moreover, the anticipated benefits of any acquisition may not be realized. If a significant number of clients of the acquired businesses cease doing business with us, we would experience lost revenue and operating profit, and any synergies from the acquisition may be lost. In addition, key personnel of an acquired company may decide not to work for us. The acquisition of another company or its products and technologies may also require us to enter into a geographic or business market in which we have little or no prior experience. Future acquisitions could result in potentially dilutive issuances of equity securities, the incurrence of debt, contingent liabilities, amortization of intangible assets or impairment of goodwill. Acquisitions could also result in a dilutive impact to our earnings.

We may need to raise additional capital to achieve our business objectives, which could result in dilution to existing investors or increase our debt obligations.

We require substantial working capital to fund our business. In January 2005, we filed a registration statement to increase our available shelf registration amount and we have \$82 million available for future use. In addition, we filed an acquisition shelf for up to approximately 1.5 million shares. In February 2006, we filed a shelf registration that would allow us to sell an undetermined amount of equity or debt securities in accordance with the recently approved rules applying to well-known seasoned issuers. If additional funds are raised through the issuance of equity securities, the percentage ownership of our stockholders will be reduced and these equity securities may have rights, preferences or privileges senior to those of our common stock. In June 2004, we issued 1.25% convertible notes which require us to make interest payments and will require us to pay principal when the notes become due in 2024 or in the event of acceleration under certain circumstances, unless the notes are converted into our common stock prior to that. On January 5, 2009, we announced that holders of 95.5% of these notes exercised the option to require us to repurchase those notes on January 2, 2009, at a purchase price of 100.25% of the principal amount of each tendered note for a total of approximately \$187.9 million, which includes accrued interest of \$1.2 million. Notes with an aggregate principal amount of \$8,805,000 remain outstanding. For a thirty day period ending January 1, 2014, the remaining note holders have the right to have the debt redeemed at 100.25% of principal face amount. We may not have sufficient capital to service this or any future debt securities that we may issue, further, the conversion of the remaining notes into our common stock would result in further dilution to our stockholders. Our capital requirements depend on several factors, including the rate of market acceptance of our products, the ability to expand our client base, the growth of sales and marketing, and opportunities for acquisitions of other businesses. We have experienced significant operating losses and negative cash flow from operations during our operating history and may do so in the future. Additional financing may not be available when needed, on terms favorable to us or at all. If adequate funds are not available or are not available on acceptable terms, we may be unable to develop or enhance our services, take advantage of future opportunities or respond to competitive pressures, which would harm our operating results and adversely affect our ability to sustain profitability.

Security breaches could hinder our ability to securely transmit confidential information and could materially affect our reputation, business operations, operating results and financial condition.

Our business depends in large part on the secure transmission of confidential information over public networks, including customers' credit card and other payment account information, and the secure storage of confidential information. We rely on encryption and authentication technology licensed from third parties to provide the security and authentication necessary for secure transmission of confidential information, such as customer credit and debit card numbers. While we take significant steps to protect the security of confidential information in our possession, we

cannot guarantee our security measures will prevent security breaches, or that future advances in computer and software capabilities and encryption technology, new cryptography tools

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and discoveries, and other events will enable us to prevent the breach or compromise of our security even if implemented by us. Further, the technology utilized in credit and debit cards, and the systems used for the transmission of payment card transactions, are controlled by the payment card industry, and vulnerabilities in these systems and technology can place payment card data at risk.

Any breach or compromise of our security could have a material adverse effect on our reputation, business, operating results and financial condition, dissuade existing and new clients from using our services, dissuade customers from transacting business through our systems, and expose us to significant costs, fines, losses, litigation, governmental investigations, and liabilities. A party who circumvents our security measures could misappropriate proprietary information or interrupt our operations. We may be required to expend significant capital and other resources to protect against security breaches or address problems caused by such breaches. Concerns over the security of the Internet and other online transactions and the privacy of users could deter people from using the Internet to conduct transactions that involve transmitting personally identifiable and other confidential information, thereby inhibiting the growth of our business.

Protecting our intellectual property is critical to our success.

We regard the protection of our trademarks, copyrights, trade secrets and other intellectual property as critical to our success. We rely on a combination of patent, copyright, trademark, service mark and trade secret laws and contractual restrictions to protect our proprietary rights. We have entered into confidentiality and invention assignment agreements with our employees and contractors, and nondisclosure agreements with parties with whom we conduct business, in order to limit access to and disclosure of our proprietary information. These contractual arrangements and the other steps taken by us to protect our intellectual property may not prevent misappropriation of our technology or deter independent third-party development of similar technologies. We also seek to protect our proprietary position by filing U.S. patent applications related to our proprietary technology, inventions and improvements that are important to the development of our business. Proprietary rights relating to our technologies will be protected from unauthorized use by third parties only to the extent they are covered by valid and enforceable patents or are effectively maintained as trade secrets. We pursue the registration of our trademarks and service marks in the U.S. and internationally. However, effective trademark, service mark, copyright and trade secret protection may not be available in every country in which our services are made available online.

The steps we have taken to protect our proprietary rights may be inadequate and third parties may infringe or misappropriate our trade secrets, trademarks and similar proprietary rights. Any significant failure on our part to protect our intellectual property could make it easier for our competitors to offer similar services and thereby adversely affect our market opportunities. In addition, litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Litigation could result in substantial costs and diversion of management and technical resources.

Claims against us related to infringement of other parties' intellectual property rights, or the products we deliver, could require us to expend significant resources, enter into unfavorable licenses or require us to change our business plans.

From time to time, we are named as a defendant in lawsuits claiming that we have, in some way, violated the intellectual property rights of others. From time to time we are notified of several potential patent disputes, and expect that we will increasingly be subject to the assertion of patent infringement claims against us as our services expand in scope and complexity. Any assertions or prosecutions of claims like these could require us to expend significant financial and managerial resources. The defense of any claims, with or without merit, could be time-consuming, result in costly litigation and diversion of technical and management personnel, cause product enhancement delays or require that we develop non-infringing technology or enter into royalty or licensing agreements. Royalty or licensing

agreements, if required, may be unavailable on terms acceptable to us or at all. In the event of a successful claim of infringement against us and our failure or inability to develop non-infringing technology or license the infringed or similar technology on a timely basis, we may be unable to pursue our current business plan. We expect that we will increasingly be subject to patent

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infringement claims as our services expand in scope and complexity, and our results of operations and financial condition could be materially adversely affected.

We may become more vulnerable to third party claims as laws such as the Digital Millennium Copyright Act, the Lanham Act and the Communications Decency Act are interpreted by the courts. Claims may be made against us for negligence, copyright or trademark infringement, products liability or other theories based on the nature and content of software products or tangible goods that we deliver electronically and physically. Because we did not create these products, we are generally not in a position to know the quality or nature of the content of these products. Although we carry general liability insurance and require that our customers indemnify us against consumer claims, our insurance and indemnification measures may not cover potential claims of this type, may not adequately cover all costs incurred in defense of potential claims, or may not reimburse us for all liability that may be imposed. Any costs or imposition of liability that are not covered by insurance or indemnification measures could be expensive and time-consuming to address, distract management and delay product deliveries, even if we are ultimately successful in the defense of these claims.

If our internal control over financial reporting or disclosure controls and procedures are not effective, there may be errors in our financial statements that could require a restatement or our filings may not be timely and investors may lose confidence in our reported financial information, which could lead to a decline in our stock price.

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to evaluate the effectiveness of our internal control over financial reporting as of the end of each year, and to include a management report assessing the effectiveness of our internal control over financial reporting in each Annual Report on Form 10-K. Section 404 also requires our independent registered public accounting firm to attest to, and report on, management's assessment of our internal control over financial reporting.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. Over time, controls may become inadequate because changes in conditions or deterioration in the degree of compliance with policies or procedures may occur. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

As a result, we cannot assure you that significant deficiencies or material weaknesses in our internal control over financial reporting will not be identified in the future. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could result in significant deficiencies or material weaknesses, cause us to fail to timely meet our periodic reporting obligations, or result in material misstatements in our financial statements. Any such failure could also adversely affect the results of periodic management evaluations and annual auditor attestation reports regarding disclosure controls and the effectiveness of our internal control over financial reporting required under Section 404 of the Sarbanes-Oxley Act of 2002 and the rules proclaimed after that. The existence of a material weakness could result in errors in our financial statements that could result in a restatement of financial statements, cause us to fail to timely meet our reporting obligations and cause investors to lose confidence in our reported financial information, leading to a decline in our stock price.

Political and economic conditions, and current turmoil in United States and global markets, may adversely affect our revenue and results of operations, and stock price.

Our revenue and growth is dependent on the continued growth in demand for our clients' products. Therefore, our operations and performance depend significantly on general geopolitical economic and business conditions, conditions in the financial services markets, the overall demand for consumer goods and services,

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and general political and economic developments. A decrease in demand for our clients' products, whether due to conditions in the economies where we sell products or changes in consumer spending resulting from the macroeconomic and political climate, could result in a decline in our revenue and impair our ability to sustain profitability. The effect of the macroeconomic and political climate could also negatively impact our clients, such as causing delays in new product introductions, changes in clients' outsourcing behavior, increasing our difficulty in collecting client receivables, and increasing the risk of client bankruptcies and/or interruption or cessation of business, which may have a negative impact on our business, operating results, and financial condition.

Recent turmoil in U.S. and foreign credit markets, equity markets, and in the global financial services industry, including the bankruptcy, failure, collapse or sale of various financial institutions, the tightening in credit markets, and an unprecedented level of intervention from the U.S. and foreign governments, may continue to place pressure on the global economy and affect overall consumer spending and the availability of credit to us, our clients, and our customers. This turmoil increases the risk that the actual amounts realized in the future on our financial instruments and investments may significantly differ from the fair values currently assigned to them. If conditions in the global economy, U.S. economy or other key vertical or geographic markets remain uncertain or weaken further, they may have a material adverse effect on our business, operating results, and financial condition. Continued uncertainty in general geopolitical economic and business conditions may result in increased or continued volatility in our stock price.

Because the e-commerce industry is highly competitive and has low barriers to entry, we may be unable to compete effectively.

The market for e-commerce solutions is extremely competitive and we may find ourselves unable to compete effectively. Because there are relatively low barriers to entry in the e-commerce market, we expect continued intense competition as current competitors expand their product offerings and new competitors enter the market. In addition, our clients and partners may become competitors in the future. Increased competition is likely to result in price reductions, reduced margins, longer sales cycles and a decrease or loss of our market share, any of which could negatively impact our revenue and earnings. We face competition from the following sources:

In-house development of e-commerce capabilities using tools or applications from companies, such as Art Technology Group, Inc. and IBM Corporation;

E-Commerce capabilities custom-developed by companies, such as IBM Global Services and Accenture, Inc.;

Other providers of outsourced e-commerce solutions, such as GSI Commerce, Inc., and asknet Inc.;

Companies that provide technologies, services or products that support a portion of the e-commerce process, such as payment processing, including CyberSource Corporation and PayPal Corp.;

Companies that offer various online marketing services, technologies and products, including ValueClick, Inc. and aQuantive, Inc.;

High-traffic, branded websites that generate a substantial portion of their revenue from e-commerce and may offer or provide to others the means to offer their products for sale, such as Amazon.com, Inc.; and

Web hosting, web services and infrastructure companies that offer portions of our solution and are seeking to expand the range of their offering, such as Network Solutions, LLC, Akamai Technologies, Inc., Yahoo!, Inc., eBay, Inc. and Hostopia.com, Inc.

We believe that the principal competitive factors for a participant in our market are the breadth of products and services offered, proven global platforms, the number of clients and online channel partnerships a participant has, brand recognition, system reliability and scalability, price, customer service, ease of use, speed to market, convenience and quality of delivery. The online channel partners and the other companies described above may compete directly with us by adopting a similar business model. Moreover, while some of these

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companies also are clients or potential clients of ours, they may compete with our e-commerce outsourcing solution to the extent that they develop e-commerce systems or acquire such systems from other software vendors or service providers.

Many of our competitors have, and new potential competitors may have, more experience developing Internet-based software and e-commerce solutions, larger technical staffs, larger customer bases, more established distribution channels and customer relationships, greater brand recognition and greater financial, marketing and other resources than we have. In addition, competitors may be able to develop services that are superior to our services, achieve greater customer acceptance or have significantly improved functionality as compared to our existing and future products and services. Our competitors may be able to respond more quickly to technological developments and changes in customers' needs. Our inability to compete successfully against current and future competitors could cause our revenue and earnings to decline.

Compliance with laws, rules and regulations, and changes in applicable laws, rules and regulations, may substantially increase our costs of doing business, limit our Internet activities, or otherwise adversely affect our ability to offer our services.

We are subject to the same international, federal, state and local laws as other companies conducting business over the Internet. We are subject to United States laws governing the conduct of business with other countries, such as export control laws, which prohibit or restrict the export of goods, services and technology to designated countries, denied persons or denied entities from the United States. Violation of these laws could result in fines or other actions by regulatory agencies and result in increased costs of doing business and reduced profits. In addition, any significant changes in these laws, particularly an expansion in export control laws, will increase our costs of compliance and may further restrict our overseas client base.

Because our services are accessible worldwide, and we facilitate sales of products to customers worldwide, international jurisdictions may claim that we are required to comply with their laws. Laws regulating Internet companies outside of the United States may be less favorable than those in the United States, giving greater rights to consumers, content owners and users. Compliance with international, federal, state and local laws may be costly or may require us to change our business practices or restrict our service offerings relative to those provided in the United States. Any failure to comply with foreign laws could subject us to penalties ranging from fines to bans on our ability to offer our services.

As our services are available over the Internet in multiple states and foreign countries, these jurisdictions may claim that we are required to qualify to do business as a foreign corporation in each state or foreign country. We and/or our subsidiaries are qualified to do business only in certain states. Failure to qualify as a foreign corporation in a required jurisdiction could subject us to taxes and penalties and could result in our inability to enforce contracts in these jurisdictions.

Today, there are relatively few laws specifically directed towards conducting business over the Internet. The adoption or modification of laws related to the Internet could harm our business, operating results and financial condition by increasing our costs and administrative burdens. Due to the increasing popularity and use of the Internet, many laws and regulations relating to the Internet are being debated at the international, federal and state levels. These laws and regulations could cover issues such as:

User privacy with respect to adults and minors;

Our ability to collect and/or share necessary information that allows us to conduct business on the Internet;

Export compliance;

Pricing, taxation, and regulatory fees;

Fraud;

Advertising;

Intellectual property rights;

Information security;

Quality of products and services;

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Taxes; and

Recycling of consumer products.

Applicability to the Internet of existing laws, rules and regulations governing issues such as property ownership, copyrights and other intellectual property issues, taxation, libel, obscenity and personal privacy, continue to be interpreted by the courts, and the applicability and reach of such laws are therefore uncertain. The vast majority of these laws were adopted prior to the advent of the Internet, and do not contemplate or address the unique issues raised thereby. Developments in the applicability of existing laws, rules and regulations, and the impact of new laws, rules and regulations, to our business could harm our operating results and substantially increase the cost to us of doing business. Any change in laws, rules or regulations applicable to the Internet and to our business might require significant management and other resources to respond appropriately.

We are subject to regulations relating to consumer privacy.

We collect and maintain customer data from our customers, which subjects us to increasing international, federal and state regulations related to online privacy and the use of personal user information. Congress has enacted anti-SPAM legislation with which we must comply when providing email campaigns for our clients. Legislation and regulations are pending in various domestic and international governmental bodies that address online privacy protections. Several governments have proposed, and some have enacted, legislation that would limit the use of personal user information or require online services to establish privacy policies. In addition, the U.S. Federal Trade Commission, or FTC, has urged Congress to adopt legislation regarding the collection and use of personal identifying information obtained from individuals when accessing websites. In the past, the emphasis has been on information obtained from minors. Focus has now shifted to include online privacy protection for minors and adults.

Even in the absence of laws requiring companies to establish these procedures, the FTC has settled several proceedings resulting in consent decrees in which Internet companies have been required to establish programs regarding the manner in which personal information is collected from users and provided to third parties. We could become a party to a similar enforcement proceeding. These regulatory and enforcement efforts could limit our collection of and/or ability to share with our clients demographic and personal information from customers, which could adversely affect our ability to comprehensively serve our clients.

The European Union has adopted a privacy directive that regulates the collection and use of information that identifies an individual person. These regulations may inhibit or prohibit the collection and sharing of personal information in ways that could harm our clients or us. Failure to comply with member state implementations of these directives may result in fines, private lawsuits and enforcement actions. These enforcement actions can include interruption or shutdown of operations relating to the collection and sharing of information pertaining to citizens of the European Union.

Failure to develop our technology to accommodate increased traffic could reduce demand for our services and impair the growth of our business.

We periodically enhance and expand our technology and transaction-processing systems, network infrastructure and other technologies to accommodate increases in the volume of traffic on our technology platforms. The volume of traffic on our technology platforms is affected by a variety of factors, including new product launches by existing clients, the launch of commerce websites on our technology platforms for new clients, and seasonal fluctuations in customer demand. Any inability to add software and hardware or to develop and upgrade existing technology, transaction-processing systems or network infrastructure to manage increased traffic and traffic spikes on our

technology platforms may cause unanticipated systems disruptions, slower response times and degradation in client services, including impaired quality and speed of order fulfillment. Failure to manage increased traffic and traffic spikes could harm our reputation and significantly reduce demand for our services, which would impair the growth of our business. We may be unable to improve and increase the capacity of our network infrastructure sufficiently or anticipate and react to expected increases in the use of the platform to handle increased volume. Further, additional network capacity may not be available from third-party suppliers when we need it. Our network and our suppliers networks may be unable to maintain an acceptable data transmission capability, especially if demands on the platform increase.

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To remain competitive, we must continue to enhance and improve the responsiveness, functionality and features of our e-commerce platforms and the underlying network infrastructure. If we incur significant costs without adequate results, or are unable to adapt rapidly to technological changes, we may fail to achieve our business plan. The Internet and the e-commerce industry are characterized by rapid technological changes, changes in user and client requirements and preferences, frequent new product and service introductions embodying new technologies and the emergence of new industry standards and practices that could render our technology and systems obsolete. To be successful, we must adapt to rapid technological changes by licensing and internally developing leading technologies to enhance our existing services, developing new products, services and technologies that address the increasingly sophisticated and varied needs of our clients, and responding to technological advances and emerging industry standards and practices on a cost-effective and timely basis. The development of our proprietary technologies involves significant technical and business risks. We may fail to use new technologies effectively or fail to adapt our proprietary technology and systems to client requirements or emerging industry standards.

