

AKAMAI TECHNOLOGIES INC  
Form 10-Q  
August 09, 2010  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2010

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-27275

**Akamai Technologies, Inc.**

(Exact name of registrant as specified in its charter)

Edgar Filing: AKAMAI TECHNOLOGIES INC - Form 10-Q

**Delaware**  
(State or other jurisdiction of

**04-3432319**  
(I.R.S. Employer

incorporation or organization)

**8 Cambridge Center**

**Identification Number)**

**Cambridge, MA 02142**

**(617) 444-3000**

(Address, Including Zip Code, and Telephone Number,

Including Area Code, of Registrant's Principal Executive Offices)

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 (the Exchange Act ) during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller

reporting company)

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

The number of shares outstanding of the registrant's common stock as of August 4, 2010: 181,605,446 shares.

**Table of Contents**

**AKAMAI TECHNOLOGIES, INC.**

**FORM 10-Q**

**For the quarterly period ended June 30, 2010**

**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
Item 1.	1
<u>Financial Statements (unaudited)</u>	
<u>Consolidated Balance Sheets at June 30, 2010 and December 31, 2009</u>	1
<u>Consolidated Statements of Operations for the three and six months ended June 30, 2010 and 2009</u>	2
<u>Consolidated Statements of Cash Flows for the six months ended June 30, 2010 and 2009</u>	3
<u>Notes to Unaudited Consolidated Financial Statements</u>	4
Item 2.	19
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	
Item 3.	34
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	
Item 4.	35
<u>Controls and Procedures</u>	
<b><u>PART II. OTHER INFORMATION</u></b>	
Item 1.	36
<u>Legal Proceedings</u>	
Item 1A.	36
<u>Risk Factors</u>	
Item 2.	46
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	
Item 6.	46
<u>Exhibits</u>	
<b><u>SIGNATURES</u></b>	<b>47</b>
<b><u>EXHIBIT INDEX</u></b>	<b>48</b>

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

**AKAMAI TECHNOLOGIES, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**(UNAUDITED)**

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
	<b>(In thousands, except share data)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 120,506	\$ 181,305
Marketable securities (including restricted securities of \$602 at June 30, 2010 and December 31, 2009)	383,682	385,436
Accounts receivable, net of reserves of \$10,900 and \$10,579 at June 30, 2010 and December 31, 2009, respectively	164,574	154,269
Prepaid expenses and other current assets	73,460	31,649
Deferred income tax assets	35,945	8,514
<b>Total current assets</b>	<b>778,167</b>	<b>761,173</b>
Property and equipment, net	227,888	182,404
Marketable securities (including restricted securities of \$27 at June 30, 2010 and \$36 at December 31, 2009)	608,087	494,743
Goodwill	452,950	441,347
Other intangible assets, net	70,853	76,273
Deferred income tax assets	53,431	127,154
Other assets	11,622	4,416
<b>Total assets</b>	<b>\$ 2,202,998</b>	<b>\$ 2,087,510</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 33,529	\$ 23,997
Accrued expenses and other current liabilities	70,165	68,566
Deferred revenue	31,696	34,184
Accrued restructuring	882	791
1% convertible senior notes	63,562	199,755
<b>Total current liabilities</b>	<b>199,834</b>	<b>327,293</b>
Other liabilities	27,088	18,818
Deferred revenue	2,988	2,677
<b>Total liabilities</b>	<b>229,910</b>	<b>348,788</b>
Commitments, contingencies and guarantees (Note 15)		
Stockholders' equity:		

Edgar Filing: AKAMAI TECHNOLOGIES INC - Form 10-Q

Preferred stock, \$0.01 par value; 5,000,000 shares authorized; 700,000 shares designated as Series A Junior Participating Preferred Stock; no shares issued or outstanding		
Common stock, \$0.01 par value; 700,000,000 shares authorized; 186,326,126 shares issued and 181,627,935 shares outstanding at June 30, 2010 and 174,575,502 shares issued and 171,248,356 outstanding at December 31, 2009	1,863	1,746
Additional paid-in capital	4,815,780	4,615,774
Accumulated other comprehensive income (loss)	(13,118)	(10,682)
Treasury stock, at cost, 4,698,191 shares at June 30, 2010 and 3,327,146 shares at December 31, 2009	(108,623)	(66,301)
Accumulated deficit	(2,722,814)	(2,801,815)
<b>Total stockholders' equity</b>	<b>1,973,088</b>	<b>1,738,722</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 2,202,998</b>	<b>\$ 2,087,510</b>

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

**Table of Contents**

**AKAMAI TECHNOLOGIES, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2009	2010	2009
	(In thousands, except per share amounts)			
Revenues	\$ 245,318	\$ 204,600	\$ 485,347	\$ 414,968
Costs and operating expenses:				
Cost of revenues	71,840	60,009	139,314	120,371
Research and development	13,577	9,378	26,756	20,234
Sales and marketing	55,203	41,437	104,871	83,707
General and administrative	43,707	35,144	83,257	71,212
Amortization of other intangible assets	4,152	4,238	8,260	8,477
Restructuring charge				454
Total costs and operating expenses	188,479	150,206	362,458	304,455
Income from operations	56,839	54,394	122,889	110,513
Interest income	3,262	4,059	6,512	8,799
Interest expense	(618)	(710)	(1,327)	(1,420)
Other income, net	122	184	47	1,318
Gain on investments, net	127	105	248	560
Loss on early extinguishment of debt	(294)		(294)	
Income before provision for income taxes	59,438	58,032	128,075	119,770
Provision for income taxes	21,315	22,025	49,074	46,682
Net income	\$ 38,123	\$ 36,007	\$ 79,001	\$ 73,088
Net income per weighted average share:				
Basic	\$ 0.22	\$ 0.21	\$ 0.46	\$ 0.43
Diluted	\$ 0.20	\$ 0.19	\$ 0.42	\$ 0.39
Shares used in per share calculations:				
Basic	173,317	172,561	172,209	171,540
Diluted	190,479	189,556	189,746	188,870

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

**Table of Contents****AKAMAI TECHNOLOGIES, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)**

	<b>For the Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(In thousands)</b>	
<b>Cash flows from operating activities:</b>		
Net income	\$ 79,001	\$ 73,088
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation and amortization	67,634	58,356
Stock-based compensation expense	39,384	28,387
Provision for deferred income taxes, net	44,611	43,167
Amortization of deferred financing costs	394	420
Provision for doubtful accounts	1,445	3,521
Excess tax benefits from stock-based compensation	(12,923)	(658)
Gains on investments and disposal of property and equipment, net	(245)	(387)
Non-cash portion of loss on early extinguishment of debt	294	
Gain on divesture of certain assets		(1,062)
<b>Changes in operating assets and liabilities, net of effects of acquisitions:</b>		
Accounts receivable	(16,406)	10,660
Prepaid expenses and other current assets	(40,284)	(4,275)
Accounts payable, accrued expenses and other current liabilities	11,878	(21,337)
Deferred revenue	(1,319)	946
Accrued restructuring	(93)	(675)
Other non-current assets and liabilities	762	4,149
<b>Net cash provided by operating activities</b>	<b>174,133</b>	<b>194,300</b>
<b>Cash flows from investing activities:</b>		
Cash paid for acquisition of business, net of cash acquired	(12,010)	(5,779)
Purchases of property and equipment	(86,446)	(34,033)
Capitalization of internal-use software costs	(14,841)	(13,687)
Purchases of short- and long-term marketable securities	(614,679)	(163,882)
Proceeds from sales of short- and long-term marketable securities	274,620	141,511
Proceeds from maturities of short- and long-term marketable securities	230,102	50,161
Increase in other investments	(500)	
Proceeds from divesture of certain assets		1,350
Proceeds from the sale of property and equipment	38	4
Decrease in restricted investments held for security deposits	8	130
<b>Net cash used in investing activities</b>	<b>(223,708)</b>	<b>(24,225)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from the issuance of common stock under stock option and employee stock purchase plans	20,993	10,763
Excess tax benefits from stock-based compensation	12,923	658
Repurchases of common stock	(42,621)	(16,905)
<b>Net cash used in financing activities</b>	<b>(8,705)</b>	<b>(5,484)</b>
Effects of exchange rate changes on cash and cash equivalents	(2,519)	418
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>(60,799)</b>	<b>165,009</b>
Cash and cash equivalents at beginning of period	181,305	156,074

## Edgar Filing: AKAMAI TECHNOLOGIES INC - Form 10-Q

Cash and cash equivalents at end of period	\$ 120,506	\$ 321,083
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$ 22,130	\$ 17,773
Cash paid for interest	966	999
Non-cash financing and investing activities:		
Capitalization of stock-based compensation, net of impairments	\$ 3,679	\$ 3,152
Common stock issued upon conversion of 1% convertible senior notes	136,193	
Common stock returned upon settlement of escrow claims related to prior business acquisitions	(125)	(213)

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



**Table of Contents**

**AKAMAI TECHNOLOGIES, INC.**

**NOTES TO UNAUDITED CONSOLIDATED**

**FINANCIAL STATEMENTS**

**1. Nature of Business and Basis of Presentation**

Akamai Technologies, Inc. ( Akamai or the Company ) provides services for accelerating and improving the delivery of content and applications over the Internet. Akamai s globally distributed platform comprises thousands of servers in hundreds of networks in approximately 70 countries. The Company was incorporated in Delaware in 1998 and is headquartered in Cambridge, Massachusetts. Akamai currently operates in one industry segment: providing services for accelerating and improving delivery of content and applications over the Internet.

The accompanying interim consolidated financial statements are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information. These financial statements include the accounts of Akamai and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in the accompanying financial statements.

Certain information and footnote disclosures normally included in the Company s annual audited consolidated financial statements and accompanying notes have been condensed or omitted in these interim financial statements. Accordingly, the unaudited consolidated financial statements included herein should be read in conjunction with the audited consolidated financial statements and accompanying notes included in Akamai s annual report on Form 10-K for the year ended December 31, 2009, filed with the Securities and Exchange Commission on March 1, 2010.

The results of operations presented in this quarterly report on Form 10-Q are not necessarily indicative of the results of operations that may be expected for any future periods. In the opinion of management, these unaudited consolidated financial statements include all adjustments and accruals, consisting only of normal recurring adjustments, that are necessary for a fair statement of the results of all interim periods reported herein.

**2. Recent Accounting Pronouncements**

In September 2009, the Emerging Issues Task Force of the Financial Accounting Standards Board ( FASB ) issued authoritative guidance on revenue arrangements with multiple deliverables. This guidance provides an alternative method for establishing the selling price for a deliverable. When vendor-specific objective evidence ( VSOE ) or third-party evidence ( TPE ) for deliverables in an arrangement cannot be determined, companies will be required to develop an estimate of the selling price for separate deliverables and allocate arrangement consideration using the relative selling price method. The Company has elected to early adopt this accounting guidance at the beginning of its first quarter of fiscal 2010 on a prospective basis for all new or materially modified arrangements entered into on or after January 1, 2010. For most arrangements, the Company has been able to determine the selling price for each element in its multiple element arrangements based on VSOE for each respective element. Specifically, the selling price is determined based upon the price charged when the element is sold separately or based on the renewal rate for services contractually offered to the customer. For arrangements in which the Company is unable to establish VSOE or TPE for each element, the Company uses the best estimate of selling price. As a result, the adoption of this guidance did not have a material impact on the Company s consolidated financial statements. In terms of the timing and pattern of revenue recognition, the new accounting guidance for revenue recognition is not expected to have a significant effect on revenues in periods after the initial adoption when applied to multiple element arrangements based on current go-to-market strategies due to the existence of VSOE across the Company s service offerings.