System failures could reduce the attractiveness of our service offerings.

We provide commerce, marketing and delivery services to our clients and consumers through our proprietary technology transaction processing and client management systems. These systems also maintain an electronic inventory of products and gather consumer marketing information. The satisfactory performance, reliability and availability of the technology and the underlying network infrastructure are critical to our operations, level of client service, reputation and ability to attract and retain clients. We have experienced periodic interruptions, affecting all or a portion of our systems, which we believe will continue to occur from time-to-time. Any systems damage or interruption that impairs our ability to accept and fill client orders could result in an immediate loss of revenue to us, and could cause some clients to purchase services offered by our competitors. In addition, frequent systems failures could harm our reputation.

Although we maintain system redundancies in multiple physical locations, our systems and operations are vulnerable to damage or interruption from:

Fire, flood and other natural disasters;

Operator negligence, improper operation by, or supervision of, employees, physical and electronic break-ins, misappropriation, computer viruses and similar events; and

Power loss, computer systems failures, denial-of-service attacks, and Internet and telecommunications failure.

We may not carry sufficient business interruption insurance to fully compensate us for losses that may occur.

We may become liable to clients who are dissatisfied with our services.

We design, develop, implement and manage e-commerce solutions that are crucial to the operation of our clients businesses. Defects in the solutions we develop could result in delayed or lost revenue, adverse consumer reaction, and/or negative publicity, which could require expensive corrections. Clients who experience these adverse consequences either directly or indirectly by using our services could bring claims against us for substantial damages. Any claims asserted could exceed the level of any insurance coverage that may be available to us. The successful assertion of one or more large claims that are uninsured, that exceed insurance coverage or that result in changes to insurance policies, including future premium increases, could adversely affect our operating results or financial condition.

Our clients' sales cycles and the implementation process for our commerce solution are time-consuming, which may cause us to incur substantial expenses and expend management time without generating corresponding consumer revenue, which would impair our cash flow.

We market our services directly to software publishers, online retailers, consumer electronics companies and other prospective customers. These relationships are typically complex and take time to finalize. Due to operating procedures in many organizations, a significant amount of time may pass between selection of our products and services by key decision-makers, the signing of a contract, and the launch of a revenue-

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generating commerce store. The period between the initial client sales call and the signing of a contract with significant sales potential is difficult to predict and typically ranges from six to twelve months. The implementation period between the signing of a contract and the launch of a revenue-generating commerce store for our larger clients is dependent on the features and functionality implemented in the commerce solution and typically ranges from one to four months. If at the end of a sales effort a prospective client does not purchase our products or services, we may have incurred substantial expenses and expended management time that cannot be recovered and that will not generate corresponding revenue. As a result, our cash flow and our ability to fund expenditures incurred during the sales cycle and implementation process may be impaired. We can incur substantial front-end cost to launch client sites and it may require a substantial time before those costs are recouped by us.

The listing of our network addresses on anti-spam lists could harm our ability to service our clients and deliver goods over the Internet.

Certain privacy and anti-email proponents have engaged in a practice of gathering, and publicly listing, network addresses that they believe have been involved in sending unwanted, unsolicited emails commonly known as spam. In response to user complaints about spam, Internet service providers have, from time to time, blocked such network addresses from sending emails to their users. If our network addresses mistakenly end up on these spam lists, our ability to provide services for our clients and consummate the sales of digital and physical goods over the Internet could be harmed.

We are exposed to foreign currency exchange risk.

Sales outside the United States accounted for approximately 42.8% of our total sales in 2008. A significant portion of our cash and marketable securities are held in non-U.S domiciled countries. The results of operations of, and certain of our intercompany balances associated with, our internationally focused websites are exposed to foreign exchange rate fluctuations. Upon translation, net sales and other operating results from our international operations may differ materially from expectations, and we may record significant gains or losses on the remeasurement of intercompany balances. If the U.S. dollar weakens against foreign currencies, the translation of these foreign-currency-denominated transactions will result in increased net revenues and operating expenses. Similarly, our net revenues and operating expenses will decrease if the U.S. dollar strengthens against foreign currencies. As we have expanded our international operations, our exposure to exchange rate fluctuations has become more pronounced. We may enter into short-term currency forward contracts to offset the foreign exchange gains and losses generated by the re-measurement of certain assets and liabilities recorded in non-functional currencies. The use of such hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movements in foreign exchange rates. See Item 7A of Part II, for information demonstrating the effect on our consolidated statements of income from changes in exchange rates versus the U.S. dollar.

Changes in our tax rates could affect our future results.

Our future effective tax rates could be favorably or unfavorably affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws or their interpretation. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse effect on our results of operations and financial condition.

Developments in accounting standards may cause us to increase our recorded expenses, which in turn would jeopardize our ability to demonstrate sustained profitability.

In January 2002, we adopted Statement of Financial Accounting Standard No. 142, Goodwill and Other Intangible Assets (SFAS No. 142). The statement generally establishes that goodwill and intangible assets with indefinite lives are not amortized, but are to be tested on an annual basis for impairment and, if impaired, are recorded as an impairment charge in income from operations. As of December 31, 2008, we had goodwill with an indefinite life of \$273.8 million from our acquisitions. If our goodwill is determined for any reason to

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be impaired, the subsequent accounting of the impaired portion as an expense would lower our earnings and jeopardize our ability to demonstrate sustained profitability. In January 2008, we adopted Statement of Financial Accounting Standard No. 157 Fair Value Measurements. The Statement requires the reporting of assets at fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of assets can shift significantly and can cause a permanent or temporary impairment.

Provisions of our charter documents, other agreements and Delaware law may inhibit potential acquisition bids for us.

Certain provisions of our amended and restated certificate of incorporation, bylaws, other agreements and Delaware law could make it more difficult for a third party to acquire us, even if a change in control would be beneficial to our stockholders.

The investment of our substantial cash balance and our investments in marketable debt securities are subject to risks which may cause losses and affect the liquidity of these investments.

As of December 31, 2008, Digital River held \$109.5 million of investments at par value, \$93.2 million fair value, in auction-rate securities (ARS), all are AAA/Aaa-rated and 105-115 over collateralized by student loans guaranteed by the U.S. government. All the securities are 100% guaranteed by the Department of Education or the Federal Family Education Loan Program (FFELP) with the exception of two securities which are 82.5% and 99% guaranteed by FFELP.

All of these securities continue to fail at auction due to illiquid market conditions. Because of this, we have recorded a \$16.3 million temporary fair value reduction to Other Comprehensive Income in 2008. The investment principal associated with failed auctions will not be accessible until successful auctions occur, a buyer is found outside of the auction process, the issuers establish a different form of financing to replace these securities, or final payments come due according to the contractual maturities of the debt issues. If none of these events occur or if the credit markets deteriorate, we may in the future be required to take a larger fair value discount and may be required to take a permanent impairment resulting in a reduction of earnings and liquidity. We intend to hold our auction-rate securities until we can recover the full principal amount and have the ability to do so based on our other sources of liquidity. Based on our expected operating cash flows, and our other sources of cash, we do not anticipate the potential lack of liquidity on these investments will affect our ability to execute our current business plan.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The following table summarizes the various facilities that we lease for our business operations:

Description of Use	Primary Locations	Square Footage(1)	Lease Expirations
Corporate Office Facilities	Minnesota	162,500	2011
Other U.S. Office Facilities	California, Colorado, Illinois, Georgia, Nebraska, Ohio, Oregon,	75,688	From 2009 to 2011

Non-U.S. Office Facilities	Pennsylvania, Utah China, Germany, Ireland, Japan, Korea, Luxembourg, Sweden, Taiwan, United Kingdom	71,127	From 2009 to 2014
Off Site U.S. Data Centers	California, Minnesota, Utah	1,668	From 2009 to 2010
Off Site non U.S. Data Centers	Germany, Ireland, Sweden	800	From 2009 to 2011

(1) Includes sub-leased space.

We believe our properties are suitable and adequate for our present needs. We periodically evaluate whether additional facilities are necessary.

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ITEM 3. *LEGAL PROCEEDINGS*

DDR Holdings, LLC has brought a claim against us and several other defendants regarding US Patents No. 6,629,135 (the 135 patent) and 6,993,572 (the 572 patent), which are owned by DDR Holdings. These patents claim e-commerce outsourcing systems and methods relating to the provision of outsourced e-commerce support pages having a common look and feel with a host s website. The case was filed in the U.S. District Court for the Eastern District of Texas on January 31, 2006. The complaint seeks injunctive relief, declaratory relief, damages and attorneys fees. We have denied infringement of any valid claim of the patents-in-suit, and have asserted counter-claims which seek a judicial declaration that the patents are invalid and not infringed. In September 2006, DDR Holdings filed an application for reexamination of its patents based upon the prior art produced by us and the other defendants in the case. As part of that application, DDR Holdings asserted that this prior art raised a substantial question as to the patentability of the inventions claimed in the patents. In December 2006, the Court stayed the litigation pending a decision on the reexamination application. In February 2007, the US Patent and Trademark Office ordered reexamination of DDR s patents. On September 4, 2008, the US Patent and Trademark Office issued a non-final office action rejecting the claims in the 572 patent which were subject to reexamination. A further office action on the 572 patent is pending following an interview of DDR Holdings by the patent examiner on December 18, 2008. Should the stay of litigation be lifted, we intend to vigorously defend ourselves in this matter. On January 5, 2009, the US Patent and Trademark Office issued a final office action rejecting the claims in the 135 patent which were subject to reexamination.

We are subject to legal proceedings, claims and litigation arising in the ordinary course of business. While the final outcome of these matters is currently not determinable, we believe there is no litigation pending against us that is likely to have, individually or in the aggregate, a material adverse effect on our consolidated financial position, results of operations or cash flows. Because of the uncertainty inherent in litigation, it is possible that unfavorable resolutions of these lawsuits, proceedings and claims could exceed the amount we have currently reserved for these matters.

Third parties have from time-to-time claimed, and others may claim in the future, that we have infringed their intellectual property rights, or that certain products and services we resell infringed their intellectual property rights. We have been notified of several potential intellectual property disputes, and expect that we will increasingly be subject to intellectual property infringement claims as our services expand in scope and complexity. We have in the past been forced to litigate such claims in some instances. We also may become more vulnerable to third-party claims as laws, such as the Digital Millennium Copyright Act, the Lanham Act and the Communications Decency Act are interpreted by the courts and as we expand geographically into jurisdictions where the underlying laws with respect to the potential liability of online intermediaries like ourselves are either unclear or less favorable. These claims, whether meritorious or not, could be time-consuming and costly to resolve, cause service upgrade delays, require expensive changes in our methods of doing business, or could require us to enter into costly royalty or licensing agreements.

ITEM 4. *SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS*

None.

Table of Contents**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 traded on the Nasdaq Global Select Market under the symbol DRIV. The following table sets forth, for the periods indicated, the high and low sale price per share of our common stock on that market. These over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, markdown or commission, and may not necessarily represent actual transactions.

2007	High	Low
First Quarter	\$ 58.67	\$ 47.80
Second Quarter	\$ 60.30	\$ 43.70
Third Quarter	\$ 49.71	\$ 41.71
Fourth Quarter	\$ 53.52	\$ 32.38
2008		
First Quarter	\$ 39.48	\$ 29.17
Second Quarter	\$ 42.62	\$ 30.68
Third Quarter	\$ 45.45	\$ 31.36
Fourth Quarter	\$ 34.02	\$ 16.88

Holder

As of February 2, 2009, there were approximately 339 holders of record of our common stock. On February 2, 2009, the last sale price reported on The Nasdaq Global Select Market for our common stock was \$24.07 per share.

Dividend Policy

We have never declared or paid any cash dividends on our capital stock. We intend to retain any future earnings to support operations and to finance the growth and development of our business and do not anticipate paying cash dividends for the foreseeable future.

Issuer Purchases of Equity Securities

In June 2007 our Board of Directors authorized a new stock buyback program to repurchase up to an aggregate of \$200 million of our common stock. This buyback program superseded the prior buyback program.

During 2008, 4,239,312 shares were repurchased under the 2007 Repurchase Program, including 3,876,612 shares repurchased pursuant to the accelerated share repurchase program. None of the repurchased shares have been retired.

The Accelerated Share Repurchase (ASR) agreement was entered into with Goldman Sachs (GS) on February 7, 2008 and called for GS to repurchase \$127 million of Digital River, Inc. stock between February 7, 2008 and June 20, 2008. Based on the agreement, Digital River received a final share count based on a discount of the Volume Weighted

Average Price of Digital River stock from February 21, 2008, through the end of the contract. On June 20, 2008, GS had concluded the ASR program with a final share delivery of 327,767 shares. The aggregate number of shares repurchased pursuant to the ASR program was 3,876,612 shares at an average price of \$32.76 per share. The ASR agreement terminated upon completion of the ASR program on June 20, 2008 in accordance with its terms. With the conclusion of the ASR program, we have completed the 2007 Repurchase Program.

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Securities Authorized for Issuance under Equity Compensation Plans

The information required in the table of Securities Authorized for Issuance under Equity Compensation Plans is incorporated by reference to our Proxy Statement in connection with our 2009 Annual Meeting to be filed in accordance with Regulation 14A under the Securities Exchange Act of 1934, as amended.

Securities Performance Measurement Comparison¹

The SEC requires a comparison on an indexed basis of cumulative total stockholder return for the Company, a relevant broad equity market index and a published industry line-of-business index. The following graph shows a total stockholder return of an investment of \$100 in cash on December 31, 2003 for (i) the Company's Common Stock; (ii) the CRSP Total Return Index for the Nasdaq Stock Market (U.S. companies) (the Nasdaq Composite Index); and (iii) the RDG Technology Composite Index. The RDG Technology Composite Index is composed of approximately 500 technology companies in the semiconductor, electronics, medical and related technology industries. Historic stock price performance is not necessarily indicative of future stock price performance. All values assume reinvestment of the full amount of all dividends.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*
Among Digital River, Inc., The NASDAQ Composite Index
And The RDG Technology Composite Index**

* \$100 invested on 12/31/03 in stock or index-including reinvestment of dividends.
Fiscal year ending December 31.

¹ This Section is not soliciting material, is not deemed filed with the SEC and is not to be incorporated by reference in any filing of the Company under the Securities Act or the Exchange Act whether made before or after the date hereof and irrespective of any general incorporation language in any such filing.

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The information set forth below is not necessarily indicative of results of future operations, and should be read in conjunction with Item 7, Management's Discussion and Analysis-Financial Condition and Results of Operations and the consolidated financial statements and related notes thereto included in Item 8 of this Form 10-K to fully understand factors that may affect the comparability of the information presented below.

The financial information that has been previously filed or otherwise reported for these periods is superseded by the information in this Annual Report on Form 10-K, and the financial statements and related financial information contained in previously-filed reports should no longer be relied upon.

	2008	2007	December 31, 2006	2005	2004
	(In thousands)				
Balance Sheet Data:					
Current Assets	\$ 603,686	\$ 774,814	\$ 704,046	\$ 413,623	\$ 315,499
Current Liabilities	443,662	245,102	206,159	168,976	116,752
Working capital	160,024	529,712	497,887	244,647	198,747
Total assets	1,070,252	1,127,744	1,006,263	669,549	504,521
Long-term obligations	24,517	206,362	196,345	195,022	195,000
Total stockholders' equity	\$ 602,073	\$ 676,280	\$ 603,759	\$ 305,551	\$ 192,769

	2008	Year Ended December 31,			2004
	(In thousands, except per share data)				
	2007	2006	2005		
Statement of Income Data:					
Revenue	\$ 394,226	\$ 349,275	\$ 307,632	\$ 220,408	\$ 154,130
Costs and expenses					
Direct cost of services	16,417	10,243	7,709	5,063	5,167
Network and infrastructure	41,040	32,309	29,250	19,817	15,164
Sales and marketing	150,118	134,401	113,462	69,371	52,083
Product research and development	51,184	39,179	32,341	20,690	14,293
General and administrative	39,525	38,937	34,158	21,484	17,006
Depreciation and amortization	15,980	12,706	10,983	8,833	8,203
Amortization of acquisition related intangibles	8,391	7,586	12,134	8,730	8,269
Total costs and expenses	322,655	275,361	240,037	153,988	120,185
Income from operations	71,571	73,914	67,595	66,420	33,945
Interest Income	18,019	32,167	22,836	9,668	3,166
Other income (expense), net	(3,319)	(3,006)	(949)	(4,701)	(1,525)
Income before income tax expense	86,271	103,075	89,482	71,387	35,586

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Income tax expense	22,676	32,261	28,672	14,875	1,079
Net income	\$ 63,595	\$ 70,814	\$ 60,810	\$ 56,512	\$ 34,507
Net income per share basic	\$ 1.72	\$ 1.75	\$ 1.58	\$ 1.64	\$ 1.07
Net income per share diluted	\$ 1.55	\$ 1.58	\$ 1.40	\$ 1.41	\$ 0.94
Shares used in per-share calculation basic	37,016	40,444	38,593	34,536	32,328
Shares used in per-share calculation diluted	42,106	45,914	44,642	41,448	38,532

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The discussion in this Annual Report contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed below. Additional factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section entitled Risk Factors, included elsewhere in this Annual Report. When used in this document, the words believes, expects, anticipates, intends, plans, and similar expressions, are intended to identify certain of these forward-looking statements. However, these words are not the exclusive means of identifying such statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. The cautionary statements made in this document should be read as being applicable to all related forward-looking statements wherever they appear in this document.

Overview

We provide e-commerce solutions globally to a wide variety of companies primarily in software, consumer electronics, and computer games and video games markets. We offer our clients a broad range of services that enable them to mitigate their risk and effectively build, manage, and grow online sales on a global basis. Our services include design, development and hosting of online stores, merchandising, order management, fraud prevention screening, popular online payment methods, export controls and management, denied parties screening, tax compliance and management, digital product delivery via download, physical product fulfillment, CD production, multi-lingual customer service, subscription management, online marketing services including email marketing, paid search program management, website optimization, web analytics, affiliate marketing and reporting.