In October 2009, the FASB issued an accounting standard for certain revenue arrangements that include software elements. This standard amends previously issued guidance to exclude tangible products containing software components and non software components that function together to deliver the product s essential

## **Table of Contents**

functionality. Entities that sell joint hardware and software products that meet the exception will be required to follow the guidance for multiple deliverable revenue arrangements. This standard is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption and retrospective application are also permitted. The Company has elected to early adopt this guidance beginning January 1, 2010. As a result, the adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

### **3. Business Acquisition**

On June 10, 2010, the Company acquired substantially all of the assets and liabilities of Velocitude LLC ( Velocitude ), in exchange for payment of approximately \$12.0 million in cash. The purchase of the assets of Velocitude was intended to further Akamai's strategic position in the mobile market. The acquisition of the assets of Velocitude was accounted for using the acquisition method of accounting. The Company allocated \$11.6 million of the cost of the acquisition to goodwill and \$2.8 million to other intangible assets. In addition, the Company has recorded a liability of \$2.4 million for contingent consideration related to the expected achievement of certain post-closing milestones. Such amount is expected to be paid over the next 18 months. The results of operations of this acquisition have been included in the consolidated financial statements of the Company since June 10, 2010, the date of acquisition, and are not material to the Company's financial position or results of operation for the three or six month periods ended June 30, 2010.

### **4. Marketable Securities and Investments**

The Company accounts for financial assets and liabilities in accordance with a fair value measurement accounting standard. The accounting standard provides a framework for measuring fair value under GAAP and requires expanded disclosures regarding fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The accounting standard also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs, where available, and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs, other than Level 1 prices, such as quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities, including certain pricing models, discounted cash flow methodologies and similar techniques.

**Table of Contents**

The following is a summary of marketable securities and other investment-related assets held at June 30, 2010 and December 31, 2009 (in thousands):

As of June 30, 2010	Cost	Gross Unrealized		Other-than-temporary Impairment Gains (Losses)	Aggregate Fair Value	Classified on Balance Sheet	
		Gains	Losses			Short-term Marketable Securities	Long-term Marketable Securities
<b>Available-for-sale securities:</b>							
Certificates of deposit	\$ 408	\$	\$	\$	\$ 408	\$ 381	\$ 27
Commercial paper	41,394	7	(77)		41,324	41,324	
U.S. corporate debt securities	471,055	899	(781)		471,173	289,109	182,064
U.S. government agency obligations	297,406	354	(29)		297,731	22,393	275,338
Auction rate securities	166,000		(15,342)		150,658		150,658
	976,263	1,260	(16,229)		961,294	353,207	608,087
<b>Trading securities:</b>							
Auction rate securities	30,475			(3,432)	27,043	27,043	
<b>Other investment-related assets:</b>							
Put option related to auction rate securities				3,432	3,432	3,432	
	\$ 1,006,738	\$ 1,260	\$ (16,229)	\$	\$ 991,769	\$ 383,682	\$ 608,087

As of December 31, 2009	Cost	Gross Unrealized		Other-than-temporary Impairment Gains (Losses)	Aggregate Fair Value	Classified on Balance Sheet	
		Gains	Losses			Short-term Marketable Securities	Long-term Marketable Securities
<b>Available-for-sale securities:</b>							
Certificates of deposit	\$ 417	\$	\$	\$	\$ 417	\$ 381	\$ 36
Commercial paper	60,976	6	(15)		60,967	60,967	
U.S. corporate debt securities	334,464	2,319	(395)		336,388	179,978	156,410
U.S. government agency obligations	228,376	303	(391)		228,288	67,910	160,378
Auction rate securities	198,700		(20,781)		177,919		177,919
	822,933	2,628	(21,582)		803,979	309,236	494,743
<b>Trading securities:</b>							
Auction rate securities	76,200			(9,614)	66,586	66,586	
<b>Other investment-related assets:</b>							
Put option related to auction rate securities				9,614	9,614	9,614	
	\$ 899,133	\$ 2,628	\$ (21,582)	\$	\$ 880,179	\$ 385,436	\$ 494,743

Unrealized gains and unrealized temporary losses on investments classified as available-for-sale are included within accumulated other comprehensive income (loss). Upon realization, those amounts are reclassified from accumulated other comprehensive income (loss) to gain (loss) on investments, net in the statement of operations. All gains and losses on investments classified as trading securities are included within the income statement as gain (loss) on investments, net. Realized gains and losses and gains and losses on other-

**Table of Contents**

than-temporary impairments on investments are reflected in the income statement as gain (loss) on investments, net. As of June 30, 2010, the Company had recorded \$196.5 million of auction rate securities at cost with gross unrealized losses and other-than-temporary impairment losses that have been in a continuous loss position for more than 12 months.

The following table details the fair value measurements within the fair value hierarchy of the Company's financial assets, including investments and cash equivalents, at June 30, 2010 (in thousands):

	Total Fair Value at June 30, 2010	Fair Value Measurements at Reporting Date Using		
		Level 1	Level 2	Level 3
Money market funds	\$ 59,562	\$ 59,562	\$	\$
Certificates of deposit	408	408		
Commercial paper	41,324		41,324	
U.S. corporate debt securities	471,173		471,173	
U.S. government agency obligations	297,731		297,731	
Auction rate securities	177,701			177,701
Put option related to auction rate securities	3,432			3,432
	\$ 1,051,331	\$ 59,970	\$ 810,228	\$ 181,133

The following table reflects the activity for the Company's major classes of assets measured at fair value using Level 3 inputs for the six months ended June 30, 2010 (in thousands):

	Auction Rate Securities	Put Option Related to Auction Rate Securities	Total
Balance as of December 31, 2009	\$ 244,505	\$ 9,614	\$ 254,119
Sales of securities	(78,425)		(78,425)
Unrealized gain included in accumulated other comprehensive income (loss), net	5,439		5,439
Unrealized gain on auction rate securities included in the statement of operations	6,182		6,182
Unrealized loss on other investment-related assets included in the statement of operations		(6,182)	(6,182)
Balance as of June 30, 2010	\$ 177,701	\$ 3,432	\$ 181,133

As of June 30, 2010, the Company had grouped money market funds and certificates of deposit using a Level 1 valuation because market prices for such investments are readily available in active markets. As of June 30, 2010, the Company had grouped commercial paper, U.S. government agency obligations and U.S. corporate debt securities using a Level 2 valuation because quoted prices for identical or similar assets are available in markets that are not active. As of June 30, 2010, the fair value of the Company's assets grouped using a Level 3 valuation consisted of auction rate securities ( ARS ) as well as a related put option described below.

In January 2010, the FASB issued authoritative guidance related to disclosures of fair value measurements. The guidance requires the gross presentation of activity within the Level 3 fair value measurement roll-forward and details of transfers in and out of Level 1 and 2 fair value measurements. It also clarifies two existing disclosure requirements on the level of disaggregation of fair value measurements and disclosures on inputs and valuation techniques. The Company adopted all of this guidance in the first quarter of 2010.

## Table of Contents

A change in the hierarchy of an investment from its current level will be reflected in the period during which the pricing methodology of such investment changed. Disclosure of the transfer of securities from Level 1 to Level 2 or Level 3 will be made in the event that the related security is significant to total cash and investments. The Company did not have any transfers of assets and liabilities between Level 1 and Level 2 of the fair value measurement hierarchy during the three or six months ended June 30, 2010.

The Company's commercial paper, U.S. government agency obligations and U.S. corporate debt securities are classified as Level 2 securities. The Company primarily relies on valuation pricing models, recent bid prices and broker quotes to determine the fair value of these securities. The valuation models for Level 2 assets are developed and maintained by third party pricing services and use a number of standard inputs to the valuation model including benchmark yields, reported trades, broker/dealer quotes where the party is standing ready and able to transact, issuer spreads, benchmark securities, bids, offers and other reference data. The valuation model may prioritize these inputs differently at each balance sheet date for any given security, based on market conditions. Not all of the standard inputs listed will be used each time in the valuation models. For each asset class, quantifiable inputs related to perceived market movements and sector news may be considered in addition to the standard inputs.

Historically, the carrying value (par value) of the Company's ARS holdings approximated fair market value due to the resetting of variable interest rates in a Dutch auction process. Beginning in mid-February 2008 and continuing throughout the period ended June 30, 2010, however, the auctions for ARS then held by the Company failed. As a result, the interest rates on ARS reset to the maximum rate per the applicable investment offering statements. The Company will not be able to liquidate affected ARS until a future auction on these investments is successful, a buyer is found outside the auction process, the securities are called or refinanced by the issuer, or the securities mature. Due to these liquidity issues, the Company used a discounted cash flow analysis to determine the estimated fair value of these investments. The discounted cash flow analysis considered the timing of expected future successful auctions, the impact of extended periods of maximum interest rates, collateralization of underlying security investments and the creditworthiness of the issuer. The discounted cash flow analysis as of June 30, 2010 assumed a weighted average discount rate of 3.53% and expected term of five years. The discount rate was determined using a proxy based upon the current market rates for similar debt offerings. The expected term was based on management's estimate of future liquidity. As a result, as of June 30, 2010, the Company has estimated an aggregate loss of \$18.8 million, of which \$15.3 million was related to the impairment of ARS deemed to be temporary and included in accumulated other comprehensive income (loss) within stockholders' equity, and of which \$3.4 million was related to the impairment of ARS deemed other-than-temporary and included in gain (loss) on investments, net in the consolidated statements of operations on a cumulative basis. The discounted cash flow analysis performed as of December 31, 2009 for ARS assumed a weighted average discount rate of 3.98% and expected term of five years. As a result, as of that date, the Company estimated an aggregate loss of \$30.4 million, of which \$20.8 million was related to the impairment of ARS deemed to be temporary and included in accumulated other comprehensive income (loss) within stockholders' equity, and of which \$9.6 million was related to the impairment of ARS deemed other-than-temporary and included in gain (loss) on investments, net in the consolidated statements of operations on a cumulative basis.

The ARS the Company holds are primarily AAA-rated bonds, most of which are collateralized by federally guaranteed student loans as part of the Federal Family Education Loan Program through the U.S. Department of Education. The Company believes the quality of the collateral underlying these securities will enable it to recover the Company's principal balance.

Despite the failed auctions, the Company continues to receive cash flows in the form of specified interest payments from the issuers of ARS. In addition, except as described below for ARS related to the put option, the Company believes it is more likely than not that it will not be required to sell the ARS prior to a recovery of par value and currently intends to hold the investments until such time because it believes it has sufficient cash and other marketable securities on-hand and from projected cash flows from operations.

**Table of Contents**

In November 2008, the Company entered into an agreement with one of its investment advisors, which requires the advisor to repurchase the \$30.5 million in par value of ARS purchased through such advisor at par value beginning on June 30, 2010. Such agreement created a separate financial instrument between the two companies (the put option). At any time during the period up until June 2010, the investment advisor had the right to call the ARS at par value but did not do so. These ARS were classified as trading securities as of June 30, 2010 and December 31, 2009. In early July 2010, the Company exercised the put option, and the \$30.5 million of ARS were repurchased by the investment advisor at par value. See Note 16.

The Company elected to apply the fair value option, permissible under the accounting standard for the fair value option for financial assets and liabilities, to the put option. As of June 30, 2010, the fair value of the put option had been reduced to \$3.4 million as compared to \$9.6 million as of December 31, 2009. As a result, the Company recorded a loss of \$6.2 million, included in gain (loss) on investments, net in the consolidated statement of operations for the six months ended June 30, 2010. As of June 30, 2010, the \$3.4 million fair value of the put option was grouped with short-term marketable securities on the Company's consolidated balance sheet. The fair value of the put option was determined by comparing the fair value of the related ARS, as described above, to their par values and also considers the credit risk associated with the investment advisor. The fair value of the put option is based on unobservable inputs and is therefore classified as Level 3 in the hierarchy.

As of June 30, 2010 and December 31, 2009, the Company classified \$150.7 million and \$177.9 million, respectively, of ARS as long-term marketable securities on its consolidated balance sheet due to management's estimate of its inability to liquidate these investments within the following twelve months. As of June 30, 2010 and December 31, 2009, the Company classified \$27.0 million and \$66.6 million, respectively, of ARS as short-term marketable securities on its consolidated balance sheet due to its ability and intent to exercise the put option that the Company has with its investment advisor shortly after June 30, 2010. Contractual maturities of the Company's marketable securities and other investment-related assets held at June 30, 2010 and December 31, 2009 were as follows (in thousands):

	June 30, 2010	December 31, 2009
<b>Available-for-sale securities:</b>		
Due in 1 year or less	\$ 353,207	\$ 309,236
Due after 1 year through 5 years	457,429	316,824
Due after 5 years	150,658	177,919
<b>Trading securities:</b>		
Due after 5 years	27,043	66,586
<b>Other investment-related assets:</b>		
Due in 1 year or less	3,432	9,614
	<b>\$ 991,769</b>	<b>\$ 880,179</b>

As of June 30, 2010, \$0.6 million of the Company's marketable securities were classified as restricted. These securities primarily represent security for irrevocable letters of credit in favor of third-party beneficiaries, mostly related to facility leases. The letters of credit are collateralized by restricted marketable securities, of which \$0.6 million are classified as short-term marketable securities and \$27,000 are classified as long-term marketable securities on the consolidated balance sheets. The restrictions on these marketable securities lapse as the Company fulfills its obligations or such obligations expire under the terms of the letters of credit. These restrictions are expected to lapse at various times through August 2014.

**Table of Contents****5. Accounts Receivable**

Net accounts receivable consisted of the following (in thousands):

	June 30, 2010	December 31, 2009
Trade accounts receivable	\$ 127,314	\$ 117,449
Unbilled accounts	48,160	47,399
<b>Gross accounts receivable</b>	<b>175,474</b>	<b>164,848</b>
Allowance for doubtful accounts	(2,075)	(4,137)
Reserve for cash-basis customers	(8,825)	(6,442)
<b>Total accounts receivable reserves</b>	<b>(10,900)</b>	<b>(10,579)</b>
<b>Accounts receivable, net</b>	<b>\$ 164,574</b>	<b>\$ 154,269</b>

The Company's accounts receivable balance includes unbilled amounts that represent revenues recorded for customers that are typically billed monthly in arrears. The Company records reserves against its accounts receivable balance. These reserves consist of allowances for doubtful accounts and reserves for cash-basis customers. Increases and decreases in the allowance for doubtful accounts are included as a component of general and administrative expenses. The Company's reserve for cash-basis customers increases as services are provided to customers where collection is no longer assured. Increases to the reserve for cash-basis customers are recorded as reductions of revenues. The reserve decreases and revenue is recognized when and if cash payments are received.

Estimates are used in determining these reserves and are based upon the Company's review of outstanding balances on a customer-specific, account-by-account basis. The allowance for doubtful accounts is based upon a review of customer receivables from prior sales with collection issues where the Company no longer believes that the customer has the ability to pay for services previously provided. The Company also performs ongoing credit evaluations of its customers. If such an evaluation indicates that payment is no longer reasonably assured for services provided, any future services provided to that customer will result in the creation of a cash-basis reserve until the Company receives consistent payments. The Company does not have any off-balance sheet credit exposure related to its customers.

**6. Accrued Expenses and Other Current Liabilities**

Accrued expenses and other current liabilities consisted of the following (in thousands):

	June 30, 2010	December 31, 2009
Payroll and other related benefits	\$ 30,317	\$ 38,841
Bandwidth and co-location	18,117	18,591
Property, use and other taxes	14,401	6,815
Professional service fees	4,216	2,846
Contingent consideration	1,807	
Other	1,307	1,473
<b>Total</b>	<b>\$ 70,165</b>	<b>\$ 68,566</b>

**7. Net Income per Share**

Basic net income per share is computed using the weighted average number of common shares outstanding during the applicable period. Diluted net income per share is computed using the weighted average number of common shares outstanding during the period, plus the dilutive effect of

## Edgar Filing: AKAMAI TECHNOLOGIES INC - Form 10-Q

potential common stock. Potential common stock consists of shares issuable pursuant to stock options, deferred stock units, restricted stock units ( RSUs ) and convertible notes.



**Table of Contents**

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2009	2010	2009
<b>Numerator:</b>				
Net income	\$ 38,123	\$ 36,007	\$ 79,001	\$ 73,088
Add back of interest expense on 1% convertible senior notes (net of tax)	396	440	818	866
Numerator for diluted net income per common share	\$ 38,519	\$ 36,447	\$ 79,819	\$ 73,954
<b>Denominator:</b>				
Denominator for basic net income per common share	173,317	172,561	172,209	171,540
<b>Effect of dilutive securities:</b>				
Stock options	3,992	3,129	3,717	2,791
Effect of escrow contingencies	339	347	339	347
RSUs and deferred stock units	1,396	583	1,299	1,256
Assumed conversion of 1% convertible senior notes	11,435	12,936	12,182	12,936
Denominator for diluted net income per common share	190,479	189,556	189,746	188,870
Basic net income per common share	\$ 0.22	\$ 0.21	\$ 0.46	\$ 0.43
Diluted net income per common share	\$ 0.20	\$ 0.19	\$ 0.42	\$ 0.39

Outstanding options to acquire an aggregate of 1.1 million and 3.0 million shares of common stock for the three months ended June 30, 2010 and 2009, respectively, were excluded from the calculation of diluted earnings per share because the exercise prices of these stock options were greater than the average market price of the Company's common stock during the respective periods. Similarly, outstanding options to acquire an aggregate of 1.6 million and 3.2 million shares of common stock for the six months ended June 30, 2010 and 2009, respectively, were excluded from the calculation of diluted earnings per share because the exercise prices of these stock options were greater than the average market price of the Company's common stock during the respective periods. Additionally, 3.2 million and 3.3 million shares of common stock issuable in respect of outstanding performance-based RSUs were excluded from the computation of diluted net income per share for the three and six months ended June 30, 2010, respectively, and 3.3 million and 2.6 million shares of common stock issuable in respect of outstanding performance-based RSUs were excluded from the computation of diluted net income per share for the three and six months ended June 30, 2009, respectively, because the performance conditions had not been met as of those dates.

The calculation of assumed proceeds used to determine the diluted weighted average shares outstanding under the treasury stock method in the periods presented was adjusted by tax windfalls and shortfalls associated with all of the Company's outstanding stock awards. Such windfalls and shortfalls are computed by comparing the tax deductible amount of outstanding stock awards to their grant date fair values and multiplying the results by the applicable statutory tax rate. A positive result creates a windfall, which increases the assumed proceeds, and a negative result creates a shortfall, which reduces the assumed proceeds.

**8. Stockholders' Equity****Stock Repurchase Program**

On April 29, 2009, the Company announced that its Board of Directors had authorized a stock repurchase program permitting purchases of up to \$100.0 million of the Company's common stock from time to time on the open market or in privately negotiated transactions. On April 28, 2010, the Company announced that its Board of Directors had authorized an extension of the stock repurchase program permitting purchases of an additional

**Table of Contents**

\$150.0 million of the Company's common stock from time to time over the next 12 months on the open market or in privately negotiated transactions. The timing and amount of any shares repurchased will be determined by the Company's management based on its evaluation of market conditions and other factors. Subject to applicable securities laws, the Company may choose to suspend or discontinue the repurchase program at any time.

During the three and six months ended June 30, 2010, the Company repurchased 536,925 and 1,371,045 shares, respectively, of its common stock for \$20.4 million and \$42.3 million, respectively. During the three and six months ended June 30, 2009, the Company repurchased 713,200 shares of its common stock for \$15.0 million. As of June 30, 2010, the Company had \$141.4 million remaining available for future purchases of shares under the approved repurchase program. Additionally, as of June 30, 2010, the Company had prepaid approximately \$0.5 million for purchases of its common stock with a settlement date in early July 2010.

**Stock-Based Compensation Expense**

The following table summarizes the components of total stock-based compensation expense included in the Company's consolidated statements of operations for the three and six months ended June 30, 2010 and 2009 (in thousands):

	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
<b>Stock-based compensation expense by type of award:</b>				
Stock options	\$ 3,628	\$ 4,429	\$ 7,397	\$ 9,277
Deferred stock units	1,885	2,085	1,885	2,085
RSUs	15,909	7,187	31,593	18,327
Shares issued under the Employee Stock Purchase Plan	1,056	863	2,188	1,850
Amounts capitalized as internal-use software	(2,202)	(1,244)	(3,679)	(3,152)
<b>Total stock-based compensation before income taxes</b>	<b>20,276</b>	<b>13,320</b>	<b>39,384</b>	<b>28,387</b>
Less: Income tax benefit	(7,271)	(5,055)	(14,999)	(11,072)
<b>Total stock-based compensation, net of taxes</b>	<b>\$ 13,005</b>	<b>\$ 8,265</b>	<b>\$ 24,385</b>	<b>\$ 17,315</b>
<b>Effect of stock-based compensation on income by line item:</b>				
Cost of revenues	\$ 707	\$ 489	\$ 1,408	\$ 1,050
Research and development expense	3,542	2,223	7,535	4,949
Sales and marketing expense	8,776	6,024	17,800	13,064
General and administrative expense	7,251	4,584	12,641	9,324
Provision for income taxes	(7,271)	(5,055)	(14,999)	(11,072)
<b>Total cost related to stock-based compensation, net of taxes</b>	<b>\$ 13,005</b>	<b>\$ 8,265</b>	<b>\$ 24,385</b>	<b>\$ 17,315</b>

In addition to the amounts of stock-based compensation reported in the table above, the Company's consolidated statements of operations for the three and six months ended June 30, 2010 also included stock-based compensation reflected as a component of amortization of capitalized internal-use software; such additional stock-based compensation was \$1.8 million and \$3.7 million, respectively, before tax. The Company's consolidated statements of operations for the three and six months ended June 30, 2009 also included stock-based compensation reflected as a component of amortization of capitalized internal-use software; such additional stock-based compensation was \$1.5 million and \$2.8 million, respectively, before tax.

**Table of Contents****9. Comprehensive Income**

The following table presents the calculation of comprehensive income and its components (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2009	2010	2009
Net income	\$ 38,123	\$ 36,007	\$ 79,001	\$ 73,088
Other comprehensive income (loss):				
Foreign currency translation adjustments	(3,094)	3,527	(4,880)	1,064
Change in unrealized gain (loss) on investments, net	3,980	5,552	3,989	17,608
Income tax (expense) benefit related to unrealized gain (loss) on investments, net	(1,542)	(2,151)	(1,545)	(6,822)
Other comprehensive (loss) income	(656)	6,928	(2,436)	11,850
Comprehensive income	\$ 37,467	\$ 42,935	\$ 76,565	\$ 84,938

Accumulated other comprehensive income (loss) consisted of (in thousands):

	June 30, 2010	December 31, 2009
Foreign currency translation adjustment	\$ (3,949)	\$ 931
Net unrealized loss on investments, net of tax of \$5,800 at June 30, 2010 and \$7,345 at December 31, 2009	(9,169)	(11,613)
Total accumulated other comprehensive income (loss)	\$ (13,118)	\$ (10,682)

**10. Goodwill and Other Intangible Assets**

The Company recorded goodwill and other intangible assets as a result of business acquisitions that occurred from 2000 through 2010. During the three months ended June 30, 2010, the Company recorded \$11.6 million and \$2.8 million of goodwill and other intangible assets, respectively, in connection with the acquisition of the assets and liabilities of Velocitude. The Company also acquired license rights from the Massachusetts Institute of Technology in 1999.

Other intangible assets that are subject to amortization consist of the following (in thousands):

	Gross Carrying Amount	June 30, 2010 Accumulated Amortization	Net Carrying Amount
Completed technology	\$ 36,731	\$ (13,528)	\$ 23,203
Customer relationships	88,700	(46,165)	42,535
Non-compete agreements	8,340	(3,426)	4,914
Trademarks and trade names	800	(599)	201
Acquired license rights	490	(490)	
Total	\$ 135,061	\$ (64,208)	\$ 70,853



**Table of Contents**

	December 31, 2009		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Completed technology	\$ 35,031	\$ (10,832)	\$ 24,199
Customer relationships	88,700	(41,312)	47,388
Non-compete agreements	7,200	(2,809)	4,391
Trademarks and trade names	800	(505)	295
Acquired license rights	490	(490)	
Total	\$ 132,221	\$ (55,948)	\$ 76,273

Aggregate expense related to amortization of other intangible assets for each of the three months ended June 30, 2010 and 2009 was \$4.2 million. For the six months ended June 30, 2010 and 2009, aggregate expense related to amortization of other intangible assets was \$8.3 million and \$8.5 million, respectively. Based on the Company's other intangible assets as of June 30, 2010, aggregate expense related to amortization of other intangible assets is expected to be \$8.4 million for the remainder of 2010, and \$16.9 million, \$15.9 million, \$13.1 million and \$7.6 million for fiscal years 2011, 2012, 2013 and 2014, respectively.