Acquisitions and Comparability of Results

We acquired Direct Response Technologies, Inc. (now DR Marketing Solutions, Inc.) in January 2006, MindVision, Inc. in June 2006, NetGiro Systems AB in September 2007, IA Users Club, Inc. d.b.a. CustomCD and DigitalSwift Corporation in January 2008 and THINK Subscription, Inc. in September 2008. The results of these acquisitions must be factored into any comparison of our 2008 results to the results for 2007 or 2006. See Note 4 of our consolidated financial statements for the year ended December 31, 2008, for pro forma financial information as if these entities had been acquired on January 1, 2007.

Critical Accounting Policies

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. The significant accounting policies that we believe are the most critical in fully understanding and evaluating our reported financial results are the following:

Revenue Recognition. We recognize revenue in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition, from services rendered once all the following criteria for revenue recognition have been met: (1) persuasive evidence of an agreement exists; (2) the services have been rendered; (3) the fee is fixed and determinable; and (4) collection of the amounts due is reasonably assured.

We evaluate the criteria outlined in Emerging Issues Task Force, (EITF) Issues No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent, in determining whether it is appropriate to record the gross amount of product

sales and related costs or the net amount earned as net revenue. We act as the merchant of record on most of the transactions processed and have contractual relationships with our clients, which obligate us to pay to the client a specified percentage of each sale. We derive our revenue primarily from transaction fees based on a percentage of the products sale price and fees from services

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rendered associated with the e-commerce and other services provided to our clients and end customers. Our revenue is recorded as net as generally our clients are subject to inventory risks and control customers' product choices. We sell both physical and digital products. Revenue is recognized upon fulfillment and based upon when products are shipped and title and significant risk of ownership passes to the customer.

We also provide customers with various proprietary software backup services. We recognize revenue for these backup services based upon historical usage within the contract period of the digital backup services when this information is available. Digital backup services are recognized straight-line over the life of the backup service when historical usage information is unavailable. Shipping revenues are recorded net of any associated costs.

We also, to a lesser extent, provide fee-based client services, which include website design, custom development and integration, analytical marketing, affiliate marketing and email marketing services. If we receive payments for fee-based services in advance of delivery, these amounts, if significant, are deferred and recognized over the service period.

Provisions for doubtful accounts and transaction losses and authorized credits are made at the time of revenue recognition based upon our historical experience. The provision for doubtful accounts and transaction losses are recorded as charges to operating expense, while the provision for authorized credits is recognized as a reduction of net revenues.

In June 2006, the EITF reached a consensus on EITF Issue No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation)* (EITF 06-3). EITF 06-3 provides that the presentation of taxes assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer on either a gross basis (included in revenues and costs) or on a net basis (excluded from revenues) is an accounting policy decision that should be disclosed. The Company presents these taxes on a net basis.

Allowance for Doubtful Accounts. We must make estimates and assumptions that can affect the amount of assets and liabilities and the amounts of revenues and expenses we report in any financial reporting period. We use estimates in determining our allowance for doubtful accounts, which are based on our historical experience and current trends. We must estimate the collectability of our billed accounts receivable. We analyze accounts receivable and consider our historical bad debt experience, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. We must make significant judgments and estimates in connection with the allowance in any accounting period. There may be material differences in our operating results for any period if we change our estimates or if the estimates are not accurate.

Credit Card Chargeback Reserve. We use estimates based on historical experience and current trends to determine accrued chargeback expenses. Significant management judgments are used and estimates made in connection with these expenses in any accounting period. There may be material differences in our operating results for any period if we change our estimates or if the estimates are not accurate.

Goodwill, Intangibles and Other Long-Lived Assets. We depreciate property, plant and equipment; amortize certain intangibles and certain other long-lived assets with definite lives over their useful lives. Useful lives are based on our estimates of the period of time over which the assets will generate revenue or benefit our business. We review assets with definite lives for impairment whenever events or changes in circumstances indicate that the value we are carrying on our financial statements for an asset may not be recoverable. Our evaluation considers non-financial data such as changes in the operating environment and business strategy, competitive information, market trends and operating performance. If there are indications that impairment may be necessary, we use an undiscounted cash flow analysis to determine the impairment amount, if any. Assets with indefinite lives are reviewed for impairment annually (or more

frequently if there are indications that an impairment may be necessary) utilizing the two-step approach prescribed in Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other

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Intangible Assets. There have been no material impairments of goodwill and other intangible assets for the years 2008, 2007 and 2006.

Income Taxes and Deferred Taxes. Deferred income taxes reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. We record deferred tax assets for favorable tax attributes, including tax loss carryforwards. We currently have U.S. tax loss carryforwards, consisting solely of acquired operating tax loss carryforwards, and a lesser amount of acquired foreign operating tax loss carryforwards. A portion of the benefit of the acquired tax loss carryforwards has been reserved by a valuation allowance pursuant to United States generally accepted accounting principles. These valuation allowances of the deferred tax asset will be reversed if and when it is more likely than not that the deferred tax asset will be realized. We evaluate the need for a valuation allowance of the deferred tax asset on a quarterly basis. Any future release of valuation allowance will reduce income tax expense.

There is uncertainty of future realization of the deferred tax assets resulting from acquired tax loss carryforwards due to anticipated limitations, including limitations under Section 382 of the Internal Revenue Code. Therefore, a valuation allowance was recorded against the tax effect of such tax loss carryforwards. At December 31, 2008, the Company has a valuation allowance on approximately \$1.4 million of deferred tax assets related to acquired operating losses and other tax attributes as we believe it is more likely than not that these deferred tax assets will not be realized. Any future release of this valuation allowance will reduce income tax expense.

On January 1, 2007, we adopted FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized under SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on various related matters such as derecognition, interest and penalties, and disclosure. As a result of the implementation of FIN 48, we recognized no material adjustment in the liability for unrecognized income tax benefits.

No provision has been made for federal income taxes on approximately \$81.3 million of our foreign subsidiaries undistributed earnings as of December 31, 2008 since we plan to indefinitely reinvest all such earnings. If these earnings were distributed to the U.S. in the form of dividends or otherwise, we would be subject to U.S. income taxes on such earnings. The amount of U.S. income taxes would be subject to adjustment for foreign tax credits and for the impact of the step-up in the basis of assets resulting from a Section 338 election made at the time of acquisition. If these earnings were to be distributed, the income tax liability would be approximately \$17.5 million.

Stock-Based Compensation Expense. On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share-Based Payment*, (SFAS 123(R)) which requires the measurement and recognition of compensation expense for all share-based payments made to employees and directors including stock options, restricted stock grants and employee stock purchases made through our Employee Stock Purchase Plan based on estimated fair values. SFAS 123(R) supersedes our previous accounting under Accounting Principles Board Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees*, for periods beginning in 2006.

Prior to the adoption of SFAS 123(R), we had elected to apply the disclosure-only provision of SFAS No. 123, *Accounting for Stock-Based Compensation* as amended by SFAS No. 148. Accordingly, we accounted for stock-based compensation using the intrinsic value method prescribed in APB 25 and related interpretations. Compensation expense for stock options was measured as the excess, if any, of the fair value of our common stock at the date of grant over the stock option exercise price.

We have adopted SFAS 123(R) using the modified prospective transition method under which prior periods are not revised. Stock-based compensation expense recognized during the period is based on the value of the portion of share-based awards that are ultimately expected to vest during the period. The fair value of

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each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model. The fair value of restricted stock is determined based on the number of shares granted and the closing price of our common stock on the date of grant. Compensation expense for all share-based payment awards is recognized using the straight-line amortization method over the vesting period. Stock-based compensation expense of \$12.5 million was charged to operating expenses during 2008.

As stock-based compensation expense recognized in our Consolidated Statement of Income for 2008 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Our pro forma information required under SFAS 123, for periods prior to 2006, accounted for forfeitures as they occurred. In March 2005 the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107), which provides supplemental implementation guidance for SFAS 123(R). We have applied the provision of SAB 107 in our adoption of SFAS 123(R).

SFAS 123(R) also requires the benefits of tax deductions in excess of recognized stock-based compensation expense be reported as a financing cash flow, rather than an operating cash flow as required prior to adoption of SFAS 123(R) in our Consolidated Statement of Cash Flows. On November 10, 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. FAS 123(R)-3 Transition Election Related to Accounting for Tax Effects of Share-based Payment Awards. We have elected not to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of stock-based compensation pursuant to SFAS 123(R).

See Note 5 in the Consolidated Financial Statements in this Form 10-K for further information regarding the impact of our adoption of SFAS 123(R) and the assumptions we use to calculate the fair value of share-based compensation.

Results of Operations

The following table presents certain items from our consolidated statements of income as a percentage of total revenue for the years indicated.

	2008	2007	2006
Revenue	100.0%	100.0%	100.0%
Costs and expenses:			
Direct cost of services	4.2	2.9	2.5
Network and infrastructure	10.4	9.3	9.5
Sales and marketing	38.1	38.5	36.9
Product research and development	13.0	11.2	10.5
General and administrative	10.0	11.1	11.1
Depreciation and amortization	4.0	3.6	3.6
Amortization of acquisition-related intangibles	2.1	2.2	3.9
Total costs and expenses	81.8	78.8	78.0
Income from operations	18.2	21.2	22.0
Interest Income	4.6	9.2	7.4
Other expense, net	(0.9)	(0.9)	(0.3)
Income before income tax expense	21.9	29.5	29.1

Income tax expense	5.8	9.2	9.3
Net income	16.1%	20.3%	19.8%

Revenue. Our revenue increased to \$394.2 million in 2008 from \$349.3 million in 2007 and \$307.6 million in 2006. The revenue increases were primarily attributable to growth in the number of online game and consumer electronic clients we served, increased sales from international sites, expanded strategic marketing

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activities with a larger number of clients, and acquisitions. Sales of security software products for PCs represent the largest contributor to our revenues. Acquisitions made during each of 2008, 2007 and 2006 generated approximately 2.6%, 1.3% and 3.5% of our total revenue for those years, respectively. International e-commerce sales have been stable at approximately 42.8%, 43.2% and 41.2% of revenue in the years ended December 31, 2008, 2007 and 2006, respectively. Sales of products for one software publisher client, Symantec Corporation, accounted for approximately 24.3% of our revenue in 2008, 26.2% in 2007 and 30.2% in 2006. In addition, revenues derived from proprietary Digital River services sold to Symantec consumers and oneNetworkDirect™ sales of Symantec products amounted to approximately 9.4% of our total revenue in 2008, 13.2% in 2007 and 16.6% in 2006.

Direct Cost of Services. Our direct cost of services expenses primarily include costs related to personnel, product fulfillment, back-up CD production and delivery solution and certain client-specific costs. Direct cost of service expense was \$16.4 million, \$10.2 million and \$7.7 million in 2008, 2007 and 2006, respectively. The increase in 2008 compared with 2007 was primarily driven by revenue growth and increased CD supply and personnel costs incurred through the DigitalSwift and CustomCD acquisitions in January 2008. The increase in 2007 compared with 2006 was primarily due to approximately \$1.6 million in increased CD supply costs associated with higher gross sales and \$0.8 million in additional personnel costs to support our largest clients and handle increased sales volume. As a percentage of revenue, direct cost of services increased to 4.2% in 2008 from 2.9% and 2.5% in 2007 and 2006, respectively.

We currently believe 2009 direct costs of services will remain relatively flat compared to 2008 in absolute dollars as costs associated with moderately higher CD sales volume are offset by lower costs and efficiencies related to the full integration of our CD companies. This outlook assumes continued financial challenges for consumers and macroeconomic uncertainty which is expected to temper our revenue performance indefinitely. If economic conditions improve or further deteriorate or we complete any future acquisitions we expect a correlating increase or decrease in direct cost of services in line with revenue.

Network and Infrastructure. Our network and infrastructure expenses primarily include personnel related expenses and costs to operate and maintain our technology platforms, customer service, data communication and data center operations. Network and infrastructure expenses were \$41.0 million in 2008, up from \$32.3 million and \$29.3 million in 2007 and 2006, respectively. The increase in 2008 from 2007 was due to \$2.7 million increased workforce related costs, \$1.9 million software licenses and \$1.4 million data telecommunication expenses to support our global data center operations and increased revenue growth. In addition, \$2.7 million of the increase in 2008 compared to 2007 was due to network and infrastructure costs related to NetGiro Systems which was acquired in September 2007. The increase in 2007 from 2006 was primarily due to \$1.8 million in additional software license amortization expense, \$1.3 million in increased data telecommunication and data center operations costs and \$1.0 million of network and infrastructure costs related to our NetGiro Systems acquisition. The 2007 increases supported our revenue growth and were partially offset by \$1.9 million lower personnel costs due primarily to Symantec Corporation bringing certain customer service activities in-house and the absence of workforce reduction related costs incurred in connection with the 2006 consolidation of our International customer service center located in Ireland. As a percentage of revenue, network and infrastructure costs increased to 10.4% from 9.3% and 9.5% in 2007 and 2006, respectively.

We currently believe network and infrastructure expenses will increase in absolute dollars in 2009 compared to 2008 as we continue to expand our global data center and customer service capacity. However, if global economic conditions further deteriorate, cost containment actions may result in lower network and infrastructure costs in 2009 as compared to 2008 to allow us to invest in higher opportunity areas of the business.

Sales and Marketing. Our sales and marketing expenses mainly include credit card transaction and other payment processing fees, personnel and related costs, advertising, promotional and product marketing expenses, credit card chargeback s and bad debt expense. Sales and marketing expenses were \$150.1 million, \$134.4 million and

\$113.5 million in 2008, 2007 and 2006, respectively. The increase in sales and marketing in 2008 compared to 2007 was due to \$5.5 million additional workforce related costs to support our global growth initiatives, \$3.9 million in credit card and other payment processing fees related to higher revenue and

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the addition of new payment methods and \$2.8 million marketing and advertising costs to strengthen our presence in the video game and consumer electronics markets. Also, an additional \$3.3 million in sales and marketing expenses were incurred in 2008 by NetGiro Systems, our global payment service provider which was acquired in September 2007. In addition, \$1.0 million of sales and marketing expenses were incurred through our January 2008 CustomCD, Inc. and Digital Swift acquisitions. The increase in 2007 from 2006 resulted from an additional \$9.2 million in personnel and related costs to support global strategic and product marketing, \$5.7 million in promotional and product marketing expenses associated with our MarketForce services, primarily paid search and a \$5.5 million increase in credit card and other payment processing fees directly related to incremental gross revenue and new international payment methods. Through our strategic marketing activities we continued to increase the value of existing client relationships. As a percentage of revenue, sales and marketing expense was 38.1% in 2008 from 38.5% and 36.9% in 2007 and 2006, respectively.

We currently believe sales and marketing expenses will remain relatively flat in absolute dollars in 2009 compared to 2008. We plan to support the expansion of our client relationships through investments in subscriptions, international payment processing and strategic marketing services. We also expect to continue our investments in key vertical markets, in particular consumer electronics and games. This outlook assumes continued financial challenges for consumers and macroeconomic uncertainty which is expected to temper our revenue performance indefinitely. If economic conditions improve or further deteriorate or we complete any future acquisitions we expect a correlating increase or decrease in sales and marketing expenses.

Product Research and Development. Our product research and development expenses include the costs of personnel and related expenses associated with developing, maintaining and enhancing our technology platforms and related systems. Product research and development expense was \$51.2 million in 2008, compared to \$39.2 million and \$32.3 million in 2007 and 2006, respectively. The increases in both 2008 and 2007 compared to the prior year were primarily due to additional workforce and facility costs in development and quality assurance. Recent acquisitions NetGiro, CustomCD, DigitalSwift and THINK Subscriptions comprised a total of approximately \$5.4 million of the increase in research and development costs in 2008 compared to 2007. Our research and development investments supported on-going initiatives in our e-commerce infrastructure to advance global system scalability, our e-marketing capabilities, data management and client reporting. Key enhancements implemented in 2008 included regulatory environmental fee management, subscription solutions and new online payment types. In addition, remote control functionality was added to our platform to make it even easier for clients to drive revenue and manage their stores without relying on our personnel. We expect these investments to drive long-term operational efficiencies across the organization and provide further competitive differentiation. Our 2007 research and development costs included the impact of our September 2007 NetGiro Systems acquisition and as well as software development expenses related to our relationship with Electronic Arts, a leading interactive entertainment software company. We capitalized \$4.7 million of internal software development employee and consultant labor costs in 2008. This capitalization was primarily related to design efforts on our new enterprise resource planning system and a new data management and reporting infrastructure. We did not capitalize any significant costs related to internal software development in 2007 or 2006. As a percentage of revenue, product research and development expense increased to 13.0% in 2008 from 11.2% in 2007 and 10.5% in 2006.

We currently believe that product research and development expenses will increase moderately in absolute dollars in 2009 compared to 2008, as a result of continued investments in product development required to remain competitive. However, if global economic conditions continue to deteriorate, cost containment actions may result in lower product research and development spending in 2009 as compared to 2008. If we complete any future acquisitions we expect research and development expenses to increase in line with higher revenue.

General and Administrative. Our general and administrative expenses primarily include the costs of executive, accounting and administrative personnel and related expenses, professional fees for legal, tax and audit services, bank

fees and insurance. General and administrative expenses were \$39.5 million in 2008 compared to \$38.9 million and \$34.2 million in 2007 and 2006, respectively. The increase in 2008 compared to 2007 was primarily due to \$1.4 million higher workforce related costs related to our September 2007 NetGiro Systems acquisition. This increase was partially offset by \$0.9 million lower legal fees in 2008 due to

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the absence of costs related to our internal review of historical stock option practices. The increase in 2007 compared to 2006 resulted primarily from additional workforce related expenses required to support our global expansion and infrastructure investments and additional bank fees mainly through our NetGiro Systems acquisition. As a percentage of revenue, general and administrative expenses decreased to 10% in 2008 from 11.1% in both 2007 and 2006.

We currently believe that general and administrative expenses will decrease in absolute dollars in 2009 compared to 2008. We plan to continue to invest in our infrastructure to support continued organic growth. However, we expect these incremental expenses will be offset by efficiencies gained through the implementation of our new Enterprise Resource Planning (ERP) system, client reporting enhancements and cost containment measures. If we complete any future acquisitions we expect a correlating increase in our general and administrative expenses in line with increased revenue.

Depreciation and Amortization. Our depreciation and amortization expenses include the depreciation of computer equipment and office furniture and the amortization of purchased and internally developed software, leasehold improvements made to our leased facilities and debt financing costs. Computer equipment, software and furniture are depreciated under the straight-line method using three to seven year lives and leasehold improvements are amortized over the shorter of the asset life or the remaining length of the lease. Depreciation and amortization expense increased to \$16.0 million in 2008 from \$12.7 million and \$11.0 million in 2007 and 2006, respectively. The increased expenses in 2008 and 2007 resulted primarily from increases in our capital equipment, as gross capitalized property and equipment increased to \$94.1 million on December 31, 2008, from \$74.1 million and \$56.4 million on December 31, 2007 and 2006, respectively.

We currently believe that depreciation and amortization expenses will increase in absolute dollars in 2009 compared to 2008 as we have and will continue to expand our worldwide customer support capacity, expand the number of operating global data centers and complete significant data management, client reporting projects to support our business initiatives and begin the amortization of our new ERP system and the depreciation of the associated equipment.

Amortization of Acquisition-Related Intangibles. In 2008, our amortization of acquisition-related intangibles line item consists of the amortization of intangible assets recorded from our nine acquisitions in the past four years. Amortization of acquisition related intangibles was \$8.4 million in 2008 compared to \$7.6 million and \$12.1 million in 2007 and 2006, respectively. The increase in 2008 reflects the expenses associated with our acquisitions of CustomCD, DigitalSwift and THINK Subscription which were partially offset by the full amortization of prior acquisitions. The decrease in 2007 from 2006 reflects the full amortization of several past acquisitions partially offset by the increased amortization of 2007 acquisitions. We complete our annual goodwill impairment test using a two-step approach in the fourth quarter of each year. Our assessment has indicated that there is no impairment of goodwill for the years ended December 31, 2008, 2007 and 2006. We have purchased, and expect to continue purchasing, assets or businesses, which may include the purchase of intangible assets.

Income from Operations. Our income from operations in 2008 was \$71.6 million, down from \$73.9 million in 2007 and up from \$67.6 million in 2006. As a percentage of revenue, income from operations was 18.2% in 2008, 21.2% in 2007 and 22.0% in 2006. Income from operations decreased during 2008 from 2007 and 2006 as a percentage of revenue as expenses grew faster than revenues primarily due to higher spending on global growth and operational efficiency initiatives.

Interest Income. Our interest income represents the total of interest income on our cash, cash equivalents, short-term investments and long-term investments. Interest income was \$18.0 million, \$32.2 million and \$22.8 million in 2008, 2007 and 2006, respectively. The decrease in interest income in 2008 compared to 2007 was primarily due to the use of \$138 million in cash for our share repurchase program during the first quarter of 2008. Also, interest income

declined in 2008 due to significantly lower market yields on our portfolio. The increase in interest income in 2007 compared to 2006 was primarily due to higher cash balances and slightly higher interest rates.

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We currently anticipate interest income will decline in 2009 due to lower cash balances and lower market yields when compared to 2008. The company used about \$187.9 million of cash in January 2009, which includes accrued interest of \$1.2 million; to satisfy the majority of holders of our 1.25% Convertible Senior Notes due 2024 who exercised their put option to require the company to repurchase their notes. In total, 95.5% of the \$195 million Convertible Senior Notes were repurchased by the company. As of January 31, 2009, approximately \$8.8 million of the Convertible Senior Notes remained outstanding.

Other Expense, Net. Our other expense, net line item includes the total of interest expense on our debt, foreign currency transaction gains and losses and asset disposal gains and losses. Interest expense was \$2.5 million in 2008 compared to \$2.4 million in 2007 and 2006 and was related primarily to our Convertible Senior Notes. We reported a \$0.3 million gain from foreign currency remeasurement in 2008 compared to a \$0.6 million loss in 2007 and a \$1.5 million gain on foreign currency remeasurement in 2006. The loss on asset disposals was \$1.1 million in 2008, and included one-time charges of approximately \$0.5 million each for a settlement of patent litigation and a write-down of intangible assets related to our 2007 Bitpass asset acquisition. Disposals of assets were immaterial in 2007 and 2006. We currently believe interest expense will decline substantially in 2009 compared to 2008 and 2007 due to the decrease in outstanding Convertible Senior Notes.

Income Tax Expense. In 2008, our tax expense was \$22.7 million, consisting of approximately \$26.9 million of current tax expense offset by approximately \$4.2 million of deferred tax benefit. In 2007, our tax expense was \$32.3 million, consisting of approximately \$37.0 million of current tax expense offset by \$4.7 million of deferred tax benefit. In 2006, our tax expense was \$28.7 million, consisting of approximately \$39.5 million of current tax expense offset by \$10.8 million of deferred tax benefit. Our effective tax rate for 2008 was 26.3% compared to 31.3% in 2007 and 32.0% in 2006. Differences in our effective tax rate from the US statutory rate are primarily due to our mix of earnings from international operations and the differences in statutory rates in these countries from the US rate.

As of December 31, 2008, we had U.S. tax loss carryforwards of approximately \$16.5 million and foreign tax loss carryforwards of \$4.3 million. These tax loss carryforwards consist solely of acquired net operating losses. The U.S. tax loss carryforwards expire in the years 2021 through 2025. However, we anticipate most U.S. tax loss carryforwards will be utilized in the next few years.

There is uncertainty of future realization of the deferred tax assets resulting from acquired tax loss carryforwards due to anticipated limitations. Therefore, a valuation allowance was recorded against the tax effect of such tax loss carryforwards. At December 31, 2008, the Company has a valuation allowance on approximately \$1.4 million of deferred tax assets related to acquired operating losses and other tax attributes as we believe it is more likely than not that these deferred tax assets will not be realized. Any future release of this valuation allowance will reduce income tax expense.

Comprehensive Income. Comprehensive income includes revenues, expenses, gains and losses that are excluded from net earnings under GAAP. Items of comprehensive income are unrealized gains and losses on short term investments and foreign currency translation adjustments which are added to net income to compute comprehensive income. Comprehensive income is net of income tax benefits or expense.

In 2008, comprehensive income included \$15.2 million recorded for unrealized foreign exchange losses on the revaluation of investments in foreign subsidiaries; \$0.6 million net of \$0.3 million tax benefit for unrealized investment losses; and \$10.2 million net of \$6.1 million tax benefit for the temporary impairment of auction rate securities. In 2007, comprehensive income included \$18.3 million recorded for unrealized foreign exchange gains on the revaluation of investments in foreign subsidiaries; and \$1.0 million net of \$0.6 million tax expense for unrealized investment gains. In 2006, comprehensive income included \$13.5 million recorded for unrealized foreign exchange losses on the revaluation of investments in foreign subsidiaries; and \$0.6 million net of \$0.2 million tax benefit for

unrealized investment losses.

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As of December 31, 2008, we had \$490.3 million of cash and cash equivalents and \$10.0 million of short-term investments. As discussed below, on January 2, 2009 we paid approximately \$187.9 million in connection with the repurchase of our Notes. The major components of our working capital are cash and cash equivalents, short-term investments and short-term receivables net of client payables. Our primary source of internal liquidity is our operating activities. Net cash provided by operating activities in 2008, 2007 and 2006 was \$95.2 million, \$146.4 million and \$117.5 million, respectively. Net cash provided by operating activities in 2008 was primarily the result of net income adjusted for non-cash expenses, and decreases in accounts receivable partially offset by increases in prepaid and other assets. Net cash provided by operating activities in 2007 and 2006 was primarily the result of net income adjusted for non-cash expenses, increases in accrued liabilities accounts payable, and accounts receivable. Due to our adoption of SFAS 123(R), as of January 1, 2006, the impact of the excess tax benefits of stock-based compensation, defined as the benefits of a tax deduction for share-based payment expenses that exceeds the recognized compensation expenses, is now reported under financing activities with a corresponding deduction from operating activities in our Consolidated Statements of Cash Flows.

Net cash provided by investing activities was \$144.8 million in 2008 and was the result of net sales of investments of \$195.2 million, cash paid for acquisitions, net of cash received, of \$23.5 million, and purchases of capital equipment of \$26.9 million. Net cash used for investing activities was \$128.7 million in 2007 and was the result of net purchases of investments of \$78.3 million, cash paid for acquisitions, net of cash received, of \$31.6 million, and purchases of capital equipment of \$18.7 million. Net cash used for investing activities was \$68.0 million in 2006 and was the result of net purchases of investments of \$14.3 million, cash paid for acquisitions, net of cash received, of \$37.8 million, and purchases of capital equipment of \$15.9 million.

Net cash used for financing activities in 2008 was \$124.2 million, net cash used for financing activities in 2007 was \$35.5 million, net cash provided by financing activities in 2006 was \$204.6 million. In 2008 our cash used in financing is mostly due to our stock repurchase which equaled \$137.9 million and has been offset by sales to employees under our employee stock purchase plan and by exercise of stock options. In 2007 our cash used in financing is mostly due to our stock repurchase which equaled \$63.0 million and has been offset by sales to employees under our employee stock purchase plan and by exercise of stock options. In 2006 our external financing has been provided primarily by the sale of our stock in private and public offerings, and, to a lesser extent, by sales to employees under our employee stock purchase plan and by exercise of stock options. In March 2006, we sold 4.0 million shares of our common stock. The offering provided net proceeds of \$172.8 million, and was made pursuant to a shelf registration statement previously filed with the Securities and Exchange Commission. During 2008, proceeds from the exercise of stock options and the employee stock purchase plan provided cash of \$9.9 million, cash used in the repurchase of restricted stock to satisfy tax withholding obligation was \$0.6 million, and proceeds of \$4.4 million were provided by the excess tax benefit from stock-based compensation. During 2007, proceeds from the exercise of stock options and the employee stock purchase plan provided cash of \$16.0 million, cash used in the repurchase of restricted stock to satisfy tax withholding obligation was \$0.5 million, and proceeds of \$12.0 million were provided by the excess tax benefit from stock-based compensation. During 2006, proceeds from the exercise of stock options provided cash of \$21.1 million, and proceeds of \$9.0 million were provided by the excess tax benefit from stock-based compensation.

As of December 31, 2008, Digital River held \$109.5 million of investments at par value, \$93.2 million fair value, in auction-rate securities (ARS), all are AAA/Aaa-rated and 105-115 over collateralized by student loans guaranteed by the U.S. government. All the securities are 100% guaranteed by the Department of Education or the Federal Family Education Loan Program (FFELP) with the exception of two securities which are 82.5% and 99% guaranteed by FFELP. All of these securities continue to fail at auction due to illiquid market conditions.

We did determine a market value discount, due to current illiquid market conditions, of \$16.3 million (14.9% of par value) existed as of December 31, 2008 and recorded a temporary fair value reduction to Other

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Comprehensive Income on the balance sheet in 2008. We believe the securities will continue to yield the coupon rates.

The determination of fair value required management to make estimates and assumptions about the securities. The discounted cash flow model we used to value the securities included the following assumptions:

determination of the penalty coupon rate, frequency of reset period associated with each ARS

an average redemption period of seven years

a contribution of the ARS paying its contractually stated interest rate

determination of the risk adjusted discount rate based on LIBOR rates for these maturities plus market information on student loan credit spreads

In aggregate the ARS portfolio is yielding 2.3% and we continue to receive 100% of the contractually required interest payments. We continue to believe that we will be able to liquidate at par over time. Accordingly, we treated the fair value decline as temporary. We anticipate we have sufficient cash flow from operations to execute our business strategy and fund our operational needs. We believe that capital markets are also available if we need to finance other investing alternatives. See Note 9 for further information.

Our principal commitments consist of interest and principal on our convertible senior notes and long-term obligations outstanding under operating leases. Although we have no material commitments for capital expenditures, we anticipate continued capital expenditures consistent with our anticipated growth in operations, infrastructure and personnel. We expect that our operating expenses will continue to grow as our overall business grows and that operating expenses will be a material use of our cash resources.

The following table summarizes our principal contractual commitments as of December 31, 2008:

Contractual Obligations	Total Amount Committed	Payment due by period (In thousands)			
		2009	2010	2011-2012	2013 and Thereafter
Operating Lease Obligations	\$ 12,527	\$ 5,048	\$ 3,735	\$ 2,999	\$ 745
Convertible Senior Notes	\$ 198,335	\$ 187,934	\$ 110	\$ 220	\$ 10,071
Total	\$ 210,862	\$ 192,982	\$ 3,845	\$ 3,219	\$ 10,816

We expect to continue to evaluate and consider a wide array of potential strategic transactions, including business combinations and acquisitions of businesses, products, services and other assets as well as licenses of technology related to our current business. At any given time, we may be engaged in discussions or negotiations with respect to one or more such transactions. Any such transactions could have a material impact on our financial position, results of operations, or cash flows. There is no assurance that any such discussions or negotiations will result in the consummation of any transaction. The process of integrating any acquisition may create unforeseen challenges for our operational, financial and management information systems, as well as unforeseen expenditures and other risks, including diversion of management's attention from other business concerns, the potential loss of key customers, employees and business partners, difficulties in managing facilities and employees in different geographic areas, and difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions. In addition, an acquisition may cause us to assume liabilities or become

subject to litigation. Further, there can be no assurance that we will realize a positive return on any acquisition or that future acquisitions will not be dilutive to our current shareholders' percentage ownership or to earnings.

With respect to our 1.25% convertible senior notes due January 1, 2024 (the "Notes"), we are required to pay interest on the Notes on January 1 and July 1 of each year so long as the Notes are outstanding. On January 2, 2009, we paid \$1.2 million in interest for the period July 1 through December 31, 2008. The Notes bear interest at a rate of 1.25% and, if specified conditions are met, are convertible into our common stock at a conversion price of \$44.063 per share. The Notes may be surrendered for conversion under certain circumstances, including the satisfaction of a market price condition, such that the price of our common stock reaches a specified threshold; the satisfaction of a trading price condition, such that the trading price of the

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Notes falls below a specified level; the redemption of the Notes by us, the occurrence of specified corporate transactions, as defined in the related indenture; and the occurrence of a fundamental change, as defined in the related indenture. The initial conversion price is equivalent to a conversion rate of approximately 22.6948 shares per \$1,000 of principal amount of the Notes. We will adjust the conversion price if certain events occur, as specified in the related indenture, such as the issuance of our common stock as a dividend or distribution or the occurrence of a stock subdivision or combination. In addition, contingent interest is required to be paid to holders if certain conditions are met. If a fundamental change, such as a change in our control, as defined in the related indenture, occurs on or before January 1, 2009, we may also be required to purchase the Notes for cash and pay an additional make whole premium payable in our common stock upon the repurchase or conversion of the Notes in connection with the fundamental change.

Holders of the Notes have the right to require us to repurchase their Notes prior to maturity on January 1, 2009, 2014 and 2019. We have the right to redeem the Notes, under certain circumstances, on or after July 1, 2007 and prior to January 1, 2009, and we may redeem the Notes at any time on or after January 1, 2009. On January 5, 2009, we announced that holders of 95.5% of the Notes exercised the option to require us to repurchase those Notes on January 2, 2009 at a purchase price of 100.25% of the principal amount of each tendered Note. We paid an aggregate of approximately \$187.9 million in connection with this repurchase, which includes \$1.2 million in interest. Notes with an aggregate principal amount of approximately \$8.8 million remain outstanding, which have been classified as long-term as of December 31, 2008.

We believe that existing sources of liquidity and the results of our operations will provide adequate cash to fund our operations and to repurchase the remaining Notes, if necessary, although we may seek to raise additional capital. In January 2005, we filed a registration statement to increase our available shelf registration amount and we have approximately \$82 million available for future use. In addition, we filed an acquisition shelf registration statement for up to approximately 1.5 million shares. In February 2006, we filed a shelf registration that would allow us to sell an undetermined amount of equity or debt securities in accordance with the recently approved rules applying to well known seasoned issuers. These filings were made to provide future flexibility for acquisition and financing purposes. The sale of additional equity or convertible debt securities could result in additional dilution to our stockholders. There can be no assurances that financing will be available in amounts or on terms acceptable to us, if at all.

2009 Outlook

We believe the outlook for our business remains positive for 2009. Global online sales continue to increase and buyers appear to be increasingly comfortable shopping online. In our core market, trends continue to favor the transition away from packaged, physical delivery of software to electronic download. Additionally, we see opportunities to grow our share of business in adjacent and complementary vertical markets such as consumer electronics and computer and video games. We also see opportunities to expand our core service offerings in areas such as payment processing, subscriptions management and strategic marketing. We anticipate making incremental investments in our people and technology in support of our strategic growth initiatives in 2009. We believe the initiatives outlined in our strategic plan will enable us to; 1) continue to be a leader in the software delivery market, 2) strengthen our product and service offering by investing in our core business, 3) expand into new vertical markets such as consumer electronics, and computer and video games and 4) supplement our growth through strategic acquisitions.

New Accounting Standards

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FAS 133* (SFAS 161). SFAS 161 applies to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133). The provisions of SFAS 161 require

entities to provide greater transparency through additional disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows.

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SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008. We are currently evaluating the effects, if any, that SFAS 161 may have on our financial statements.

In December 2007, the FASB issued SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements* (SFAS 160). SFAS 160 requires entities to report non-controlling (minority) interests in subsidiaries as equity in the consolidated financial statements. SFAS 160 is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the effects, if any, that SFAS 160 may have on our financial statements.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations*. This revised Statement, which we refer to as SFAS No. 141R, is intended to simplify existing guidance and converge rulemaking under U.S. GAAP with international accounting rules. SFAS No. 141R will significantly change the accounting for business combinations in a number of areas, including the treatment of contingent consideration, contingencies, acquisition costs and restructuring costs. Also under this Statement, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. SFAS No. 141R is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the effects, if any, that SFAS No. 141R may have on our financial statements.