**11. Concentration of Credit Risk**

Financial instruments that subject the Company to credit risk consist of cash and cash equivalents, marketable securities and accounts receivable. The Company maintains the majority of its cash, cash equivalents and marketable securities balances principally with domestic financial institutions that the Company believes are of high credit standing.

At June 30, 2010 and December 31, 2009, the Company held ARS, with an estimated fair value of \$177.7 million and \$244.5 million, respectively, that have experienced failed auctions, preventing the Company from liquidating those investments. Based on its ability to access its cash and short-term investments and its expected cash flows, the Company does not anticipate the current lack of liquidity with respect to these ARS to have a material impact on its financial condition or results of operations during 2010. As of June 30, 2010, the Company had recorded a pre-tax cumulative unrealized loss of \$15.3 million related to the temporary impairment of the ARS, which was included in accumulated other comprehensive loss on its consolidated balance sheet. See Note 4.

Concentrations of credit risk with respect to accounts receivable are limited to certain customers to which the Company makes substantial sales. The Company's customer base consists of a large number of geographically dispersed customers diversified across numerous industries. To reduce risk, the Company routinely assesses the financial strength of its customers. Based on such assessments, the Company believes that its accounts receivable credit risk exposure is limited. One customer accounted for 11% of accounts receivable as of June 30, 2010. No customers accounted for 10% or more of accounts receivable as of December 31, 2009. The Company believes that, at June 30, 2010, concentration of credit risk related to accounts receivable is not significant.

**12. 1% Convertible Senior Notes**

As of June 30, 2010, the carrying amount and fair value of the Company's 1% convertible senior notes were \$63.6 million and \$185.1 million, respectively. The initial, and current, conversion price of the 1% convertible senior notes is \$15.45 per share (equivalent to 64.7249 shares of common stock per \$1,000 principal amount of 1% convertible senior notes). The conversion price is subject to adjustment in certain events. During the three months ended June 30, 2010, the Company issued 8.8 million shares of common stock in connection with the conversion of \$136.2 million in aggregate principal amount of its 1% convertible senior notes. The Company may redeem the 1% convertible senior notes on or after December 15, 2010 at the Company's option at 100% of

---

**Table of Contents**

the principal amount together with accrued and unpaid interest. Conversely, holders of the 1% convertible senior notes may require the Company to repurchase all or a portion of such notes at 100% of the principal amount plus accrued and unpaid interest on certain specified dates beginning on December 15, 2010. As of June 30, 2010 and December 31, 2009, the 1% convertible senior notes were classified as a short-term liability to reflect the ability of the bondholders to redeem these notes in less than 12 months. In the event of a change of control of the Company, the holders may require Akamai to repurchase all or a portion of such 1% convertible senior notes at a repurchase price of 100% of the principal amount plus accrued and unpaid interest. Interest on the 1% convertible senior notes began to accrue as of the issue date and is payable semiannually on June 15 and December 15 of each year. The 1% convertible senior notes are senior unsecured obligations and are the same rank as all existing and future senior unsecured indebtedness of Akamai. The 1% convertible senior notes rank senior to all of the Company's subordinated indebtedness. Deferred financing costs of \$5.9 million, including the initial purchaser's discount and other offering expenses, for the 1% convertible senior notes are being amortized over the first seven years of the term of these notes to reflect the put and call rights discussed above. Amortization of deferred financing costs of the 1% convertible senior notes was approximately \$0.2 million and \$0.4 million for each of the three and six-month periods ended June 30, 2010 and 2009, respectively. Using the effective interest method, the Company records the amortization of deferred financing costs as interest expense in the consolidated statement of operations.

**13. Segment and Geographic Information**

Akamai's chief decision-maker, as defined under the authoritative guidance that discusses disclosures about segments of an enterprise and related information, is the Chief Executive Officer and the executive management team. As of June 30, 2010, Akamai operated in one industry segment: providing services for accelerating and improving the delivery of content and applications over the Internet. The Company is not organized by market and is managed and operated as one business. A single management team that reports to the Chief Executive Officer comprehensively manages the entire business. The Company does not operate any material separate lines of business or separate business entities with respect to its services. Accordingly, the Company does not accumulate discrete financial information with respect to separate product lines and does not have separately reportable segments as defined in the guidance.

The Company deploys its servers into networks worldwide. As of June 30, 2010, the Company had \$163.7 million and \$64.2 million of property and equipment, net of accumulated depreciation, located in the United States and in foreign locations, respectively. As of December 31, 2009, the Company had \$139.8 million and \$42.6 million of property and equipment, net of accumulated depreciation, located in the United States and in foreign locations, respectively. Akamai sells its services through a direct sales force and channel partners located both in the United States and certain foreign locations. For each of the three months ended June 30, 2010 and 2009, 28% of the Company's revenues were derived from operations located outside of the United States, including 18% derived from Europe during the three months ended June 30, 2010 and 17% derived from Europe during the three months ended June 30, 2009. For each of the six months ended June 30, 2010 and 2009, 28% of the Company's revenues were derived from operations located outside of the United States, including 18% derived from Europe during the six months ended June 30, 2010 and 17% derived from Europe during the six months ended June 30, 2009. No single country outside the United States accounted for 10% or more of revenues during these periods. For each of the three and six months ended June 30, 2010 and 2009, no customer accounted for 10% or more of total revenues.

**14. Income Taxes**

The Company's effective income tax rate, including discrete items, was 38.3% and 39.0% for the six months ended June 30, 2010 and 2009, respectively. The effective income tax rate is based upon the estimated income for the year, the estimated composition of the income in different jurisdictions and discrete adjustments, if any, in the applicable quarterly periods including settlements of tax audits or assessments, the resolution or identification of tax position uncertainties, and acquisitions of other companies. The discrete items also include the tax effect of disqualifying dispositions of incentive stock options and shares purchased under its Employee

**Table of Contents**

Stock Purchase Plan. For the six months ended June 30, 2010 and 2009, the effective income tax rates were higher than the federal statutory tax rate mainly due to the effects of accounting for stock-based compensation in accordance with the authoritative guidance for share-based payments, and state income tax expense.

**15. Commitments, Contingencies and Guarantees*****Operating Lease Commitments***

The Company leases its facilities under non-cancelable operating leases. These operating leases expire at various dates through December 2019 and generally require the payment of real estate taxes, insurance, maintenance and operating costs.

The expected minimum aggregate future obligations under non-cancelable leases as of June 30, 2010 were as follows (in thousands):

	<b>Operating Leases</b>
Remaining 2010	\$ 11,522
2011	22,831
2012	19,543
2013	18,315
2014	17,534
Thereafter	69,957
<b>Total</b>	<b>\$ 159,702</b>

***Purchase Commitments***

The Company has long-term commitments for bandwidth usage and co-location services with various network and Internet service providers. For the remainder of 2010 and for the years ending December 31, 2011, 2012 and 2013, the minimum commitments pursuant to these contracts in effect as of June 30, 2010, are \$42.9 million, \$21.4 million, \$3.0 million and \$0.3 million, respectively. As of June 30, 2010, the Company had entered into purchase orders with various vendors for aggregate purchase commitments of \$29.4 million, which are expected to be paid over the next twelve months.

***Litigation***

Between July 2, 2001 and November 7, 2001, purported class action lawsuits seeking monetary damages were filed in the U.S. District Court for the Southern District of New York against the Company as well as against the underwriters of its October 28, 1999 initial public offering of common stock. The complaints were filed allegedly on behalf of persons who purchased the Company's common stock during different time periods, all beginning on October 28, 1999 and ending on various dates. The complaints are similar and allege violations of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, primarily based on the allegation that the underwriters received undisclosed compensation in connection with the Company's initial public offering. On April 19, 2002, a single consolidated amended complaint was filed, reiterating in one pleading the allegations contained in the previously filed separate actions. The consolidated amended complaint defines the alleged class period as October 28, 1999 through December 6, 2000. A Special Litigation Committee of the Company's Board of Directors authorized management to negotiate a settlement of the pending claims substantially consistent with a Memorandum of Understanding that was negotiated among class plaintiffs, all issuer defendants and their insurers. The parties negotiated a settlement that was subject to approval by the District Court. On February 15, 2005, the Court issued an Opinion and Order preliminarily approving the settlement, provided that the defendants and plaintiffs agree to a modification narrowing the scope of the bar order set forth in the original settlement agreement. On June 25, 2007, the District Court signed an order terminating the settlement. On August 25, 2009, the plaintiffs filed a motion for final approval of a new

## **Table of Contents**

proposed settlement (among plaintiffs, the underwriter defendants, the issuer defendants and the insurers for the issuer defendants), plan of distribution of the settlement fund, and certification of the settlement classes. On October 5, 2009, the District Court issued an opinion and order granting plaintiffs' motion for final approval of the settlement, approval of the plan of distribution of the settlement fund, and certification of the settlement classes. An order and final judgment was entered on November 4, 2009. Notices of appeal of the District Court's October 5, 2009 opinion and order have been filed in the United States Court of Appeals for the Second Circuit. If the District Court's order is upheld on appeal, the Company would have no material liability in connection with this litigation, and the litigation would be resolved. The Company has recorded no liability for this matter as of June 30, 2010.

In addition, on or about October 3, 2007, a purported Akamai shareholder filed a complaint in the U.S. District Court for the Western District of Washington, against the underwriters involved in its 1999 initial public offering of common stock, alleging violations of Section 16(b) of the Exchange Act of 1934, as amended. The complaint alleges that the combined number of shares of the Company's common stock beneficially owned by the lead underwriters and certain unnamed officers, directors and principal shareholders exceeded ten percent of its outstanding common stock from the date of the Company's initial public offering on October 29, 1999, through at least October 28, 2000. The complaint further alleges that those entities and individuals were thus subject to the reporting requirements of Section 16(a) and the short-swing trading prohibition of Section 16(b) and failed to comply with those provisions. The complaint seeks to recover from the lead underwriters any short-swing profits obtained by them in violation of Section 16(b). Akamai was named as a nominal defendant in the action but has no liability for the asserted claims. None of the Company's directors or officers serving in such capacities at the time of its initial public offering are currently named as defendants in this action, but there can be no guarantee that the complaint will not be amended or a new complaint or suit filed to name such directors or officers as defendants in this action or another action alleging a violation of the same provisions of the Securities Exchange Act of 1934, as amended. On March 12, 2009, the Court granted a joint motion by the Company and other issuer defendants to dismiss the complaint without prejudice on the grounds that the plaintiff had failed to make an adequate demand on the Company prior to filing her complaint. In its order, the Court stated it would not permit the plaintiff to amend her demand letters while pursuing her claims in the litigation. Because the Court dismissed the case on the grounds that it lacked subject matter jurisdiction, it did not specifically reach the issue of whether the plaintiff's claims were barred by the applicable statute of limitations. However, the Court also granted a Joint Motion to Dismiss by the underwriter defendants in the action with respect to cases involving non-moving issuers, holding that the cases were barred by the applicable statute of limitations because the issuers' shareholders had notice of the potential claims more than five years prior to filing suit. The plaintiff filed a Notice of Appeal on April 10, 2009. The Company does not expect the results of this action to have a material adverse effect on its business, results of operations or financial condition. The Company has recorded no liability for this matter as of June 30, 2010.

The Company is party to various other litigation matters that management considers routine and incidental to its business. Management does not expect the results of any of these routine actions to have a material adverse effect on the Company's business, results of operations or financial condition.