Off Balance Sheet Arrangements

None

ITEM 7A. *QUALITATIVE AND QUANTITATIVE DISCLOSURE ABOUT MARKET RISK*

Interest Rate Risk

Our portfolio of cash equivalents and investments is maintained in a variety of securities, including government obligations and money market funds. Investments are classified as available-for-sale securities and carried at their market value with cumulative unrealized gains or losses recorded as a component of accumulated other comprehensive income/(loss) within stockholders' equity. A sharp rise in interest rates could have an adverse impact on the market value of certain securities in our portfolio. We do not currently hedge our interest rate exposure and do not enter into financial instruments for trading or speculative purposes or utilize derivative financial instruments. A hypothetical and immediate one percent (1%) increase in interest rates would decrease the fair value in our investment portfolio held at December 31, 2008 and 2007, by \$0.2 million and by \$1.48 million, respectively. A hypothetical and immediate one percent (1%) decrease in interest rates would increase the fair value in our investment portfolio held at December 31, 2008 and 2007, by \$0.2 million and by \$1.48 million, respectively. The approximate gains or losses in earnings are estimates, and actual results could vary due to the assumptions used. At December 31, 2008 and 2007, we had \$195.0 million of 1.25% fixed rate contingent convertible debt outstanding.

Foreign Currency Risk

A large portion of our business is transacted in currencies other than the U.S. dollar, and, therefore, is subject to material foreign currency exchange rate risk. Because of our extensive international operations, we also face other risks, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures and other regulations and restrictions. Accordingly, our future results could be materially adversely impacted by changes in these or other factors.

Foreign exchange rate fluctuations may adversely impact our consolidated results of operations as exchange rate fluctuations on transactions denominated in currencies other than our functional currencies result in gains and losses that are reflected in our Condensed Consolidated Statement of Income. To the extent the U.S. dollar weakens against

foreign currencies, the translation of these foreign currency-denominated transactions will result in increased net revenues and operating expenses. Conversely, our net revenues and operating expenses will decrease when the U.S. dollar strengthens against foreign currencies. The following schedule summarizes revenue, costs and expenses and income from operations that would have resulted had exchange

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rates in the current period been the same as those in effect in the comparable prior-year period for operating results.

The effect on our consolidated statements of income from changes in exchange rates versus the U.S. Dollar is as follows (in thousands):

	Year Ended December 31, 2008			Year Ended December 31, 2007			Year Ended December 31, 2006		
	At Prior Year Rates(1)	Exchange Rate Effect(2)	As Reported	At Prior Year Rates(1)	Exchange Rate Effect(2)	As Reported	At Prior Year Rates(1)	Exchange Rate Effect(2)	As Reported
Revenue	\$ 391,481	\$ 2,745	\$ 394,226	\$ 341,293	\$ 7,982	\$ 349,275	\$ 307,071	\$ 561	\$ 307,632
Costs and expenses	318,471	4,184	322,655	269,682	5,679	\$ 275,361	239,621	416	\$ 240,037
Income from operations	\$ 73,010	\$ (1,439)	\$ 71,571	\$ 71,611	\$ 2,303	\$ 73,914	\$ 67,450	\$ 145	\$ 67,595

- (1) Represents the outcome that would have resulted had exchange rates in the current period been the same as those in effect in the comparable prior-year period for operating results.
- (2) Represents the increase (decrease) in reported amounts resulting from changes in exchange rates from those in effect in the comparable prior-year period for operating results.

Transaction Exposure

The Company enters into short term foreign currency forward contracts to offset the foreign exchange gains and losses generated by the re-measurement of certain assets and liabilities recorded in non-functional currencies. Changes in the fair value of these derivatives, as well as re-measurement gains and losses, are recognized in current earnings in other income, net. Foreign currency transaction gains and losses were a gain of \$0.3 million in 2008, a loss of \$0.6 million in 2007 and a gain of \$1.5 million in 2006.

Translation Exposure

Foreign exchange rate fluctuations may adversely impact our consolidated financial position as the assets and liabilities of our foreign operations are translated into U.S. dollars in preparing our consolidated balance sheet. These gains or losses are recognized as an adjustment to stockholders' equity through accumulated other comprehensive income/(loss) net of tax benefit or expense. The potential loss in fair value resulting from a hypothetical 10% adverse currency movement is \$24.7 million and \$22.9 million for 2008 and 2007, respectively.

Table of Contents**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA****QUARTERLY FINANCIAL DATA (UNAUDITED)**

Our Financial Statements and Notes thereto appear beginning at page 53 of this report.

	Quarter Ended			
	March 31	June 30	September 30	December 31
(In thousands, except per share data)				
2008				
Revenue	\$ 103,634	\$ 98,374	\$ 96,301	\$ 95,917
Income from operations	20,617	14,227	17,515	19,212
Net income	18,283	13,219	15,634	16,459
Net income per share basic	\$ 0.47	\$ 0.36	\$ 0.43	\$ 0.45
Net income per share diluted	\$ 0.43	\$ 0.33	\$ 0.39	\$ 0.41

	Quarter Ended			
	March 31	June 30	September 30	December 31
(In thousands, except per share data)				
2007				
Revenue	\$ 91,631	\$ 78,227	\$ 82,539	\$ 96,878
Income from operations	23,015	12,998	14,646	23,255
Net income	20,706	14,493	15,299	20,316
Net income per share basic	\$ 0.51	\$ 0.35	\$ 0.38	\$ 0.51
Net income per share diluted	\$ 0.46	\$ 0.32	\$ 0.35	\$ 0.46

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES**(a) Disclosure Controls and Procedures**

Based on their evaluation of our disclosure controls and procedures conducted as of December 31, 2008, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934) were effective at reasonable assurance levels to ensure that the information required to be disclosed by us in this Form 10-K was recorded, processed, summarized and reported within the time periods specified in the rules and instructions for Form 10-K.

(b) Management's Annual Report on Internal Control over Financial Reporting

Our management, including the Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining an adequate system of internal control over financial reporting. This system of internal accounting controls is designed to provide reasonable assurance that assets are safeguarded, transactions are properly recorded and executed in accordance with management's authorization and financial statements are prepared in accordance with generally accepted accounting principles. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent

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limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Management conducted an evaluation of the effectiveness of the system of internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, management concluded that our internal control over financial reporting was effective as of December 31, 2008, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Ernst & Young LLP, an independent registered public accounting firm, has audited the effectiveness of our internal control over financial reporting as of December 31, 2008, as stated in their report in which they expressed an unqualified opinion, which is included herein.

(c) Changes in Internal Control over Financial Reporting

During the quarter ended December 31, 2008, there was no change in our internal control over financial reporting that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

(d) Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Digital River, Inc.

We have audited Digital River, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Digital River, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on Digital River, Inc.'s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that

transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized

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acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Digital River, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Digital River, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2008 of Digital River, Inc. and our report dated February 19, 2009 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Minneapolis, Minnesota
February 19, 2009

ITEM 9B. OTHER INFORMATION

None.

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PART III

Certain information required in Part III of this report is incorporated by reference to our Proxy Statement in connection with our 2009 Annual Meeting to be filed in accordance with Regulation 14A under the Securities Exchange Act of 1934, as amended.

ITEM 10. *DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE*

Other than the identification of executive officers, which is set forth in Part I, Item 1 hereof, the information required in Item 10 of Part III of this report is incorporated by reference to our Proxy Statement in connection with our 2009 Annual Meeting to be filed in accordance with Regulation 14A under the Securities Exchange Act of 1934, as amended.

We have adopted a Code of Conduct and Ethics, a copy of which we undertake to provide to any person, without charge, upon request. Such requests can be made in writing to the attention of Corporate Secretary at our principal executive offices address. To the extent permitted by the rules promulgated by NASDAQ, we intend to disclose any amendments to, or waivers from, the Code provisions applicable to our principal executive officer or senior financial officers, including our chief financial officer and controller, or with respect to the required elements of the Code, on our website, www.digitalriver.com under the Investor Relations link.

ITEM 11. *EXECUTIVE COMPENSATION*

The information required in Item 11 of Part III of this report is incorporated by reference to our Proxy Statement in connection with our 2009 Annual Meeting to be filed in accordance with Regulation 14A under the Securities Exchange Act of 1934, as amended.

ITEM 12. *SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS*

The information required in Item 12 of Part III of this report is incorporated by reference to our Proxy Statement in connection with our 2009 Annual Meeting to be filed in accordance with Regulation 14A under the Securities Exchange Act of 1934, as amended.

ITEM 13. *CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE*

The information required in Item 13 of Part III of this report is incorporated by reference to our Proxy Statement in connection with our 2009 Annual Meeting to be filed in accordance with Regulation 14A under the Securities Exchange Act of 1934, as amended.

ITEM 14. *PRINCIPAL ACCOUNTANT FEES AND SERVICES*

The information required in Item 14 of Part III of this report is incorporated by reference to our Proxy Statement in connection with our 2009 Annual Meeting to be filed in accordance with Regulation 14A under the Securities Exchange Act of 1934, as amended.

Table of Contents**PART IV****ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a) The following documents are filed as part of this report:

(1) *Financial Statements.*

The consolidated financial statements required by this item are submitted in a separate section beginning on page 53 of this report.

<u>Report of Independent Registered Public Accounting Firm</u>	52
<u>Consolidated Balance Sheets</u>	53
<u>Consolidated Statements of Income</u>	54
<u>Consolidated Statements of Stockholders' Equity</u>	55
<u>Consolidated Statements of Cash Flows</u>	56
<u>Notes to Consolidated Financial Statements</u>	57

(2) *Financial Statement Schedules.*

All schedules for which provision is made in the applicable accounting regulations of the SEC have been omitted as not required or not applicable, or the information required has been included elsewhere by reference in the financial statements and related notes, except for Schedule II, which is included with this Form 10-K, as filed with the SEC.

(3) *Exhibits.*

Exhibit Number	Description of Document
3.1(2)	Amended and Restated Certificate of Incorporation of the Registrant, as currently in effect.
3.2(4)	Amended and Restated Bylaws of the Registrant, as currently in effect.
4.1(5)	Specimen Stock Certificate.
4.2(9)	Indenture dated as of June 1, 2004, between Digital River, Inc. and Wells Fargo Bank, N.A. as trustee, including therein the form of the Note.
10.1(5)	Form of Indemnity Agreement between Registrant and each of its directors and executive officers.
10.3(5)	Consent to Assignment and Assumption of Lease dated April 22, 1998, by and between CSM Investors, Inc., IntraNet Integration Group, Inc. and Registrant.
10.4(3)	Assignment of Lease dated April 21, 1998, by and between Intranet Integration Group, Inc. and Registrant.
10.5(3)	Lease Agreement dated January 18, 2000, between Property Reserve, Inc. and Registrant.
10.6(4)	First Amendment of Lease dated January 31, 2001, to that certain Lease dated April 24, 1996, between CSM Investors, Inc. and Registrant (as assignee of Intranet Integration Group, Inc.).
10.7(6)	1998 Stock Option Plan, as amended and superseded by Exhibit 10.18.*
10.8(7)	

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- 1999 Stock Option Plan, formerly known as the 1999 Non-Officer Stock Option Plan, as amended and superseded by Exhibit 10.18.*
- 10.9(6) 2000 Employee Stock Purchase Plan, as amended, and offering.*
- 10.11(8) Second Amendment of Lease dated April 22, 2002, to that certain Lease dated April 24, 1996, between CSM Investors, Inc. and Registrant (as assignee of Intranet Integration Group, Inc.) as amended.
- 10.12(8) Second Amendment of Lease dated April 28, 2003, to that certain Lease dated January 18, 2000, between Property Reserve Inc. and Registrant.
- 10.15(9) Registration Rights Agreement dated as of June 1, 2004, between Digital River, Inc. and the initial purchasers of Senior Convertible Notes due January 1, 2024.

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Exhibit Number	Description of Document
10.16(13)	Summary of Compensation Program for Non-Employee Directors.
10.17(14)	Second Amended and Restated Symantec Online Store Agreement, by and among Symantec Corporation, Symantec Limited, Digital River, Inc. and Digital River Ireland Limited effective April 1, 2006
10.18(10)	1998 Equity Incentive Plan (formerly known as 1998 Stock Option Plan).*
10.19(13)	Amended and Restated Employment Agreement for Joel A. Ronning.*
10.20(13)	Change of Control and Severance Agreement for Thomas M. Donnelly.*
10.21(11)	Form of Amendment to Non-Qualified Stock Option Agreement.*
10.22(12)	Inducement Equity Incentive Plan.*
10.23(15)	2007 Equity Incentive Plan.*
10.24(13)	Change of Control and Severance Agreement for Kevin L. Crudden.*
12.1++	Computation of Ratio of Earnings to Fixed Charges.
21.1++	Subsidiaries of Digital River, Inc.
23.1++	Consent of Independent Registered Public Accounting Firm, dated February 19, 2009.
24.1++	Power of Attorney, pursuant to which amendments to this Annual Report on Form 10-K may be filed, is included on the signature pages of this Annual Report on Form 10-K.
31.1++	Certification of Digital River, Inc. s Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2++	Certification of Digital River, Inc. s Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32++	Certification of Digital River, Inc. s Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

++ Filed herewith.

* Management contract or compensatory plan.

Confidential treatment has been requested for portions of this agreement, which portions have been filed separately with the SEC.

- (1) Incorporated by reference from the Company s Current Report on Form 8-K filed on May 4, 2004.
- (2) Incorporated by reference from the Company s Current Report on Form 8-K filed on June 1, 2006.
- (3) Incorporated by reference from the Company s Annual Report on Form 10-K for the year ended December 31, 1999, filed on March 30, 2000.
- (4) Incorporated by reference from the Company s Annual Report on Form 10-K for the year ended December 31, 2000, filed on March 27, 2001.
- (5) Incorporated by reference from the Company s Registration Statement on Form S-1 (File No. 333-56787), declared effective on August 11, 1998.
- (6)

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Incorporated by reference from the Company's Registration Statement on Form S-8 (File No. 333-105864) filed on June 5, 2003.

- (7) Incorporated by reference from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003, filed on August 14, 2003.
- (8) Incorporated by reference from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2003, filed on May 15, 2003.
- (9) Incorporated by reference from the Company's Current Report on Form 8-K filed on July 13, 2004.
- (10) Incorporated by reference from the Company's Current Report on Form 8-K filed on May 31, 2005.

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- (11) Incorporated by reference from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005, filed on August 9, 2005.
- (12) Incorporated by reference from the Company's Current Report on Form 8-K filed on December 20, 2005.
- (13) Incorporated by reference from the Company's Current Report on Form 8-K filed on March 10, 2008.
- (14) Incorporated by reference from the Company's Annual Report on Form 10-K for the year ended December 31, 2006, filed on March 1, 2007.
- (15) Incorporated by reference from the Company's Annual Report on Form 10-K for the year ended December 31, 2007, filed on February 29, 2008.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Eden Prairie, State of Minnesota, on February 19, 2009.

DIGITAL RIVER, INC.

By: /s/ Joel A. Ronning

Joel A. Ronning
Chief Executive Officer

We, the undersigned, directors and officers of Digital River, Inc., do hereby severally constitute and appoint Joel A. Ronning and Thomas M. Donnelly and each or any of them, our true and lawful attorneys and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2008, and to file the same with all exhibits thereto, and all other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys and agents, and each or any of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys and agents, and each of them, or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Form 10-K has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

Signature	Title	Date
/s/ Joel A. Ronning Joel A. Ronning	Chief Executive Officer and Director (Principal Executive Officer)	February 19, 2009
/s/ Thomas M. Donnelly Thomas M. Donnelly	Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)	February 19, 2009
/s/ Perry W. Steiner Perry W. Steiner	Director	February 19, 2009
/s/ William Lansing William Lansing	Director	February 19, 2009
/s/ Thomas F. Madison Thomas F. Madison	Director	February 19, 2009
/s/ J. Paul Thorin J. Paul Thorin	Director	February 19, 2009

Paul Thorin

/s/ Frederic Seegal

Director

February 19, 2009

Frederic Seegal

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Digital River, Inc.

We have audited the accompanying consolidated balance sheets of Digital River, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. Our audits also included the financial statement schedule listed in Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Digital River, Inc. and subsidiaries at December 31, 2008 and 2007, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth herein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Digital River, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 19, 2009 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Minneapolis, Minnesota
February 19, 2009

Table of Contents**DIGITAL RIVER, INC.****Consolidated Balance Sheets**

	December 31, 2008	December 31, 2007
	(In thousands)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 490,335	\$ 381,788
Short-term investments	10,000	315,636
Accounts receivable, net of allowance of \$2,457 and \$2,489	53,216	64,914
Deferred income taxes	7,613	7,899
Prepaid expenses and other	42,522	4,577
Total current assets	603,686	774,814
Property and equipment, net	41,733	31,102
Goodwill	273,788	261,885
Intangible assets, net of accumulated amortization of \$66,345 and \$59,493	32,222	32,382
Long-term investments	93,213	
Deferred income taxes	24,824	15,606
Other assets	786	11,955
TOTAL ASSETS	\$ 1,070,252	\$ 1,127,744

LIABILITIES AND STOCKHOLDERS EQUITY

CURRENT LIABILITIES:		
Convertible senior notes	\$ 186,195	\$
Accounts payable	184,361	180,386
Accrued payroll	14,841	12,704
Deferred revenue	13,651	10,384
Accrued acquisition costs	3,278	399
Other accrued liabilities	41,336	41,229
Total current liabilities	443,662	245,102
NON-CURRENT LIABILITIES:		
Convertible senior notes	8,805	195,000
Other liabilities	15,712	11,362
Total non-current liabilities	24,517	206,362
TOTAL LIABILITIES	468,179	451,464

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS EQUITY:

Preferred Stock, \$.01 par value; 5,000,000 shares authorized; no shares issued or outstanding		
Common Stock, \$.01 par value; 120,000,000 shares authorized; 43,225,401 and 42,502,019 shares issued	432	425
Treasury stock at cost; 6,211,477 and 1,952,884 shares	(216,163)	(77,707)
Additional paid-in capital	623,778	597,128
Retained earnings	189,096	125,501
Accumulated other comprehensive income	4,930	30,933
Total stockholders equity	602,073	676,280
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 1,070,252	\$ 1,127,744

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

Table of Contents**DIGITAL RIVER, INC.****Consolidated Statements of Income**

	For the Years Ended December 31		
	2008	2007	2006
	(In thousands except per share data)		
Revenue	\$ 394,226	\$ 349,275	\$ 307,632
Costs and expenses			
Direct cost of services	16,417	10,243	7,709
Network and infrastructure	41,040	32,309	29,250
Sales and marketing	150,118	134,401	113,462
Product research and development	51,184	39,179	32,341
General and administrative	39,525	38,937	34,158
Depreciation and amortization	15,980	12,706	10,983
Amortization of acquisition-related intangibles	8,391	7,586	12,134
Total costs and expenses	322,655	275,361	240,037
Income from operations	71,571	73,914	67,595
Interest Income	18,019	32,167	22,836
Other expense, net	(3,319)	(3,006)	(949)
Income before income tax expense	86,271	103,075	89,482
Income tax expense	22,676	32,261	28,672
Net income	\$ 63,595	\$ 70,814	\$ 60,810
Net income per share basic	\$ 1.72	\$ 1.75	\$ 1.58
Net income per share diluted	\$ 1.55	\$ 1.58	\$ 1.40
Shares used in per-share calculation basic	37,016	40,444	38,593
Shares used in per-share calculation diluted	42,106	45,914	44,642

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

Table of Contents**DIGITAL RIVER, INC.****Consolidated Statements of Stockholders' Equity**

	Common Stock		Treasury	Additional	Deferred	Accumulated	Retained	Total	
	Shares	Amount	Stock	Paid-In	Compensation	Comprehensive	Earnings	Stockholder	Compre
				Capital		Income	(Accumulated	Equity	Income
				(In thousands)		(Loss)	Deficit)		(Loss)
NCE, December 31,	35,034	\$ 355	\$ (13,586)	\$ 329,327	\$ (1,990)	\$ (2,431)	\$ (6,123)	\$ 305,552	\$ 54,687
Income							60,810	60,810	60,810
Classification of deferred									
contribution balance upon									
adoption of SFAS 123(R)				(1,990)	1,990				
Realized gain on									
investments						576		576	
Gain in currency									
translation gain						13,463		13,463	13,463
Issuance of common stock	4,000	40		172,740				172,780	
Issued for									
acquisition	28		(12)	1,184				1,172	
Exercise of stock options	1,220	12		21,106				21,118	
Share-based compensation	113	1		13,903				13,904	
Stock withheld in restricted									
investing	(8)		(426)					(426)	
Benefit of stock-based									
contribution				12,700				12,700	
Issuance of common stock									
under the Employee Stock									
Ownership Plan	71	1		2,110				2,111	
NCE, December 31,	40,458	\$ 409	\$ (14,024)	\$ 551,080	\$	\$ 11,608	\$ 54,687	\$ 603,760	\$ 74,687
Income							70,814	70,814	70,814
Realized gain on									
investments						1,006		1,006	1,006
Gain in currency									
translation gain						18,319		18,319	18,319
Repurchase of common	(1,372)		(62,968)					(62,968)	
Issued for									
acquisition	44	1	(189)	2,337				2,149	
Exercise of stock options	1,220	12		13,498				13,510	

based compensation				13,742				13,742	
ected stock issued									
equity incentive									
net of forfeitures	135	2		(2)					
withheld in restricted									
esting	(11)		(526)					(526)	
enefit of stock-based									
nsation				13,990				13,990	
on stock issued									
the Employee Stock									
se Plan	76	1		2,483				2,484	
NCE, December 31,	40,550	\$ 425	\$ (77,707)	\$ 597,128	\$	\$ 30,933	\$ 125,501	\$ 676,280	\$ 90
come							63,595	63,595	63
ized loss on									
ments						(10,822)		(10,822)	(10
n currency									
tion loss						(15,181)		(15,181)	(15
hase of common									
	(4,239)		(137,858)					(137,858)	
se of stock options	426	4		7,167				7,171	
based compensation				12,548				12,548	
ected stock issued									
equity incentive									
net of forfeitures	186	2		(2)					
withheld in restricted									
esting	(19)		(598)					(598)	
enefit of stock-based									
nsation				4,223				4,223	
on stock issued									
the Employee Stock									
se Plan	112	1		2,714				2,715	
NCE, December 31,	37,016	\$ 432	\$ (216,163)	\$ 623,778	\$	\$ 4,930	\$ 189,096	\$ 602,073	\$ 37

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

Table of Contents**DIGITAL RIVER, INC.****Consolidated Statements of Cash Flows**

	For the Years Ended December 31,		
	2008	2007	2006
	(In thousands)		
OPERATING ACTIVITIES:			
Net income	\$ 63,595	\$ 70,814	\$ 60,810
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization of acquisition-related intangibles	8,391	7,586	12,134
Change in accounts receivable allowance, net of acquisitions	434	(174)	1,215
Depreciation and amortization	15,980	12,706	10,983
Stock-based compensation expense related to stock-based compensation plans	12,548	13,742	13,904
Excess tax benefits from stock-based compensation	(4,390)	(12,030)	(8,980)
Deferred income taxes and other	4,971	27,522	19,583
Change in operating assets and liabilities (net of acquisitions):			
Accounts receivable	11,332	(6,863)	(14,678)
Prepaid and other assets	(26,505)	1,325	(1,293)
Accounts payable	6,531	32,181	3,701
Deferred revenue	3,235	3,046	811
Income tax payable	(5,366)	(7,076)	8,126
Accrued payroll and other accrued liabilities	4,478	3,609	11,190
Net cash provided by operating activities	95,234	146,388	117,506
INVESTING ACTIVITIES:			
Purchases of investments	(480,917)	(436,806)	(193,609)
Sales of investments	676,108	358,470	179,296
Cash paid for acquisitions, net of cash received	(23,465)	(31,625)	(37,800)
Purchases of equipment and capitalized software	(26,898)	(18,722)	(15,907)
Net cash provided by/(used for) investing activities	144,828	(128,683)	(68,020)
FINANCING ACTIVITIES:			
Proceeds from sales of common stock			172,780
Exercise of stock options	7,171	13,510	21,118
Sales of common stock under employee stock purchase plan	2,715	2,483	2,109
Repurchase of common stock	(137,858)	(62,968)	
Repurchase of restricted stock to satisfy tax withholding obligation	(598)	(528)	(426)
Excess tax benefits from stock-based compensation	4,390	12,030	8,980
Net cash (used for)/provided by financing activities	(124,180)	(35,473)	204,561
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(7,335)	9,313	4,426

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	108,547	(8,455)	258,473
CASH AND CASH EQUIVALENTS, beginning of year	774,814	704,046	413,623
CASH AND CASH EQUIVALENTS, end of year	\$ 883,361	\$ 695,591	\$ 672,096
SUPPLEMENTAL DISCLOSURES:			
Cash paid for interest on Convertible Senior Notes	\$ 2,438	\$ 2,438	\$ 2,438
Cash paid for income taxes	\$ 20,503	\$ 8,232	\$ 2,006
Noncash investing and financing activities:			
Common stock issued in acquisitions and earn-outs	\$	\$ 2,150	\$ 1,172

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

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DIGITAL RIVER, INC.

**Notes to Consolidated Financial Statements
December 31, 2008 and 2007**

1. Nature of Operations and Summary of Significant Accounting Policies

We provide outsourced e-commerce solutions globally to a wide variety of companies primarily in the software, consumer electronics, computer game and video game markets. We were incorporated in 1994 and began building and operating online stores for our clients in 1996. We generate revenue primarily based on the sales of products made in those stores, and in addition, offer services designed to increase traffic to our clients' online stores and to improve the sales effectiveness of those stores.

Principles of Consolidation and Classification

The consolidated financial statements include the accounts of Digital River, Inc. and our wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in accordance with the United States generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Foreign Currency Translation

Substantially all of our foreign subsidiaries use the local currency of their respective countries as their functional currency. Assets and liabilities are translated at exchange rates prevailing at the balance sheet dates. Revenues, costs and expenses are translated into U.S. dollars at average exchange rates for the period. Gains and losses resulting from translation are recorded as a component of equity. Gains and losses resulting from foreign currency transactions are recognized as other (expense), net.

We are exposed to market risk from changes in foreign currency exchange rates. Our primary risk is the effect of foreign currency exchange rate fluctuations on the U.S. dollar value of foreign currency denominated operating sales and expenses. At December 31, 2008, these exposures were mitigated through the use of foreign exchange forward contracts with maturities of approximately one week. The principal currency exposures being mitigated were the euro, British pound, Australian dollar, Swiss franc, Norwegian krone, Swedish krona and Canadian dollar. We also are exposed to foreign currency exchange risk as a result of changes in intercompany balance sheet accounts and other balance sheet items.

Our foreign currency forward contracts contain credit risk to the extent that our bank counterparties may be unable to meet the terms of the agreements. We minimize such risk by limiting our counterparties to major financial institutions of high credit quality.

Cash and Cash Equivalents

We consider all short-term, highly liquid investments, primarily high grade commercial paper and money market accounts, that are readily convertible into known amounts of cash and that have original or remaining maturities of

three months or less at the date of purchase to be cash equivalents. As of December 31, 2008 and 2007, cash balances of \$0.0 million and \$1.5 million, respectively, were held by banks or credit card processors to secure potential future credit card fees, fines and chargebacks or for other payments. In addition, at December 31, 2008 and 2007, \$0.3 million and \$0.4 million were restricted by letter of credit and agreements required by international tax jurisdictions as security for potential tax liabilities.

Table of Contents**DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)*****Short-Term Investments***

Our short-term investments consist of debt securities that are classified as available-for-sale and are carried on our balance sheet at their market value with cumulative unrealized gains or losses recorded as a component of accumulated other comprehensive income within stockholders' equity. We classify all of our available-for-sale securities as current assets, as these securities represent investments available for current corporate purposes.

Property and Equipment

Computer equipment, software and furniture are depreciated under the straight-line method using estimated useful lives of three to seven years and leasehold improvements are amortized over the shorter of the asset life or remaining length of the lease. Property and equipment at December 31 consisted of the following (in thousands):

	2008	2007
Computer hardware and software	\$ 78,660	\$ 60,977
Furniture, fixtures and leasehold improvements	15,475	13,077
Total property and equipment	\$ 94,135	\$ 74,054
Accumulated depreciation	(52,402)	(42,952)
Net property and equipment	\$ 41,733	\$ 31,102

Purchased Intangible Assets

Through both domestic and international acquisitions, we have continued to expand our global online businesses. Tangible net assets for our acquisitions were valued at their respective carrying amounts as we believe these amounts approximated their current fair values at the respective acquisition dates. The valuation of identifiable intangible assets acquired reflects management's estimates based on, among other factors, use of established valuation methods. Such assets consist of customer lists and user base, trademarks and trade names, developed technologies and other acquired intangible assets, including contractual agreements. Identifiable intangible assets are amortized using the straight-line method over the estimated useful lives, generally three to ten years. We believe the straight-line method of amortization best represents the distribution of the economic value of the identifiable intangible assets acquired to date. Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in each business combination. The purchase prices of the acquisitions described in Note 4 below exceeded the estimated fair value of the respective related identifiable intangible and tangible assets because we believe these acquisitions will assist with our strategy of establishing and expanding our global online marketplace.

Long-Lived Assets

We review all long-lived assets, including intangible assets with definite lives, for impairment in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived

Assets (SFAS 144). Under SFAS 144, impairment losses are recorded whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. For long-lived assets used in operations, impairment losses are only recorded if the asset's carrying amount is not recoverable through its undiscounted, probability-weighted cash flows. We measure the impairment loss based on the difference between the carrying amount and estimated fair value. An impairment loss is recognized when estimated undiscounted cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. As part of our evaluation, we consider certain non-financial data as indicators of impairment such as changes in the operating

Table of Contents**DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)**

environment and business strategy, competitive information, market trends and operating performance. When an impairment loss is identified, the carrying amount of the asset is reduced to its estimated fair value. There were no significant impairments of long-lived assets, including definite-lived intangible assets, recorded in 2008, 2007 or 2006.

Other Assets

The following table summarizes our other assets as of December 31 (in thousands):

	2008	2007
Unamortized debt financing costs	\$ 224	\$ 5,298
Cost of investment		6,000
Other	562	657
Total other assets	\$ 786	\$ 11,955

Unamortized debt financing costs, in the amount of about \$5.1 million, related to the January 2, 2009 repurchase of our convertible senior notes, were reclassified to current as of December 31, 2008. In 2008, our cost of investment, which are preferred shares in a publicly traded company accounted for under the cost method of accounting, were reclassified to current assets due to their pending liquidation which occurred on January 20, 2009.

Other Accrued Liabilities

The following table summarizes our other accrued liabilities as of December 31 (in thousands):

	2008	2007
Accrued expenses	\$ 24,148	\$ 20,631
Sales, value-added and transaction taxes	19,788	20,598
Current income taxes	(2,600)	
Total other accrued liabilities	\$ 41,336	\$ 41,229

Comprehensive Income

Comprehensive income includes revenues, expenses, gains and losses that are excluded from net earnings under GAAP. Items of comprehensive income are unrealized gains and losses on short term investments and foreign currency translation adjustments which are added to net income to compute comprehensive income. Comprehensive income is net of income tax benefits or expense.

In 2008, comprehensive income included \$15.2 million recorded for unrealized foreign exchange losses on the revaluation of investments in foreign subsidiaries; \$0.6 million net of \$0.3 million tax benefit for unrealized investment losses; and \$10.2 million net of \$6.1 million tax benefit for the temporary impairment of auction rate securities. In 2007, comprehensive income included \$18.3 million recorded for unrealized foreign exchange gains on the revaluation of investments in foreign subsidiaries, and \$1.0 million net of \$0.6 million tax expense for unrealized investment gains. In 2006, comprehensive income included \$13.5 million recorded for unrealized foreign exchange gains on the revaluation of investments in foreign subsidiaries, and \$0.6 million net of \$0.2 million tax expense for unrealized investment gains

Revenue Recognition

We recognize revenue in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition*, from services rendered once all the following criteria for revenue recognition have been met: (1) persuasive

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DIGITAL RIVER, INC.

Notes to Consolidated Financial Statements (Continued)

evidence of an agreement exists; (2) the services have been rendered; (3) the fee is fixed and determinable; and (4) collection of the amounts due is reasonably assured.

We evaluate the criteria outlined in Emerging Issues Task Force, (EITF) Issues No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent, in determining whether it is appropriate to record the gross amount of product sales and related costs or the net amount earned as net revenue. We act as the merchant of record on most of the transactions processed and have contractual relationships with our clients, which obligate us to pay to the client a specified percentage of each sale. We derive our revenue primarily from transaction fees based on a percentage of the products sale price and fees from services rendered associated with the e-commerce and other services provided to our clients and end customers. Our revenue is recorded as net as generally our clients are subject to inventory risks and control customers product choices. We sell both physical and digital products. Revenue is recognized upon fulfillment and based upon when products are shipped and title and significant risk of ownership passes to the customer.

We also provide customers with various proprietary software backup services. We recognize revenue for these backup services based upon historical usage within the contract period of the digital backup services when this information is available. Digital backup services are recognized straight-line over the life of the backup service when historical usage information is unavailable. Shipping revenues are recorded net of any associated costs.

We also, to a lesser extent, provide fee-based client services, which include website design, custom development and integration, analytical marketing, affiliate marketing and email marketing services. If we receive payments for fee-based services in advance of delivery, these amounts, if significant, are deferred and recognized over the service period.

Provisions for doubtful accounts and transaction losses and authorized credits are made at the time of revenue recognition based upon our historical experience. The provision for doubtful accounts and transaction losses are recorded as charges to operating expense, while the provision for authorized credits is recognized as a reduction of net revenues.

In June 2006, the EITF reached a consensus on EITF Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation) (EITF 06-3). EITF 06-3 provides that the presentation of taxes assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer on either a gross basis (included in revenues and costs) or on a net basis (excluded from revenues) is an accounting policy decision that should be disclosed. The Company presents these taxes on a net basis.

Deferred Revenue

Deferred revenue is recorded when service payment is received in advance of performing our service obligation. Revenue is recognized over either the estimated usage period when usage information is available, or ratably over the service period when usage information is not available.

Advertising Costs

The costs of advertising are charged to sales and marketing expense as incurred. We incurred advertising expense of \$0.7 million, \$0.1 million and \$1.5 million in 2008, 2007 and 2006, respectively.

Income Taxes

Deferred income taxes reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. We record deferred tax assets for favorable tax attributes, including tax loss carryforwards. We currently have U.S. tax

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DIGITAL RIVER, INC.

Notes to Consolidated Financial Statements (Continued)

loss carryforwards, consisting solely of acquired operating tax loss carryforwards, and a lesser amount of acquired foreign operating tax loss carryforwards. A portion of the benefit of the acquired tax loss carryforwards has been reserved by a valuation allowance pursuant to United States generally accepted accounting principles. These valuation allowances of the deferred tax asset will be reversed if and when it is more likely than not that the deferred tax asset will be realized. We evaluate the need for a valuation allowance of the deferred tax asset on a quarterly basis.

Interest Income

Our interest income line item is the total of interest income on our cash, cash equivalents, and investments. Interest income was \$18.0 million, \$32.2 million and \$22.8 million in 2008, 2007 and 2006, respectively. The decrease in interest income from 2007 to 2008 was due to the use of \$138 million in cash for our share repurchase program during the first quarter of 2008. Interest income also declined due to lower yields on our portfolio during 2008. The increase from 2006 to 2007 in interest income was primarily due to higher cash balances.

Other (Expense), Net

Our other (expense), net line item is the total of interest expense on our debt and foreign currency transaction gains and losses and disposals of asset gains and losses. Interest expense was \$2.5 million in 2008 compared to \$2.4 million in 2007 and 2006 and was related primarily to our Convertible Senior Notes. Our gain from foreign currency remeasurement was \$0.3 million in 2008 compared to a loss of \$0.6 million in 2007 and a gain of 1.5 million in 2006. The loss on disposals of assets was \$1.1 million in 2008. Disposals of assets were immaterial in 2007 and 2006.

Research and Development and Software Development

Research and development expenses consist primarily of development personnel and non-employee contractor costs related to the development of new products and services, enhancement of existing products and services, quality assurance, and testing. We follow AICPA Statement of Position No. 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, in accounting for internally developed software. We capitalized \$5.3 million related to software development during 2008, inclusive of amounts outside of Product Research and Development as recorded in our Consolidated Statement of Income. In 2007 and 2006, we capitalized \$0.0 million and \$0.1 million, respectively, of software development costs.