### ***Guarantees***

The Company has identified guarantees in accordance with the authoritative guidance for guarantor's accounting and disclosure requirements for guarantees, including indirect guarantees of indebtedness of others which is an interpretation of previous accounting statements and rescission of previous guidance. This guidance elaborates on the existing disclosure requirements for most guarantees, including loan guarantees such as standby letters of credit. The guidance also clarifies that at the time an entity issues a guarantee, that entity must recognize an initial liability for the fair value, or market value, of the obligation it assumes under the guarantee and must disclose that information in its interim and annual financial statements. The Company evaluates losses for guarantees under the statement for accounting for contingencies, as interpreted by the guidance for guarantor's accounting and disclosure requirements for guarantees, including direct guarantees of indebtedness.



**Table of Contents**

of others. The Company considers such factors as the degree of probability that the Company would be required to satisfy the liability associated with the guarantee and the ability to make a reasonable estimate of the amount of loss. To date, the Company has not encountered material costs as a result of such obligations and has not accrued any liabilities related to such obligations in its financial statements. The fair value of the Company's outstanding guarantees as of June 30, 2010 was determined to be immaterial.

**16. Subsequent Events**

In early July 2010, the Company exercised its right to require one of its investment advisors to repurchase \$30.5 million of ARS at par value.

On July 22, 2010, the Board of Directors of the Company elected David Kenny as President, effective September 7, 2010. Paul Sagan will remain with the Company as its Chief Executive Officer.

## **Table of Contents**

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*This quarterly report on Form 10-Q, particularly Management's Discussion and Analysis of Financial Condition and Results of Operations set forth below, and notes to our unaudited consolidated financial statements included herein contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are subject to risks and uncertainties and are based on the beliefs and assumptions of our management as of the date hereof based on information currently available to our management. Use of words such as believes, expects, anticipates, intends, plans, estimates, should, forecasts, if, continues, goal, likely or similar expressions indicates a forward-looking statement. Forward-looking statements are not guarantees of future performance and involve risks, uncertainties and assumptions. Actual results may differ materially from the forward-looking statements we make. See Risk Factors elsewhere in this quarterly report on Form 10-Q for a discussion of certain risks associated with our business. We disclaim any obligation to update forward-looking statements as a result of new information, future events or otherwise.*

We provide services for accelerating and improving the delivery of content and applications over the Internet. We primarily derive income from the sale of services to customers executing contracts with terms of one year or longer, which we refer to as recurring revenue contracts or long-term contracts. These contracts generally commit the customer to a minimum monthly level of usage with additional charges applicable for actual usage above the monthly minimum. In recent years, however, we have entered into increasing numbers of customer contracts that have minimum usage commitments that are based on quarterly, twelve-month or longer periods. Our goal of having a consistent and predictable base level of income is important to our financial success. Accordingly, to be successful, we must maintain our base of recurring revenue contracts by eliminating or reducing lost monthly, quarterly or annual recurring revenue due to customer cancellations or terminations and build on that base by adding new customers and increasing the number of services, features and functionalities that our existing customers purchase. At the same time, we must ensure that our expenses do not increase faster than, or at the same rate as, our revenues. Accomplishing these goals requires that we compete effectively in the marketplace on the basis of quality, price and the attractiveness of our services and technology.

### ***Recent Events***

In early July 2010, we exercised our right to require one of our investment advisors to repurchase \$30.5 million of ARS at par value.

On July 22, 2010, our Board of Directors elected David Kenny as President, effective September 7, 2010. Paul Sagan will remain with Akamai as our Chief Executive Officer.

**Table of Contents****Overview of Financial Results**

The following sets forth, as a percentage of revenues, consolidated statements of operations data, for the periods indicated:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2009	2010	2009
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	29.3	29.3	28.7	29.0
Research and development expense	5.5	4.6	5.5	4.9
Sales and marketing expense	22.5	20.3	21.6	20.2
General and administrative expense	17.8	17.2	17.2	17.2
Amortization of other intangible assets	1.7	2.0	1.7	2.0
Restructuring charge				0.1
Total cost and operating expenses	76.8	73.4	74.7	73.4
Income from operations	23.2	26.6	25.3	26.6
Interest income	1.3	2.0	1.3	2.1
Interest expense	(0.3)	(0.3)	(0.2)	(0.3)
Other income, net		0.1		0.3
Gain on investments, net	0.1		0.1	0.1
Loss on early extinguishment of debt	(0.1)		(0.1)	
Income before provision for income taxes	24.2	28.4	26.4	28.8
Provision for income taxes	8.7	10.8	10.1	11.2
Net income	15.5%	17.6%	16.3%	17.6%

We were profitable for the fiscal year 2009 and for the six months ended June 30, 2010; however, we cannot guarantee continued profitability or profitability for any period in the future at the levels we have recently experienced, or at all. We have observed the following trends and events that are likely to have an impact on our financial condition and results of operations in the foreseeable future:

During each of the first two quarters of 2010, we were able to offset lost monthly or recurring revenue due to customer cancellations or terminations by adding new customers and increasing the number of services, features and functionalities that our existing customers purchase. A continuation of this trend, in conjunction with increased revenues from non-recurring revenue contracts, could lead to increased revenues; however, any such increased revenues could be offset if lower traffic reduces the revenues we earn on a non-committed basis or as a result of declines in the prices we charge.

During each of the first two quarters of 2010, unit prices offered to some new and existing customers declined, primarily as a result of increased competition from new and established competitors that are willing to use low unit prices as a method of differentiation. These price reductions primarily impacted customers, such as digital media companies, for which we deliver high volumes of traffic over our network. Budgetary constraints facing our customers due to current economic conditions also contributed to pricing pressure on certain services. If we continue to experience decreases in unit prices for new and existing customers and we are unable to offset such reductions with increased traffic over our network, our revenues and profit margins could decrease.

## Edgar Filing: AKAMAI TECHNOLOGIES INC - Form 10-Q

Historically, we have experienced seasonal variations in our quarterly revenues attributable to e-commerce services used by our retail customers, with higher revenues in the fourth quarter of the year and lower revenues during the summer months. If this trend continues, our ability to generate quarterly revenue growth on a sequential basis could be impacted.

**Table of Contents**

During each of the first two quarters of 2010, we reduced our network bandwidth costs per unit by entering into new supplier contracts with lower pricing and amending existing contracts to take advantage of price reductions offered by our existing suppliers. Additionally, we continued to invest in internal-use software development to improve the performance and efficiency of our network. Due to the increased traffic delivered over our network, our total bandwidth costs increased during each of the first two quarters of 2010 as compared to the same quarters in 2009. We believe that our overall bandwidth costs will continue to increase in the remaining quarters of 2010 as compared to the same periods in 2009 as a result of expected higher traffic levels, partially offset by anticipated continued reductions in bandwidth costs per unit. If we do not experience lower per unit bandwidth pricing or we are unsuccessful at effectively routing traffic over our network through lower cost providers, total network bandwidth costs could increase more than expected during the remainder of 2010.

During each of the first two quarters of 2010, revenues derived from customers outside the United States accounted for 28% of our total revenues, consistent with prior quarters in 2009. We expect revenues from such customers as a percentage of our total revenues to be between 26% and 30% for fiscal 2010.

Depreciation and amortization expense related to our network equipment and internal-use software development costs increased during each of the first two quarters of 2010 as compared to the same quarters in 2009. Due to expected additional purchases of network equipment for continued build out of our network during 2010, we believe that depreciation expense related to our network equipment will increase in the remainder of 2010 as compared to the same periods in 2009.

For the three and six months ended June 30, 2010, our stock-based compensation expense was \$20.3 million and \$39.4 million, respectively, as compared to \$13.3 million and \$28.4 million, respectively, for the three and six months ended June 30, 2009. The increase in stock-based compensation expense for the three and six months ended June 30, 2010 as compared to the same periods in 2009 was primarily due to a change in management's assessment during the period of the expected vesting of performance-based restricted stock units, or RSUs, granted in 2009 and 2010. We expect that stock-based compensation expense will remain relatively flat in the third quarter of 2010 as compared to each of the first two quarters of 2010. As of June 30, 2010, our total pre-tax unrecognized compensation costs for stock-based awards were \$126.5 million, which we expect to recognize as expense over a weighted average period of 1.5 years through 2014.

As of June 30, 2010, we had recorded a pre-tax net cumulative unrealized loss in stockholders' equity of \$15.0 million related to the temporary impairment of some of our marketable security investments. For the six months ended June 30, 2010, we recorded an unrealized gain of \$6.2 million in our statement of operations related to a decrease in the other-than-temporary impairment of our investments in auction rate securities, or ARS. For the six months ended June 30, 2010, we also recorded an unrealized loss of \$6.2 million in our statement of operations related to a decrease in the net unrealized gain from a put option we recorded in connection with an agreement we entered into with one of our investment advisors. Under the terms of the agreement, the investment advisor agreed to repurchase, beginning on June 30, 2010, the ARS it previously sold to us. In July 2010, we exercised the put option and \$30.5 million of ARS were repurchased at par value. The loss related to the put option incorporated into this agreement was included in gain (loss) on investments, net in our statement of operations. Based upon our cash, cash equivalents and marketable securities balance of \$1,112.3 million at June 30, 2010 and expected operating cash flows, we do not anticipate that the lack of liquidity associated with our ARS will adversely affect our ability to conduct business during the remainder of 2010. We believe we have the ability to hold these ARS until a recovery of the auction process, a buyer is found outside the auction process, the securities are called or refinanced by the issuer, or until maturity.

During the six months ended June 30, 2010, our effective income tax rate, including discrete items, was 38.3%. While we expect our effective income tax rate to remain relatively consistent in the remaining quarters of 2010, this expectation does not take into consideration the effect of any potential discrete

---

**Table of Contents**

items to be recorded in future periods. Due to our continued utilization of available net operating losses, or NOLs, and tax credit carryforwards, our tax payments are expected to be significantly lower than our recorded income tax provision in 2010. If we continue to generate taxable income at levels consistent with recent years, we will utilize most of our NOLs and tax credit carryforwards in 2010. Once we have done so, the amount of cash tax payments we make will likely increase over those made in previous years.

Based on our analysis of, among other things, the aforementioned trends and events, as of the date of this quarterly report on Form 10-Q, we expect to continue to generate net income on a quarterly and annual basis during 2010 and 2011; however, our future results are likely to be affected by many factors identified in the section captioned "Risk Factors" and elsewhere in this quarterly report on Form 10-Q, including our ability to:

increase our revenue by adding customers through long-term contracts and limiting customer cancellations and terminations;

offset unit price declines for our services with higher volumes of traffic delivered on our network as well as increased sales of our value-added solutions;

prevent disruptions to our services and network due to accidents or intentional attacks; and

maintain our network bandwidth costs and other operating expenses consistent with our revenues.

As a result, there is no assurance that we will achieve our expected financial objectives, including generating positive net income, in any future period.

Our management's discussion and analysis of our financial condition and results of operations are based upon our unaudited consolidated financial statements included elsewhere in this quarterly report on Form 10-Q, which have been prepared by us in accordance with accounting principles generally accepted in the United States of America, or GAAP, for interim periods and with Regulation S-X promulgated under the Securities Exchange Act of 1934, as amended, or the Exchange Act. The preparation of these unaudited consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related items, including, but not limited to, revenue recognition, accounts receivable and related reserves, valuation and impairment of investments and marketable securities, goodwill and other intangible assets, capitalized internal-use software costs, impairment and useful lives of long-lived assets, tax reserves, loss contingencies and stock-based compensation costs. We base our estimates and judgments on historical experience and on various other assumptions that we believe to be reasonable under the circumstances at the time they were made. Actual results may differ from our estimates. See the section entitled "Application of Critical Accounting Policies and Estimates" in our annual report on Form 10-K for the year ended December 31, 2009 for further discussion of our critical accounting policies and estimates.