Stock-Based Compensation Expense

On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (Revised 2004), Share-Based Payment, (SFAS 123(R)) which requires the measurement and recognition of compensation expense for all share-based payments made to employees and directors including stock options, restricted stock grants and employee stock purchases made through our Employee Stock Purchase Plan based on estimated fair values.

We have adopted SFAS 123(R) using the modified prospective transition method under which prior periods are not revised. Stock-based compensation expense recognized during the period is based on the value of the portion of share-based awards that are ultimately expected to vest during the period. The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model. The fair value of restricted stock is determined based on the number of shares granted and the closing price of our common stock on the date of grant.

Compensation expense for all share-based payment awards is recognized using the straight-line amortization method over the vesting period. Stock-based compensation expense of \$12.5 million was charged to operating expenses during 2008.

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DIGITAL RIVER, INC.

Notes to Consolidated Financial Statements (Continued)

As stock-based compensation expense recognized in our Consolidated Statement of Income for 2008 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

SFAS 123(R) also requires the benefits of tax deductions in excess of recognized stock-based compensation expense be reported as a financing cash flow, rather than an operating cash flow as required prior to adoption of SFAS 123(R) in our Consolidated Statement of Cash Flows.

See Note 5 for further information regarding the impact of our adoption of SFAS 123(R) and the assumptions we use to calculate the fair value of share-based compensation.

Recent Accounting Pronouncements

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FAS 133* (SFAS 161). SFAS 161 applies to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under SFAS No. 133

Accounting for Derivative Instruments and Hedging Activities (SFAS 133). The provisions of SFAS 161 require entities to provide greater transparency through additional disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008. We are currently evaluating the effects, if any, that SFAS 161 may have on our financial statements.

In December 2007, the FASB issued SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements* (SFAS 160). SFAS 160 requires entities to report non-controlling (minority) interests in subsidiaries as equity in the consolidated financial statements. SFAS 160 is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the effects, if any, that SFAS 160 may have on our financial statements.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations*. This revised Statement, which we refer to as SFAS No. 141(R), is intended to simplify existing guidance and converge rulemaking under U.S. GAAP with international accounting rules. SFAS No. 141(R) will significantly change the accounting for business combinations in a number of areas, including the treatment of contingent consideration, contingencies, acquisition costs and restructuring costs. Also under this Statement, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the effects, if any, that SFAS No. 141R may have on our financial statements.

2. Net Income per Share

Basic income per common share is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per common share is calculated by dividing net income, adjusted to exclude interest expense and financing cost amortization related to potentially dilutive securities,

by the weighted average number of common shares related to potentially dilutive securities outstanding during the period, plus any additional common shares that would have been outstanding if potentially dilutive common shares had been issued during the period.

Table of Contents**DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)**

The following table summarizes the computation of basic and diluted earnings per share (in thousands, except per share data):

	For the Years Ended December 31,		
	2008	2007	2006
Earnings per share basic			
Net income basic	\$ 63,595	\$ 70,814	\$ 60,810
Weighted average shares outstanding basic	37,016	40,444	38,593
Earnings per share basic	\$ 1.72	\$ 1.75	\$ 1.58
Earnings per share diluted			
Net income basic	63,595	\$ 70,814	\$ 60,810
Exclude: Interest expense and amortized financing cost of convertible senior notes, net of tax benefit	1,739	1,739	1,739
Net income diluted	\$ 65,334	\$ 72,553	\$ 62,549
Weighted average shares outstanding basic	37,016	40,444	38,593
Dilutive impact of non-vested stock and options outstanding	665	1,045	1,624
Dilutive impact of convertible senior notes	4,425	4,425	4,425
Weighted average shares outstanding diluted	42,106	45,914	44,642
Earnings per share diluted	\$ 1.55	\$ 1.58	\$ 1.40

In accordance with the Emerging Issues Task Force (EITF), Issue No. 04-8, the unissued shares underlying contingent convertible notes are treated as if such shares were issued and outstanding for the purposes of calculating GAAP diluted earnings per share beginning with the issuance of our 1.25% convertible senior notes on June 1, 2004.

3. Investments

As of December 31, 2008 and 2007, our available-for-sale securities consisted of the following (in thousands):

	Unrealized Gain/(Loss)			Maturities/Reset Dates	
	Less than 12 Months	Greater than 12 Months		Less than 12 Months	Greater than 12 Months
Cost	Months	Months	Fair Value	Months	Months

2008

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U.S. government sponsored entities	\$ 9,900	\$ 100	\$	\$ 10,000	\$ 10,000	\$
Student loan bonds	109,500	(16,287)		93,213		93,213
Total available-for-sale securities	\$ 119,400	\$ (16,187)	\$	\$ 103,213	\$ 10,000	\$ 93,213

2007

U.S. government sponsored entities	\$ 139,377	\$ 94	\$ 859	\$ 140,330	\$ 69,070	\$ 71,260
Student loan bonds	119,750			119,750	119,750	
Other	55,556			55,556	55,556	
Total available-for-sale securities	\$ 314,683	\$ 94	\$ 859	\$ 315,636	\$ 244,376	\$ 71,260

Realized gains or losses on investments are recorded in our statement of income within other income (expense), net. Realized losses on sales of investments were immaterial in 2008, 2007 and 2006.

Table of Contents**DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)****4. Business Combinations, Goodwill and Intangible Assets**

The following table summarizes the purchase acquisitions completed during the three years in the period ended December 31, 2008 (in thousands):

Acquisition	Initial Shares Issued	Initial Purchase Consideration	Acquired Assets	Assumed Liabilities	Goodwill	Other Intangible Assets		
						Technology/ Trademarks	Customer Relationships	Non-competes Agreements
2008								
Think Subscription, Inc.		\$ 5,100	\$ 644	\$ (1,019)	\$ 2,007	\$ 1,209	\$ 1,813	\$
CustomCD, Inc.		7,000	764	(355)	3,136	2,059	1,468	
DigitalSwift Corporation		9,200	427	(459)	4,673	487	4,325	
Total		\$ 21,300	\$ 1,835	\$ (1,833)	\$ 9,816	\$ 3,755	\$ 7,606	\$
2007								
Netgiro Systems AB		\$ 27,386	\$ 8,567	\$ (7,477)	\$ 9,742	\$ 4,424	\$ 12,372	\$
Total		\$ 27,386	\$ 8,567	\$ (7,477)	\$ 9,742	\$ 4,424	\$ 12,372	\$
2006								
Mindvision, Inc.		\$ 24,975	\$ 2,555	\$ (8,036)	\$ 18,859	\$ 3,170	\$ 4,490	\$ 40
Direct Response Technologies, Inc.		14,876	1,573	(3,723)	11,343	2,465	3,620	
Total		\$ 39,851	\$ 4,128	\$ (11,759)	\$ 30,202	\$ 5,635	\$ 8,110	\$ 40

Note: Balances as of acquisition date and do not reflect subsequent earn-outs, adjustments or currency translation.

Acquisitions completed in 2008

On September 1, 2008, we acquired all of the capital stock of THINK Subscription, Inc. (Think Subscription), a privately-held company based in Provo, Utah, for approximately \$5.1 million in cash. Think Subscription provides subscription management and fulfillment software to content publishers, online service providers, media vendors and other subscription-based businesses. The agreement also provides Think Subscription shareholders with an earn-out opportunity based on Think Subscription achieving certain revenue and earnings targets during the first three years subsequent to the acquisition. Any future earn-out will result in additional goodwill.

On January 1, 2008, we acquired all of the capital stock of DigitalSwift Corporation (DigitalSwift), a privately-held company based in Madison, Georgia, for approximately \$9.2 million in cash. DigitalSwift is a manufacturer and fulfiller of on-demand, dynamic and build-to-order CDs and DVDs to consumers. The agreement also provides

DigitalSwift shareholders with an earn-out opportunity based on DigitalSwift achieving certain revenue and earnings targets during the first year subsequent to the acquisition. In 2008, we paid earn-outs of \$1.0 million and accrued \$3.0 million for future earn-out payments. Earn-outs were recorded as goodwill in 2008 as they were considered incremental to the purchase price.

On January 1, 2008, we acquired the assets of IA Users Club d.b.a. CustomCD, Inc. (CustomCD), a privately held company based in Portland, Oregon and Krefeld, Germany, for approximately \$7.0 million in cash. This acquisition involved an asset purchase of the US-based business and a stock purchase of the business located in Germany. CustomCD creates, sells and delivers to consumers custom CDs and DVDs containing software, games, and other licensed content. The agreement also provides CustomCD shareholders with an earn-out opportunity based on CustomCD achieving certain revenue and earnings targets during the

Table of Contents**DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)**

first two years subsequent to the acquisition. In 2008, we paid earn-outs of \$1.3 million. Earn-outs were recorded as goodwill in 2008 as they were considered incremental to the purchase price. Any future earn-out will result in additional goodwill.

Acquisitions completed in 2007

On September 1, 2007, we acquired all of the capital stock of NetGiro Systems AB (NetGiro), a privately held company based in Stockholm, Sweden, for approximately \$27.4 million in cash. NetGiro is an online payment service provider.

Acquisitions completed in 2006

In June 2006, we acquired all of the capital stock of MindVision, Inc., a privately held e-commerce company based in Lincoln, Nebraska, for approximately \$25.0 million comprised of payments to stockholders of \$21.2 million plus the assumption of certain liabilities totaling approximately \$3.7 million. In November 2006, we recorded \$0.2 million as acquisition cost related to a restructuring plan for employee severance to be paid out over a six month period.

In January 2006, we acquired all of the capital stock of Direct Response Technologies, Inc. (Direct Response), a privately held company based in Pittsburgh, Pennsylvania, for approximately \$15.0 million in cash. Direct Response, a provider of tools for managing affiliate networks, is now named DR Marketing Solutions, Inc. The agreement also provided Direct Response shareholders with an earn-out opportunity based on DR Marketing Solutions, Inc. achieving certain revenue and earnings targets during the first three years subsequent to the acquisition. In 2006, we accrued \$3.5 million for future earn-out payments. In 2007, pursuant to the January 2006 acquisition agreement, certain adjustments were made to the earn-out obligations under this agreement. Under the restructured earn-out agreement a final earn-out of \$3.5 million was accrued and paid in 2007. These earn-outs have been recorded as goodwill in 2006 and 2007 as they were considered incremental to the purchase price.

Future Earn-outs

As of December 31, 2008, there were estimated future earn-outs of \$3.0 million in accrued acquisition liabilities. Any of the estimated maximum potential future earn-out beyond the \$3.0 million accrual will result in additional goodwill.

Pro Forma Operating Results (Unaudited)

The consolidated financial statements include the operating results of each business acquired from the date of acquisition. The following unaudited pro forma condensed results of operations for 2008, 2007 and 2006 have been prepared as if each of the acquisitions in 2008 had occurred on January 1, 2007, and as if each of the 2007 acquisitions had occurred on January 1, 2006 (in thousands except per share data):

	2008	2007	2006
Revenue	\$ 395,698	\$ 366,208	\$ 322,296
Income from operations	70,373	70,590	68,260

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Net income	62,400	67,494	61,338
Diluted income per share	\$ 1.52	\$ 1.51	\$ 1.41

This pro forma financial information does not purport to represent results that would actually have been obtained if the transactions had been in effect on January 1, 2007 or 2006, as applicable, or any future results that may be realized.

Table of Contents**DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)****Goodwill**

We account for our goodwill in accordance with SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 142 precludes the amortization of goodwill and intangible assets with indefinite lives, but these assets are reviewed annually (or more frequently if impairment indicators arise) for impairment.

We complete our annual impairment test using a two-step approach based in the fourth quarter of each fiscal year and reassess any intangible assets, including goodwill, recorded in connection with earlier acquisitions. Our assessment has indicated that there is no impairment of goodwill for the years ended December 31, 2008, 2007 and 2006.

The changes in the net carrying amount of goodwill for the years ended December 31, 2008 and 2007 are as follows (in thousands):

	Total
Balance as of December 31, 2006	\$ 243,799
Goodwill from acquisitions and earn-outs	13,774
Adjustments(1)	4,312
Balance as of December 31, 2007	\$ 261,885
Goodwill from acquisitions and earn-outs	14,955
Adjustments(1)	(3,052)
Balance as of December 31, 2008	\$ 273,788

(1) Adjustments to goodwill during the year ended December 31, 2008 and December 31, 2007, resulted primarily from foreign currency translation and tax adjustments relating to goodwill associated with our current and prior period acquisitions.

Intangible Assets

Information regarding our other intangible assets is as follows (in thousands):

	As of December 31, 2008		
	Carrying Amount Gross	Accumulated Amortization	Carrying Amount Net
Customer relationships	\$ 62,265	\$ 37,931	\$ 24,334
Non-compete agreements	5,312	5,301	11

Technology/tradename	30,991	23,114	7,877
Total	\$ 98,568	\$ 66,346	\$ 32,222

	As of December 31, 2007		
	Carrying Amount Gross	Accumulated Amortization	Carrying Amount Net
Customer relationships	\$ 57,327	\$ 33,761	\$ 23,566
Non-compete agreements	5,351	5,328	23
Technology/tradename	29,197	20,404	8,793
Total	\$ 91,875	\$ 59,493	\$ 32,382

Amortization expense was \$8.4 million, \$7.6 million and \$12.1 million, respectively for the years ended 2008, 2007 and 2006, respectively. The result of the allocation of the purchase price between amortizable costs

Table of Contents**DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)**

and goodwill could have an impact on our future operating results. The components of intangible assets acquired during the years ended December 31, 2008, 2007 and 2006, are as follows (in thousands). No significant residual value is estimated for these assets.

	2008		2007		2006	
	Amount	Weighted Average Life	Amount	Weighted Average Life	Amount	Weighted Average Life
Customer relationships	\$ 7,606	6 years	\$ 12,372	10 years	\$ 8,110	8 years
Non-compete agreements					40	4 years
Technology/tradename	3,755	4 years	4,424	8 years	5,635	4 years
Total	\$ 11,361	5 years	\$ 16,796	10 years	\$ 13,785	6 years

Estimated amortization expense for the remaining life of the intangible assets, based on intangible assets as of December 31, 2008, is as follows (in thousands):

Year	
2009	\$ 7,378
2010	5,868
2011	4,706
2012	4,543
2013	2,617
Thereafter	7,110
Total	\$ 32,222

Following is an allocation of the net assets acquired from the acquisitions consummated and amounts paid under earn-out arrangements in 2008 and 2007 (in thousands) which includes subsequent year activity for 2007 acquisitions:

	2008	2007
Tangible assets	\$ 1,835	\$ 8,567
Liabilities assumed	(1,833)	(7,477)
Customer relationships	7,606	12,372
Technology/tradename	3,755	4,424
Goodwill (year of acquisition)	9,816	9,742
Goodwill (subsequent to year of acquisition)		5,058

Net assets acquired	\$ 21,179	\$ 32,686
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5. Stock-Based Compensation

Our stockholders approved the Digital River, Inc. 2007 Equity Incentive Plan (the 2007 Plan) at the Company's annual stockholder meeting held on May 31, 2007. The number of shares issuable under the 2007 Plan equals 2,000,000 shares of our common stock. In addition, shares not issued under the 1998 Plan shall become available for issuance under the 2007 Plan to the extent a stock option or other stock award under the 1998 Plan expires or terminates before shares of common stock are issued under the award. Under our 2007 Equity Incentive Plan we have the flexibility to grant incentive and non-statutory stock options, restricted stock awards, restricted stock unit awards and performance shares to our directors, employees, and consultants.

Our current plan is described more fully in Note 11.

Table of Contents**DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)*****Expense Information under SFAS 123(R)***

On January 1, 2006, we adopted SFAS 123(R) which requires measurement and recognition of compensation expense for all stock-based payments made to employees and directors including stock options, restricted stock grants and employee stock purchases made through our Employee Stock Purchase Plan based on estimated fair values. The following table summarizes stock-based compensation expense, net of tax, related to our stock-based compensation plans recognized under SFAS 123(R):

	Year Ended December 31,	
	2008	2007
	(In	thousands)
	thousands)	(In thousands)
Costs and expenses		
Direct cost of services	\$ 785	\$ 807
Network and infrastructure	192	270
Sales and marketing	4,562	5,028
Product research and development	1,258	1,736
General and administrative	5,751	5,901
Stock-based compensation included in costs and expenses	12,548	13,742
Tax benefit	(2,802)	(3,737)
Stock-based compensation expense, net of tax	\$ 9,746	\$ 10,005

Valuation Information under SFAS 123(R)

During the twelve months ending ended December 31, 2008, 2007 and 2006 we used the Black-Scholes option pricing model with the following weighted average assumptions:

	2008	2007	2006
Risk-free interest rate	2.0%	4.5%	4.7%
Expected life (years)	3.37	3.46	4.08
Volatility factor	0.45	0.50	0.59
Expected dividends			
Weighted average fair value of options granted	\$ 10.74	\$ 23.11	\$ 19.00

The risk-free interest rate assumption is based on observed interest rates appropriate for the term of our stock options. The expected life of stock options represents the weighted-average period the stock options are expected to remain outstanding and is based on historical exercise patterns. We used historical closing stock price volatility for a period

equal to the expected term of the options granted. The dividend yield assumption is based on our history and expectation of future dividend payouts.

As stock-based compensation expense recognized in the Consolidated Statement of Income for the twelve months ended December 31, 2008 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience.

At December 31, 2008, there was approximately \$24.4 million of total unrecognized stock-based compensation expense, adjusted for estimated forfeitures, related to unvested share-based awards. Unrecognized stock-based compensation expense is expected to be recognized over the next 2.44 years on a weighted average basis and will be adjusted for any future changes in estimated forfeitures.