**Recent Accounting Pronouncements**

In September 2009, the Emerging Issues Task Force of the Financial Accounting Standards Board, or FASB, issued authoritative guidance on revenue arrangements with multiple deliverables. This guidance provides an alternative method for establishing the selling price for a deliverable. When vendor-specific objective evidence, or VSOE, or third-party evidence, or TPE, for deliverables in an arrangement cannot be determined, companies will be required to develop an estimate of the selling price for separate deliverables and allocate arrangement consideration using the relative selling price method. We have elected to early adopt this accounting guidance at the beginning of our first quarter of fiscal 2010 on a prospective basis for all new or materially modified arrangements entered into on or after January 1, 2010. For most arrangements, we have been able to determine the selling price for each element in multiple element arrangements based on VSOE for each respective element. Specifically, the selling price is determined based upon the price charged when the element is sold separately or based on the renewal rate for services contractually offered to the customer. For arrangements in which we are unable to establish VSOE or TPE for each element, we use the best estimate of selling price. As a result, the adoption of this guidance did not have a material impact on our consolidated financial statements. In

**Table of Contents**

terms of the timing and pattern of revenue recognition, the new accounting guidance for revenue recognition is not expected to have a significant effect on revenues in periods after the initial adoption when applied to multiple element arrangements based on current go-to-market strategies due to the existence of VSOE across our service offerings.

In October 2009, the FASB issued an accounting standard for certain revenue arrangements that include software elements. This standard amends previously issued guidance to exclude tangible products containing software components and non software components that function together to deliver the product's essential functionality. Entities that sell joint hardware and software products that meet the exception will be required to follow the guidance for multiple deliverable revenue arrangements. This standard is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption and retrospective application are also permitted. We have elected to early adopt this guidance beginning January 1, 2010. As a result, the adoption of this guidance did not have a material impact on our consolidated financial statements.

**Results of Operations**

*Revenues.* Total revenues increased 20%, or \$40.7 million, to \$245.3 million for the three months ended June 30, 2010 as compared to \$204.6 million for the three months ended June 30, 2009. For the six months ended June 30, 2010, revenues increased 17%, or \$70.4 million, to \$485.3 million as compared to \$415.0 million for the six months ended June 30, 2009. The increase in revenues for the three and six months ended June 30, 2010 as compared to the same periods in the prior year was primarily attributable to an increase in the number of customers under recurring revenue contracts, as well as increases in traffic and premium services sold to new and existing customers. We believe that the continued growth in the use of the Internet by businesses and consumers was the principal factor driving increased purchases of our services.

For each of the three and six months ended June 30, 2010 and 2009, 28% of our revenues were derived from our operations located outside of the United States, including 18% derived from Europe during the three and six months ended June 30, 2010 and 17% derived from Europe during the three and six months ended June 30, 2009. No single country outside of the United States accounted for 10% or more of revenues during these periods. For each of the three and six months ended June 30, 2010, resellers accounted for 19% of revenues, as compared to 18% and 17% of total revenues for the three and six months ended June 30, 2009, respectively. For each of the three and six months ended June 30, 2010 and 2009, no customer accounted for 10% or more of revenues.

*Cost of Revenues.* Cost of revenues includes fees paid to network providers for bandwidth and co-location of our network equipment. Cost of revenues also includes payroll and payroll-related costs and stock-based compensation expense for network operations personnel, cost of software licenses, depreciation of network equipment used to deliver our services and amortization of internal-use software.

Cost of revenues was comprised of the following (in millions):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2009	2010	2009
Bandwidth, co-location and storage fees	\$ 41.3	\$ 35.3	\$ 80.1	\$ 71.5
Payroll and related costs of network operations personnel	3.3	2.6	6.4	5.5
Stock-based compensation, including amortization of prior capitalized amounts	2.5	2.0	5.1	3.9
Depreciation and impairment of network equipment	18.3	15.6	34.9	31.0
Amortization of internal-use software	6.4	4.5	12.8	8.5
Total cost of revenues	\$ 71.8	\$ 60.0	\$ 139.3	\$ 120.4

---

**Table of Contents**

Cost of revenues increased 20%, or \$11.8 million, to \$71.8 million for the three months ended June 30, 2010 as compared to \$60.0 million for the three months ended June 30, 2009. For the six months ended June 30, 2010, cost of revenues increased 16%, or \$18.9 million, to \$139.3 million as compared to \$120.4 million for the six months ended June 30, 2009. This increase was primarily due to an increase in amounts paid to network providers for bandwidth due to higher traffic levels, partially offset by reduced bandwidth costs per unit, an increase in co-location costs as we deployed more servers, and an increase in depreciation expense of network equipment and amortization of internal-use software as we continued to invest in our infrastructure.

Cost of revenues during the three and six months ended June 30, 2010 also included credits received of approximately \$1.1 million and \$2.1 million, respectively, from settlements and renegotiated contracts entered into in connection with billing disputes related to bandwidth contracts. During the three and six months ended June 30, 2009, cost of revenues included similar credits of approximately \$1.0 million and \$1.3 million, respectively. Credits of this nature may occur in the future; however, the timing and amount of future credits, if any, is unpredictable.

We have long-term purchase commitments for bandwidth usage and co-location services with various network and Internet service providers. For the remainder of 2010 and for the years ending December 31, 2011, 2012 and 2013, we estimate that the minimum commitments related to bandwidth usage and co-location services under agreements currently in effect are approximately \$42.9 million, \$21.4 million, \$3.0 million and \$0.3 million, respectively.

We believe that cost of revenues will increase during the remainder of 2010 as compared to each of the first two quarters of 2010. We expect to deliver more traffic on our network, which would result in higher expenses associated with the increased traffic; however, such costs are likely to be partially offset by lower bandwidth costs per unit. There is no guarantee, however, that bandwidth costs per unit will continue to decline. Additionally, for the remainder of 2010, we anticipate increases in co-location costs as we continue to add servers to our network, and depreciation expense related to our network equipment and amortization of internal-use software development costs, along with increased payroll and related costs, as we continue to make investments in our network with the expectation that our customer base will continue to expand.

*Research and Development.* Research and development expenses consist primarily of payroll and related costs and stock-based compensation expense for research and development personnel who design, develop, test and enhance our services and our network. Research and development costs are expensed as incurred, except certain internal-use software development costs eligible for capitalization. During the three and six months ended June 30, 2010, we capitalized software development costs of \$7.2 million and \$13.7 million, respectively, net of impairments. During the three and six months ended June 30, 2009, we capitalized software development costs of \$6.0 million and \$13.1 million, respectively, net of impairments. These development costs consisted of external consulting expenses and payroll and payroll-related costs for personnel involved in the development of internal-use software used to deliver our services and operate our network. Additionally, during the three and six months ended June 30, 2010, we capitalized \$2.1 million and \$3.5 million of stock-based compensation, respectively, as compared to \$1.2 million and \$3.2 million during the three and six months ended June 30, 2009, respectively. These capitalized internal-use software costs are amortized to cost of revenues over their estimated useful lives of two years.

Research and development expenses increased 45%, or \$4.2 million, to \$13.6 million for the three months ended June 30, 2010 as compared to \$9.4 million for the three months ended June 30, 2009. For the six months ended June 30, 2010, research and development expenses increased 32%, or \$6.5 million, to \$26.8 million as compared to \$20.2 million for the six months ended June 30, 2009. The increase during the three and six months ended June 30, 2010 as compared to the same periods in 2009 was due to an increase in payroll and related costs as well as stock-based compensation, partially offset by an increase in capitalized salaries.



**Table of Contents**

The following table quantifies the changes in the various components of our research and development expenses for the periods presented (in millions):

	<b>For the Three Months Ended June 30, 2010 as compared to 2009</b>	<b>For the Six Months Ended June 30, 2010 as compared to 2009</b>
Payroll and related costs	\$ 3.5	\$ 4.1
Stock-based compensation	1.3	2.6
Capitalized salaries and other expenses	(0.6)	(0.2)
<b>Total net increase</b>	<b>\$ 4.2</b>	<b>\$ 6.5</b>

We believe that research and development expenses, in absolute dollar terms, will increase in the remaining quarters of 2010 as compared to the first six months of 2010 because we expect to continue to hire additional development personnel in order to make improvements in our core technology, develop new services and make refinements to our other service offerings.

*Sales and Marketing.* Sales and marketing expenses consist primarily of payroll and related costs, stock-based compensation expense and commissions for personnel engaged in marketing, sales and support functions, as well as advertising and promotional expenses.

Sales and marketing expenses increased 33%, or \$13.8 million, to \$55.2 million for the three months ended June 30, 2010 as compared to \$41.4 million for the three months ended June 30, 2009. For the six months ended June 30, 2010, sales and marketing expenses increased 25%, or \$21.2 million, to \$104.9 million, as compared to \$83.7 million for the six months ended June 30, 2009. The increase in sales and marketing expenses during the three and six months ended June 30, 2010 as compared to the same periods in 2009 was primarily due to an increase in payroll and related costs, an increase in stock-based compensation, as well as an increase in marketing and related costs and other expenses, such as travel costs.

The following table quantifies the changes in the various components of our sales and marketing expenses for the periods presented (in millions):

	<b>For the Three Months Ended June 30, 2010 as compared to 2009</b>	<b>For the Six Months Ended June 30, 2010 as compared to 2009</b>
Payroll and related costs	\$ 8.8	\$ 13.4
Stock-based compensation	2.8	4.8
Marketing and related costs	0.8	2.2
Other expenses	1.4	0.8
<b>Total net increase</b>	<b>\$ 13.8</b>	<b>\$ 21.2</b>

We believe that sales and marketing expenses will increase, in absolute dollar terms, for the remaining quarters of 2010 as compared to the first two quarters of 2010 due to an expected increase in commissions on higher forecasted sales of our services and an increase in payroll and related costs due to continued headcount growth in our sales and marketing organization.

*General and Administrative.* General and administrative expenses consist primarily of the following components:

## Edgar Filing: AKAMAI TECHNOLOGIES INC - Form 10-Q

payroll, stock-based compensation expense and other related costs, including expenses for executive, finance, business applications, network management, human resources and other administrative personnel;

depreciation and amortization of property and equipment we use internally;

**Table of Contents**

fees for professional services;

rent and other facility-related expenditures for leased properties;

the provision for doubtful accounts;

insurance costs; and

non-income related taxes.

General and administrative expenses increased 24%, or \$8.6 million, to \$43.7 million for the three months ended June 30, 2010 as compared to \$35.1 million for the three months ended June 30, 2009. For the six months ended June 30, 2010, general and administrative expenses increased 17%, or \$12.0 million, to \$83.3 million as compared to \$71.2 million for the six months ended June 30, 2009. The increase in general and administrative expenses for the three and six months ended June 30, 2010 as compared to the same periods in 2009 was primarily due to an increase in payroll and related costs, stock-based compensation, facilities and related costs and legal fees. These increases were partially offset by reductions in the provision for doubtful accounts.

The following table quantifies the changes in various components of our general and administrative expenses for the periods presented (in millions):

	<b>For the Three Months Ended June 30, 2010 as compared to 2009</b>	<b>For the Six Months Ended June 30, 2010 as compared to 2009</b>
Payroll and related costs	\$ 5.1	\$ 6.5
Stock-based compensation	2.7	3.4
Depreciation and amortization	0.2	0.4
Facilities and related costs	1.5	2.4
Legal fees	0.4	1.6
Provision for doubtful accounts	(3.0)	(4.0)
Non-income related taxes	0.2	(0.4)
Consulting and advisory services	(0.1)	0.4
Other expenses	1.6	1.7
<b>Total net increase</b>	<b>\$ 8.6</b>	<b>\$ 12.0</b>

We expect general and administrative expenses for the remaining quarters of 2010 to increase, in absolute dollar terms, as compared to each of the first two quarters of 2010 due to anticipated higher payroll and related costs attributable to increased hiring and growth in other administrative expenses as well as additional capital purchases.