Table of Contents**DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)****6. Income Taxes**

The components of pretax income are as follows (in thousands):

	Year Ended December 31,		
	2008	2007	2006
United States	\$ 46,988	\$ 74,595	\$ 65,171
International	39,283	28,480	24,311
Total	\$ 86,271	\$ 103,075	\$ 89,482

The provision (benefit) for income taxes is composed of the following (in thousands):

	Year Ended December 31,		
	2008	2007	2006
Current tax expense (benefit):			
United States federal	\$ 18,792	\$ 29,204	\$ 34,362
State and local	1,223	1,842	2,160
International	6,858	5,939	2,915
Total current provision for income taxes	26,873	36,985	39,437
Deferred tax expense (benefit):			
United States federal	(3,926)	(3,896)	(10,136)
State and local	(255)	(227)	(637)
International	(16)	(601)	8
Total deferred provision (benefit) for income taxes	(4,197)	(4,724)	(10,765)
Provision for income taxes	\$ 22,676	\$ 32,261	\$ 28,672

The following is a reconciliation of the difference between the actual provision for income taxes and the provision computed by applying the federal statutory rate of 35% to income before income taxes (in thousands):

	Year Ended December 31,		
	2008	2007	2006
Tax expense at statutory rate	\$ 30,195	\$ 36,076	\$ 31,319

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State taxes, net of federal benefit	968	1,615	1,469
International rate differential	(7,860)	(4,623)	(3,193)
Tax Credits	(955)	(671)	(1,909)
Nondeductible expense and other	328	(136)	986
Total	\$ 22,676	\$ 32,261	\$ 28,672

Table of Contents**DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)**

Deferred income taxes reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the bases for income tax purposes. Significant components of deferred income taxes are as follows (in thousands):

	2008	2007
Deferred tax assets:		
Net operating loss and credit carryforwards	\$ 8,646	\$ 12,412
Nondeductible reserves and accruals	21,075	9,144
Depreciation and amortization	4,777	3,339
Valuation allowance	(2,061)	(1,390)
Total deferred tax assets	32,437	23,505
Deferred tax liabilities:		
Depreciation	(1,191.00)	
Other intangibles	(11,016)	(5,054)
Total deferred tax liabilities	(12,207)	(5,054)
Net deferred tax assets	\$ 20,230	\$ 18,451

As of December 31, 2008, we had U.S. tax loss carryforwards of approximately \$16.5 million and foreign tax loss carryforwards of \$4.3 million. These tax loss carryforwards consist solely of acquired net operating losses. The U.S. tax loss carryforwards expire in the years 2021 through 2025. However, we anticipate most U.S. tax loss carryforwards will be utilized in the next few years.

There is uncertainty of future realization of the deferred tax assets resulting from acquired tax loss carryforwards due to anticipated limitations, including limitations under Section 382 of the Internal Revenue Code. Therefore, a valuation allowance was recorded against the tax effect of such tax loss carryforwards. At December 31, 2008, the Company has a valuation allowance on approximately \$1.4 million of deferred tax assets related to acquired operating losses and other tax attributes as we believe it is more likely than not that these deferred tax assets will not be realized. Any future release of this valuation allowance will reduce expense.

On January 1, 2007, we adopted the provisions of Financial Standards Accounting Board Interpretation No. 48

Accounting for Uncertainty in Income Taxes (FIN 48) an interpretation of FASB Statement No. 109 (SFAS 109). As a result of the implementation of FIN 48, we recognized no material adjustment in the liability for unrecognized income tax benefits. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

Balance at January 1, 2007	\$ 3,340
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Increases for tax positions taken during current year	1,072
Decreases for tax positions taken during prior years	1,035
Balance at December 31, 2007	5,447
Increases for tax positions taken during current year	2,957
Increases for tax positions taken during prior years	613
Decreases as a result of settlements with taxing authorities	(2,622)
Balance at December 31, 2008	\$ 6,395

All of these unrecognized tax benefits would affect our effective tax rate if recognized. We recognize interest and penalties related to uncertain tax positions in income tax expense. We had approximately

Table of Contents**DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)**

\$0.8 million and \$0.1 million of accrued interest and penalties related to uncertain tax positions at December 31, 2008 and December 31, 2007, respectively.

The Company and its subsidiaries file income tax returns in U.S. federal and various state jurisdictions, and foreign jurisdictions. The tax years 2004-2008 remain open to examination by the major taxing jurisdictions to which we are subject. During 2008, the Internal Revenue Service (IRS) examined the Company's 2004 U.S. income tax return. The examination was substantially completed, resulting in only minor agreed upon adjustments. The Company expects the examination to be finalized in 2009. Several of the Company's international subsidiaries were also under examination during 2008 and the Company expects these examinations to be completed in 2009 as well. Due to the potential resolution of examinations currently being performed by taxing authorities, and the expiration of various statutes of limitation, it is reasonably possible that our gross unrecognized tax benefits balance may change within the next twelve months by a range of zero to \$2.2 million.

No provision has been made for federal income taxes on approximately \$81.3 million of our foreign subsidiaries undistributed earnings as of December 31, 2008 since we plan to indefinitely reinvest all such earnings. If these earnings were distributed to the U.S. in the form of dividends or otherwise, we would be subject to U.S. income taxes on such earnings. The amount of U.S. income taxes would be subject to adjustment for foreign tax credits and for the impact of the step-up in the basis of assets resulting from a Section 338 election made at the time of acquisition. If these earnings were to be distributed, the income tax liability would be approximately \$17.5 million.

7. Commitments and Contingencies***Leases***

We currently have 38 facility leases in addition to leasing certain computer equipment under non-cancelable operating leases. Total rent expense, including common area maintenance charges, recognized under all leases was \$7.1 million, \$5.7 million and \$4.3 million for the years ended December 31, 2008, 2007 and 2006, respectively. The minimum annual rents under long-term leases at December 31, 2008, were as follows (in thousands):

Year ending December 31,	Lease Obligations
2009	5,048
2010	3,735
2011	2,312
2012	687
Thereafter	745
Total future minimum obligations	\$ 12,527

Litigation

We are subject to legal proceedings, claims and litigation arising in the ordinary course of business. While the final outcome of these matters is currently not determinable, we believe there is no litigation pending against us that is likely to have, individually or in the aggregate, a material adverse effect on our consolidated financial position, results of operation or cash flows. Because of the uncertainty inherent in litigation, it is possible that unfavorable resolutions of these lawsuits, proceedings and claims could exceed the amount we have currently reserved for these matters.

Third parties have from time-to-time claimed, and others may claim in the future, that we have infringed their intellectual property rights. We have been notified of several potential patent disputes, and expect that we

Table of Contents**DIGITAL RIVER, INC.****Notes to Consolidated Financial Statements (Continued)**

will increasingly be subject to patent infringement claims as our services expand in scope and complexity. We have in the past been forced to litigate such claims. We may also become more vulnerable to third-party claims as laws, such as the Digital Millennium Copyright Act, the Lanham Act and the Communications Decency Act are interpreted by the courts and as we expand geographically into jurisdictions where the underlying laws with respect to the potential liability of online intermediaries like ourselves are either unclear or less favorable. These claims, whether meritorious or not, could be time consuming and costly to resolve, cause service upgrade delays, require expensive changes in our methods of doing business, or could require us to enter into costly royalty or licensing agreements.

Indemnification Provisions

In the ordinary course of business we have included limited indemnification provisions in certain of our agreements with parties with whom we have commercial relations. Under these contracts, we generally indemnify, hold harmless and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party in connection with claims by any third party with respect to our domain names, trademarks, logos and other branding elements to the extent that such marks are applicable to our performance under the subject agreement. In certain agreements, including both agreements under which we have developed technology for certain commercial parties and agreements with our clients, we have provided an indemnity for other types of third-party claims. To date, no significant costs have been incurred, either individually or collectively, in connection with our indemnification provisions.

In addition, we are required by our credit card processors to comply with credit card association operating rules, and we have agreed to indemnify our processors for any fines they are assessed by credit card associations as a result of processing payments for us. The credit card associations and their member banks set and interpret the credit card rules. Visa, MasterCard, American Express, or Discover could adopt new operating rules or re-interpret existing rules that we or our credit card processors might find difficult to follow. We have had payment processing agreements with certain of our payment processors terminated due to violations of their rules. We also could be subject to fines or increased fees from MasterCard and Visa.

8. Debt

In 2004 we sold and issued \$195.0 million in aggregate principal amount of 1.25% convertible senior notes due January 1, 2024 (Notes), in a private, unregistered offering. The Notes were sold at 100% of their principal amount.

We are required to pay interest on the Notes on January 1 and July 1 of each year so long as the Notes are outstanding. The Notes bear interest at a rate of 1.25% and, if specified conditions are met, are convertible into our common stock at a conversion price of \$44.063 per share. The Notes may be surrendered for conversion under certain circumstances, including the satisfaction of a market price condition, such that the price of our common stock reaches a specified threshold; the satisfaction of a trading price condition, such that the trading price of the Notes falls below a specified level; the redemption of the Notes by us, the occurrence of specified corporate transactions, as defined in the related indenture; and the occurrence of a fundamental change, as defined in the related indenture. The initial conversion price is equivalent to a conversion rate of approximately 22.6948 shares per \$1,000 of principal amount of the Notes. We will adjust the conversion price if certain events occur, as specified in the related indenture, such as the issuance of our common stock as a dividend or distribution or the occurrence of a stock subdivision or combination. If a fundamental change, such as a change in our control, as defined in the related indenture, occurs on or before January 1, 2009, we may also be required to purchase the Notes for cash and pay an additional make whole premium

payable in our common stock upon the repurchase or conversion of the Notes in connection with the fundamental change.

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DIGITAL RIVER, INC.

Notes to Consolidated Financial Statements (Continued)

Holders of the Notes have the right to require us to repurchase their Notes prior to maturity on January 1, 2009, 2014 and 2019. We have the right to redeem the Notes at any time on or after January 1, 2009. On January 5, 2009, we announced that holders of 95.5% of the Notes exercised the option to require us to repurchase those Notes on January 2, 2009 at a purchase price of 100.25% of the principal amount of each tendered Note. Notes with an aggregate principal amount of \$8,805,000 remain outstanding. In light of the right of holders to require us to redeem the Notes on January 1, 2009, on January 1, 2008, we reclassified the Notes as short-term debt. As such right has expired and the exercise of the next right to require us to redeem the Notes will not occur until January 1, 2014, we have reclassified the remaining Notes as long-term debt.

We incurred interest expense of \$2.5 million in 2008 and made interest payments of \$2.4 million. We incurred interest expense of \$2.4 million in 2007 and made interest payments of \$2.4 million. We incurred interest expense of \$2.5 million in 2006 and made interest payments of \$2.4 million.

9. Fair Value Measurements

Effective January 1, 2008, we adopted the provisions of Statement of Financial Accounting Standards No. 157, Fair Value Measurements, (FAS 157) for financial instruments. FAS 157 defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and requires enhanced disclosures about fair value measurements. FAS 157 does not require any new fair value measurements; rather it specifies valuation methods and disclosures to be applied when fair value measurements are required under existing or future accounting pronouncements.

FAS 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, FAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1 Observable inputs such as quoted prices in active markets;
- Level 2 Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3 Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumption.

As of December 31, 2008, we held certain assets that are required to be measured at fair value on a recurring basis. These included cash equivalents and short and long-term investments.

As of December 31, 2008, Digital River held \$109.5 million of investments at par value, \$93.2 million fair value, in auction-rate securities (ARS), all are AAA/Aaa-rated and 105-115 over collateralized by student loans guaranteed by the U.S. government. All the securities are 100% guaranteed by the Department of Education or the Federal Family Education Loan Program (FFELP) with the exception of two securities which are 82.5% and 99% guaranteed by FFELP. All of these securities continue to fail at auction due to illiquid market conditions.

We did determine a market value discount, due to current illiquid market conditions, of \$16.3 million (14.9% of par value) existed as of December 31, 2008 and recorded a temporary fair value reduction to Other Comprehensive Income on the balance sheet in 2008. We believe the securities will continue to yield the coupon rates.

The determination of fair value required management to make estimates and assumptions about the securities. The discounted cash flow model we used to value the securities included the following assumptions:

determination of the penalty coupon rate, frequency of reset period associated with each ARS

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an average redemption period of seven years

a contribution of the ARS paying its contractually stated interest rate

determination of the risk adjusted discount rate based on LIBOR rates for these maturities plus market information on student loan credit spreads

In aggregate the ARS portfolio is yielding 2.3% and we continue to receive 100% of the contractually required interest payments. We continue to believe that we will be able to liquidate at par over time. Accordingly, we treated the fair value decline as temporary. We anticipate we have sufficient cash flow from operations to execute our business strategy and fund our operational needs. We believe that capital markets are also available if we need to finance other investing alternatives.

The table below presents our assets measured at fair value on a recurring basis as of December 31, 2008:

	Fair Value Measurements As of December 31, 2008			
	Total	Level 1	Level 2	Level 3
Cash equivalents	\$ 490,335	\$ 490,335	\$	\$
Short-term investments	10,000	10,000		
Long-term investments	93,213			93,213
Total assets measured at fair value	\$ 593,548	\$ 500,335	\$	\$ 93,213

Based on market conditions, we have classified auction rate securities as Level 3 within FAS 157's hierarchy since our initial adoption of FAS 157 at January 1, 2008. As of December 31, 2008, the difference between fair value and par value of these securities was \$16.3 million, or 2.7% of total assets measured at fair value or 1.5% of total assets reported in our financial statements.

The following is a reconciliation of assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3 inputs) (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
	Short-term Investments	Long-term Investments	Total
Balance as of January 1, 2008	\$ 119,750	\$	\$ 119,750

Total gains or losses (realized/unrealized)			
Included in other comprehensive income		(16,287)	(16,287)
Purchases, issuances, and settlements	(10,250)		(10,250)
Transfers in and/or out of Level 3	(109,500)	109,500	
Balance as of December 31, 2008	\$	\$ 93,213	\$ 93,213

Fair Value of Financial Instruments

The carrying amount of cash and cash equivalents, accounts receivable, notes payable and accounts payable approximates fair value because of the short maturity of these instruments. As of December 31, 2008 and 2007, the fair value of our \$195 million 1.25% fixed rate convertible senior notes was valued at \$166 million and \$246 million, respectively, based on the quoted fair market value of the debt.

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DIGITAL RIVER, INC.

Notes to Consolidated Financial Statements (Continued)

10. Stockholders Equity

Share Repurchase Program

In June 2007 our Board of Directors authorized a new stock buyback program to repurchase up to an aggregate of \$200 million of our common stock. This buyback program superseded the prior buyback program.

During 2008, 4,239,312 shares were repurchased under the 2007 Repurchase Program, including 3,876,612 shares repurchased pursuant to the accelerated share repurchase program. None of the repurchased shares have been retired.

The Accelerated Share Repurchase (ASR) agreement was entered into with Goldman Sachs (GS) on February 7, 2008 and called for GS to repurchase \$127 million of Digital River, Inc. stock between February 7, 2008 and June 20, 2008. Based on the agreement, Digital River received a final share count based on a discount of the Volume Weighted Average Price of Digital River stock from February 21, 2008, through the end of the contract. On June 20, 2008, GS had concluded the ASR program with a final share delivery of 327,767 shares. The aggregate number of shares repurchased pursuant to the ASR program was 3,876,612 shares at an average price of \$32.76 per share. The ASR agreement terminated upon completion of the ASR program on June 20, 2008 in accordance with its terms. With the conclusion of the ASR program, we completed the 2007 Repurchase Program.

During 2007, we repurchased 1,372,185 shares for \$63.0 million. No shares were repurchased during 2006. None of the repurchased shares have been retired.

11. Employee Benefit Plans

Option and Restricted Stock Awards

2007 Plan

Our stockholders approved the Digital River, Inc. 2007 Equity Incentive Plan (the 2007 Plan) at the Company's annual stockholder meeting held on May 31, 2007. The number of shares issuable under the 2007 Plan equals 2,000,000 shares of our common stock. In addition, shares not issued under the 1998 Plan shall become available for issuance under the 2007 Plan to the extent a stock option or other stock award under the 1998 Plan expires or terminates before shares of common stock are issued under the award. Under our 2007 Equity Incentive Plan we have the flexibility to grant incentive and non-statutory stock options, restricted stock awards, restricted stock unit awards and performance shares to our directors, employees, and consultants.

1998 Plan

The 1998 Equity Incentive Plan expired in June 2008 except as to options still outstanding under the Plan.

General Stock Award Information

As of December 31, 2008, there were 1,976,462 shares available for future awards under our 2007 Plan, respectively. The number of shares available has been reduced by three shares for every two shares granted under the stock award

plan that does not provide for full payment by the participant.

Options granted to employees typically expire no later than ten years after the date of grant. Incentive stock option grants must have an exercise price of at least 100% of the fair market value of a share of common stock on the grant date. Incentive stock options granted to employees who, immediately before such grant, owned stock directly or indirectly representing more than 10% of the voting power of our stock, will

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have an exercise price of 110% of the fair market value of a share of common stock on the grant date and will expire no later than five years from the date of grant.

A summary of the changes in outstanding options is as follows:

	Shares Available for Grant	Options Outstanding	Options Price Per Share	Weighted Average Price Per Share
Balance, December 31, 2005	1,928,584	4,523,385	\$ 2.59 - \$31.13	\$ 16.69
Granted	(395,000)	395,000	29.75 - 57.36	38.64
Restricted stock effect on shares available for grant	(134,250)	N/A	N/A	N/A
Exercised		(1,219,736)	2.59 - 45.24	17.31
Canceled/expired	140,866	(140,866)	2.59 - 30.69	22.57
Balance, December 31, 2006	1,540,200	3,557,783	\$ 2.59 - \$57.36	\$ 18.68
Granted	(573,376)	573,376	45.07 - 56.61	54.17
Restricted stock effect on shares available for grant	(251,426)	N/A	N/A	N/A
Exercised		(1,219,519)	2.59 - 45.24	11.08
Canceled/expired	133,330	(133,330)	4.56 - 56.61	38.01
Additional Shares Reserved	2,000,000	N/A	N/A	N/A
Balance, December 31, 2007	2,848,728	2,778,310	\$ 2.59 - \$57.36	\$ 28.41
Granted	(807,000)	807,000	19.28 - 41.44	31.10
Restricted stock effect on shares available for grant	(278,952)	N/A	N/A	N/A
Exercised		(425,774)	4.56 - 38.17	16.84
Canceled/expired	213,686	(213,686)	9.13 - 56.61	38.59