*Amortization of Other Intangible Assets.* Amortization of other intangible assets consists of amortization of intangible assets acquired in business combinations and amortization of acquired license rights. Amortization of other intangible assets remained consistent at \$4.2 million for each of the three months ended June 30, 2010 and 2009. For the six months ended June 30, 2010, amortization of other intangible assets decreased 3%, or \$0.2 million, to \$8.3 million as compared to \$8.5 million for the six months ended June 30, 2009. Based on our intangible assets at June 30, 2010, we expect amortization of other intangible assets to be approximately \$8.4 million for the remainder of 2010, and \$16.9 million, \$15.9 million, \$13.1 million and \$7.6 million for fiscal years 2011, 2012, 2013 and 2014, respectively.

*Restructuring charge.* During the six months ended June 30, 2009, we recorded a restructuring charge of \$0.5 million related to one-time benefits provided to terminated employees in connection with the workforce reduction we announced in November 2008.



---

**Table of Contents**

*Interest Income.* Interest income includes interest earned on invested cash balances and marketable securities. Interest income decreased 20%, or \$0.8 million, to \$3.3 million for the three months ended June 30, 2010, as compared to \$4.1 million for the three months ended June 30, 2009. For the six months ended June 30, 2010, interest income decreased 26%, or \$2.3 million, to \$6.5 million as compared to \$8.8 million for the six months ended June 30, 2009. The decreases were due to lower interest rates earned on our investments during the first two quarters of 2010 as compared to the same periods in 2009.

*Interest Expense.* Interest expense includes interest paid on our debt obligations as well as amortization of deferred financing costs. Interest expense was \$0.6 million and \$0.7 million for the three month periods ended June 30, 2010 and June 30, 2009, respectively. Interest expense was \$1.3 million and \$1.4 million for the six month periods ended June 30, 2010 and June 30, 2009, respectively. An aggregate of \$136.2 million in principal amount of our 1% convertible notes were converted into shares of our common stock during the three-month period ended June 30, 2010. Accordingly, based on our outstanding indebtedness at June 30, 2010, we believe that interest expense on our debt obligations, including deferred financing amortization, will not exceed \$1.8 million for fiscal 2010.

*Other Income, net.* Other income, net primarily represents net foreign exchange gains and losses incurred, gains from legal settlements, and other non-operating (expense) income items. Other income, net for the three months ended June 30, 2010 decreased 34%, or \$62,000, to \$122,000 as compared to \$184,000 for the three months ended June 30, 2009. For the six months ended June 30, 2010, other income, net decreased 96%, or \$1.3 million, to \$47,000 as compared to \$1.3 million for the six months ended June 30, 2009. The changes in both periods of 2010 as compared to the same periods in 2009 were primarily due to exchange rate fluctuations as well as a legal settlement gain of \$0.8 million recorded during the first quarter of 2009. Other (expense) income, net may fluctuate in the future based upon movements in foreign exchange rates, the outcome of legal proceedings, or other events.

*Gain on Investments, net.* During each of the three months ended June 30, 2010 and 2009, we recorded net gain on investments of \$0.1 million related to the sale of marketable securities. During the six months ended June 30, 2010, we recorded net gain on investments of \$0.2 million related to the sale of marketable securities. Additionally, during the six months ended June 30, 2010, we recorded a gain of \$6.2 million due to a decrease in the other-than-temporary impairment of certain ARS and a loss of \$6.2 million on a put option related to our ARS holdings. During the six months ended June 30, 2009, we recorded net gain on investments of \$0.6 million, which related primarily to a gain of \$3.3 million due to a decrease in the other-than-temporary impairment of certain ARS and a loss of \$2.8 million on a put option related to our ARS holdings.

*Loss on Early Extinguishment of Debt.* During the three months ended June 30, 2010, we recorded a loss on early extinguishment of debt of \$0.3 million as a result of the conversion of \$136.2 million in principal amount of our 1% convertible notes into shares of our common stock.

*Provision for Income Taxes.* For the six months ended June 30, 2010 and 2009, our effective income tax rate, including discrete items, was 38.3% and 39.0%, respectively. For each of the three and six months ended June 30, 2010 and 2009, our effective income tax rates were higher than the federal statutory tax rate mainly due to the effects of accounting for stock-based compensation and state income tax expense. The effective income tax rate is based upon the estimated income for the year, the estimated composition of the income in different jurisdictions and discrete adjustments, if any, in the applicable quarterly periods, including settlements of tax audits or assessments, the resolution or identification of tax position uncertainties, and acquisitions of other companies. Provision for income taxes decreased 3%, or \$0.7 million, to \$21.3 million for the three months ended June 30, 2010 as compared to \$22.0 million for the three months ended June 30, 2009. Provision for income taxes increased 5%, or \$2.4 million, to \$49.1 million for the six months ended June 30, 2010 as compared to \$46.7 million for the six months ended June 30, 2009. The decrease in the three months ended June 30, 2010 as compared to the same period in 2009 was mainly due to the discrete adjustments for stock based compensation and reserves under FIN 48. The increase in the six months ended June 30, 2010 as compared to the same period in 2009 was mainly due to the increase in operating income.

## **Table of Contents**

While we expect our effective income tax rate for the remaining quarters of 2010 to remain relatively consistent with the rate through the second quarter of 2010, this expectation does not take into consideration the effect of any potential discrete items to be recorded in the future. Our effective tax rate could be materially different depending on the nature and timing of dispositions of incentive stock option and other employee equity awards. Further, our effective tax rate may fluctuate within a fiscal year and from quarter to quarter, due to items arising from discrete events, including settlements of tax audits and assessments, the resolution or identification of tax position uncertainties and acquisitions of other companies. Due to our continued utilization of net operating losses, or NOLs, and tax credit carryforwards our tax payments were significantly lower than our recorded income tax provision. If we continue to generate taxable income at levels consistent with recent years, we will utilize most of our NOL and tax credit carryforwards in 2010. Once we have done so, the amount of cash tax payments we make will increase over those made in previous years.

In determining our net deferred tax assets and valuation allowances, annualized effective tax rates, and cash paid for income taxes, management is required to make judgments and estimates about domestic and foreign profitability, the timing and extent of the utilization of NOL carryforwards, applicable tax rates, transfer pricing methodologies and tax planning strategies. Judgments and estimates related to our projections and assumptions are inherently uncertain; therefore, actual results could differ materially from our projections.

We have recorded certain tax reserves to address potential exposures involving our income tax and sales and use tax positions. These potential tax liabilities result from the varying application of statutes, rules, regulations and interpretations by different taxing jurisdictions. Our estimate of the value of these tax reserves reflects assumptions based on past experiences and judgments about the interpretation of statutes, rules and regulations by taxing jurisdictions. It is possible that the ultimate tax liability or benefit from these matters may be materially greater or less than the amount that we have estimated.

## **Non-GAAP Measures**

In addition to the traditional financial measurements that are reflected in our financial statements that have been prepared in accordance with GAAP, we also compile and monitor certain non-GAAP financial measures related to the performance of our business. We typically discuss the non-GAAP financial measures described below on our quarterly public earnings release calls. A non-GAAP financial measure is a numerical measure of a company's historical or future financial performance that excludes amounts that are included in the most directly comparable measure calculated and presented in the GAAP statement of operations.

We believe that making available the non-GAAP financial measures described below helps investors to gain a meaningful understanding of our past performance and future prospects, especially when comparing such results to previous periods, forecasts or competitors' financial statements. Our management uses these non-GAAP measures, in addition to GAAP financial measures, as the basis for measuring our core operating performance and comparing such performance to that of prior periods and to the performance of our competitors. These measures are also used by management in its financial and operational decision-making.

We consider fully taxed normalized net income and fully taxed normalized net income per diluted common share to be important indicators of our overall performance as they eliminate the effects of events that are either not part of our core operations or are non-cash. We define fully taxed normalized net income as net income determined in accordance with GAAP excluding the following pre-tax items: amortization of other acquired intangible assets, stock-based compensation expense, stock-based compensation reflected as a component of amortization of capitalized internal-use software, restructuring charges and benefits, acquisition related costs, certain gains and losses on investments and loss on early extinguishment of debt.

**Table of Contents**

The following table reconciles GAAP net income to fully taxed normalized net income and fully taxed normalized net income per diluted share for the three and six months ended June 30, 2010 and 2009:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2009	2010	2009
	(in thousands, except per share data)			
Net income	\$ 38,123	\$ 36,007	\$ 79,001	\$ 73,088
Amortization of other intangible assets	4,152	4,238	8,260	8,477
Stock-based compensation	20,276	13,320	39,384	28,387
Amortization of capitalized stock-based compensation	1,830	1,461	3,705	2,768
Gain on investments, net				(455)
Utilization of tax NOLs/credits*				
Loss on early extinguishment of debt	294		294	
Acquisition related costs	345		345	
Restructuring charge				454
Total fully taxed normalized net income	\$ 65,020	\$ 55,026	\$ 130,989	\$ 112,719
Fully taxed normalized net income per diluted share	\$ 0.34	\$ 0.29	\$ 0.69	\$ 0.60
Shares used in per share calculations	190,479	189,556	189,746	188,870

\* For the three and six months ended June 30, 2009, we previously reported Utilization of tax NOLs/credits of \$20,236 and \$43,087, respectively, which increased our non-GAAP net income. Beginning in 2010, we no longer include Utilization of tax NOLs/credits in determining our non-GAAP net income due to the expectation of fully utilizing most of our NOLs and tax credit carryforwards in 2010. We consider Adjusted EBITDA to be another important indicator of our operational strength and performance of our business and a good measure of our historical operating trend. Adjusted EBITDA eliminates items that are either not part of our core operations or do not require a cash outlay. We define Adjusted EBITDA as net income before interest, income taxes, depreciation and amortization of tangible and intangible assets, stock-based compensation expense, stock-based compensation reflected as a component of amortization of capitalized internal-use software, restructuring charges and benefits, acquisition related costs, certain gains and losses on investments, foreign exchange gains and losses, loss on early extinguishment of debt, and gains or losses on legal settlements.

**Table of Contents**

The following table reconciles GAAP net income to Adjusted EBITDA for the three and six months ended June 30, 2010 and 2009:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2010	2009	2010	2009
	(in thousands, except per share data)			
Net income	\$ 38,123	\$ 36,007	\$ 79,001	\$ 73,088
Amortization of other intangible assets	4,152	4,238	8,260	8,477
Stock-based compensation	20,276	13,320	39,384	28,387
Amortization of capitalized stock-based compensation	1,830	1,461	3,705	2,768
Gain on investments, net				(455)
Utilization of tax NOLs/credits*				
Loss on early extinguishment of debt	294		294	
Acquisition related costs	345		345	
Restructuring charge				454
Interest income, net	(2,771)	(3,454)	(5,433)	(7,484)
Provision for income taxes	21,315	22,025	49,074	46,682
Depreciation and amortization	28,692	23,979	55,669	47,110
Other income, net	(122)	(184)	(47)	(1,318)
Adjusted EBITDA	\$ 112,134	\$ 97,392	\$ 230,252	\$ 197,709

These non-GAAP financial measures should be used in addition to and in conjunction with results presented in accordance with GAAP.

**Liquidity and Capital Resources**

To date, we have financed our operations primarily through public and private sales of debt and equity securities, proceeds from exercise of stock awards and cash generated by operations.

As of June 30, 2010, our cash, cash equivalents and marketable securities, which consisted of corporate debt securities, U.S. Treasury and government agency securities, commercial paper, corporate debt securities, student loan-backed ARS and other investment-related assets, totaled \$1,112.3 million. We place our cash investments in instruments that meet high credit quality standards, as specified in our investment policy. Our investment policy also limits the amount of our credit exposure to any one issue or issuer and seeks to manage these assets to achieve our goals of preserving principal, maintaining adequate liquidity at all times, and maximizing returns subject to our investment policy.

We held approximately \$196.5 million and \$274.9 million in par value of ARS as of June 30, 2010 and December 31, 2009, respectively. The ARS are primarily AAA-rated bonds, most of which are guaranteed by the U.S. government as part of the Federal Family Education Loan Program through the U.S. Department of Education. None of the ARS in our portfolio are mortgage-based or collateralized debt obligations. In mid-February 2008, all of our ARS experienced failed auctions, which failures continued throughout the period ended June 30, 2010. As a result, we have been unable to liquidate most of our holdings of ARS. Based on our ability to access our cash and other short-term investments, our expected operating cash flows, and our other sources of cash, we do not anticipate the current lack of liquidity on these investments to have a material impact on our financial condition or results of operations in 2010. During the six months ended June 30, 2010, we had \$78.4 million of ARS redeemed at par value. In November 2008, we entered into an agreement with one of our investment advisors that provides for the repurchase beginning June 30, 2010 of all of the ARS we purchased through such financial advisor if we have been unable to achieve liquidity with respect to such securities before that time. In early July 2010, we exercised our put right under the agreement and the investment advisor repurchased \$30.5 million of ARS at par value.



**Table of Contents**

Net cash provided by operating activities was \$174.1 million for the six months ended June 30, 2010, compared to \$194.3 million for the six months ended June 30, 2009. We expect that cash provided by operating activities will increase as a result of an expected increase in cash collections related to anticipated higher revenues, partially offset by an anticipated increase in operating expenses that require cash outlays such as salaries and higher commissions. Current economic conditions could negatively impact our cash provided by operating activities if we are unable to manage our days sales outstanding or our business otherwise deteriorates.

Net cash used in investing activities was \$223.7 million for the six months ended June 30, 2010, compared to \$24.2 million for the six months ended June 30, 2009. Cash used in investing activities for the six months ended June 30, 2010 reflects purchases of short- and long-term marketable securities of \$614.7 million, purchases of property and equipment of \$101.3 million, including \$14.8 million related to the capitalization of internal-use software development costs, cash paid for the acquisition of substantially all of the assets of Velocitude of \$12.0 million, and an increase in other investments of \$0.5 million. Amounts attributable to these purchases and investments were offset, in part, by proceeds from sales and maturities of short- and long-term marketable securities of \$504.7 million. Cash used in investing activities for the six months ended June 30, 2009 reflects a \$5.8 million payment associated with the purchase of the holding company of aCerno, Inc., net purchases of short- and long-term marketable securities of \$163.9 million and purchases of property and equipment of \$47.7 million, including \$13.7 million related to the capitalization of internal-use software development costs. Amounts attributable to these purchases and investments were offset, in part, by proceeds from sales and maturities of short- and long-term marketable securities of \$191.7 million. For fiscal year 2010, we expect total capital expenditures, a component of cash used in investing activities, to be approximately 17% of total revenue for the year. We expect to fund such capital expenditures through cash generated from operations.

Net cash used in financing activities was \$8.7 million for the six months ended June 30, 2010, as compared to the \$5.5 million provided by financing activities for the six months ended June 30, 2009. Cash used in financing activities during the six months ended June 30, 2010 consisted of \$42.6 million related to a common stock repurchase program we initiated in April 2009 and extended in April 2010, as described more fully below. Cash provided by financing activities for the six months ended June 30, 2010 consisted of \$12.9 million related to excess tax benefits resulting from the exercise of stock options and vesting of RSUs and proceeds of \$21.0 million from the issuance of common stock upon exercises of stock options under our stock option plans and employee stock purchase plans. Cash used in financing activities during the six months ended June 30, 2009 consisted of \$16.9 million related to the common stock repurchase program. Cash provided by financing activities for the six months ended June 30, 2009 consisted of \$0.7 million related to excess tax benefits resulting from the exercise of stock options and vesting of RSUs and proceeds of \$10.8 million from the issuance of common stock upon exercises of stock options under our stock option plans and employee stock purchase plans.

Changes in cash, cash equivalents and marketable securities are dependent upon changes in, among other things, working capital items such as deferred revenues, accounts payable, accounts receivable and various accrued expenses, as well as changes in our capital and financial structure due to debt repurchases and issuances, stock option exercises, purchases and sales of equity investments and similar events.

**Table of Contents**

The following table presents the net inflows and outflows of cash, cash equivalents and marketable securities for the periods presented (in millions):

	For the Six Months Ended June 30, 2010	For the Six Months Ended June 30, 2009
Cash, cash equivalents and marketable securities balance as of December 31, 2009 and 2008, respectively	\$ 1,061.5	\$ 771.6
Changes in cash, cash equivalents and marketable securities:		
Receipts from customers	486.7	440.1
Payments to vendors	(287.1)	(190.1)
Payments for employee payroll	(126.3)	(107.0)
Debt interest and premium payments	(1.0)	(1.0)
Stock option exercises and employee stock purchase plan issuances	21.0	10.8
Cash used in business acquisition	(12.0)	(5.8)
Common stock repurchases	(42.6)	(16.9)
Realized and unrealized gains (losses) on marketable investments and other investment-related assets, net	4.2	17.6
Interest income	6.5	8.8
Other	1.4	(1.3)
<b>Net increase</b>	<b>50.8</b>	<b>155.2</b>
Cash, cash equivalents and marketable securities balance as of June 30, 2010 and 2009, respectively	\$ 1,112.3	\$ 926.8

As part of an agreement entered into with one of our investment advisors under which it agreed to repurchase all of our ARS with that investment advisor in July 2010 if we had been unable to achieve liquidity with respect to such ARS before then, we were also offered the ability to enter into a line of credit that would be collateralized by the underlying ARS investments. In January 2009, the line of credit was approved by the investment advisor. We did not use the line of credit. In early July 2010, we exercised our right under the agreement and our investment advisor repurchased \$30.5 million of ARS at par value.

On April 29, 2009, we announced that our Board of Directors had authorized a stock repurchase program permitting purchases of up to \$100.0 million of our common stock from time to time on the open market or in privately negotiated transactions. In April 2010, the Board of Directors authorized a \$150.0 million, one-year extension of such stock repurchase program. During the six months ended June 30, 2010, we repurchased 1.4 million shares of common stock for an aggregate of \$42.3 million at an average price of \$30.87 per share. The timing and amount of any future share repurchases will be determined by our management based on its evaluation of market conditions and other factors. We may choose to suspend or discontinue the repurchase program at any time. Any purchases made under the program will be reflected as an increase in cash used in financing activities.

We believe, based on our present business plan, that our current cash, cash equivalents and marketable securities and forecasted cash flows from operations will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 24 months. If the assumptions underlying our business plan regarding future revenue and expenses change, if we are unable to liquidate our marketable securities, or if unexpected opportunities or needs arise, we may seek to raise additional cash by selling equity or debt securities. We may not, however, be able to sell equity or debt securities on terms we consider reasonable, or at all. If additional funds are raised through the issuance of equity or debt securities, these securities could have rights, preferences and privileges senior to those accruing to holders of common stock, and the terms of any such debt could impose restrictions on our operations. The sale of additional equity or convertible debt securities could result in additional dilution to our existing stockholders. See Risk Factors elsewhere in this quarterly report on Form 10-Q for a discussion of additional factors that could affect our liquidity.

**Table of Contents****Contractual Obligations, Contingent Liabilities and Commercial Commitments**

The following table presents our contractual obligations and commercial commitments, as of June 30, 2010, for the next five years and thereafter (in millions):

Contractual Obligations as of June 30, 2010	Payments Due by Period				
	Total	Less than 12 Months	12-36 Months	36-60 Months	More than 60 Months
1% convertible senior notes, assuming full redemption in December 2010	\$ 63.6	\$ 63.6	\$	\$	\$
Interest on 1% convertible senior notes, assuming full redemption in December 2010	0.3	0.3			
Bandwidth and co-location agreements	67.6	58.7	8.9		
Real estate operating leases	159.7	23.0	40.2	35.3	61.2
Open vendor purchase orders	29.4	29.4			
<b>Total</b>	<b>\$ 320.6</b>	<b>\$ 175.0</b>	<b>\$ 49.1</b>	<b>\$ 35.3</b>	<b>\$ 61.2</b>

Our 1% convertible senior notes provide for the bondholders to redeem the bonds at par value plus accrued interest at various times. The first redemption date is December 15, 2010. Based upon the ability of the bondholders to redeem the outstanding 1% convertible senior notes within less than 12 months, the outstanding balance has been classified as short-term debt on our consolidated balance sheet as of June 30, 2010 and December 31, 2009.

In accordance with authoritative guidance issued by FASB, as of June 30, 2010, we had unrecognized tax benefits of \$14.7 million, which included approximately \$3.9 million of accrued interest and penalties. We do not expect to recognize any of these tax benefits in 2010. Furthermore, we are not able to provide a reasonably reliable estimate of the timing of future payments relating to these unrecognized benefits.

**Letters of Credit**

As of June 30, 2010, we had \$5.6 million in outstanding irrevocable letters of credit in favor of third-party beneficiaries, primarily related to facility leases. Approximately \$0.6 million of these letters of credit are collateralized by restricted marketable securities, of which \$0.6 million are classified as short-term marketable securities and \$27,000 are classified as long-term marketable securities on the consolidated balance sheet at June 30, 2010. The restrictions on these marketable securities lapse as we fulfill our obligations or as such obligations expire as provided by the letters of credit. These restrictions are expected to lapse through August 2014. The remaining \$5.0 million of irrevocable letters of credit are unsecured and are expected to remain in effect until December 2019.

**Off-Balance Sheet Arrangements**

We have entered into indemnification agreements with third parties, including vendors, customers, landlords, our officers and directors, shareholders of acquired companies, joint venture partners and third parties to which we license technology. Generally, these indemnification agreements require us to reimburse losses suffered by a third party due to various events, such as lawsuits arising from patent or copyright infringement or our negligence. These indemnification obligations are considered off-balance sheet arrangements in accordance with the authoritative guidance for guarantors accounting and disclosure requirements for guarantees, including indirect guarantees of indebtedness of others. See also Note 11 to our consolidated financial statements included in our annual report on Form 10-K for the year ended December 31, 2009 for further discussion of these indemnification agreements. The fair value of guarantees issued or modified during the three months ended June 30, 2010 was determined to be immaterial.

**Table of Contents**

The conversion features of our 1% convertible senior notes due December 15, 2033 are equity-linked derivatives. As such, we recognize these instruments as off-balance sheet arrangements. The conversion features associated with these notes would be accounted for as derivative instruments, except that they are indexed to our common stock and classified in stockholders' equity. Therefore, these instruments meet the scope exception of the accounting standard for accounting for derivatives instruments and hedging activities, and accordingly are not accounted for as derivatives.

As of June 30, 2010, we did not have any additional material off-balance sheet arrangements.

**Litigation**

We are party to litigation that we consider to be routine and incidental to our business and certain non-routine legal proceedings. Management does not expect the results of any of these routine actions to have a material impact on our financial condition or results of operations. See *Legal Proceedings* in Item 1 of Part II of this quarterly report on Form 10-Q and Note 15 to our unaudited consolidated financial statements elsewhere in this quarterly report on Form 10-Q for further discussion on litigation, including any developments related to material non-routine proceedings that have arisen since the filing of our annual report on Form 10-K.

**Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

Our exposure to market risk for changes in interest rates relates primarily to our debt and investment portfolio. In our investment portfolio, we do not use derivative financial instruments. We place our investments with high quality issuers and, by policy, limit the amount of risk by investing primarily in money market funds, U.S. Treasury obligations, high-quality corporate and municipal obligations and certificates of deposit. Our investment policy also limits the amount of our credit exposure to any one issue or issuer and seeks to manage these assets to achieve our goals of preserving principal, maintaining adequate liquidity at all times and maximizing returns subject to our investment policy.

At June 30, 2010, we held \$196.5 million in par value of ARS that have experienced failed auctions, which has prevented us from liquidating those investments. Due to these liquidity issues, we used a discounted cash flow analysis to determine the estimated fair value of these ARS investments. Such analysis considered the timing of expected future successful auctions, the impact of extended periods of maximum interest rates, collateralization of underlying security investments and the creditworthiness of the issuer. The discounted cash flow analysis as of June 30, 2010 assumed a weighted average discount rate of 3.53% and expected term of five years. The discount rate was determined using a proxy based upon the current market rates for similar debt offerings. The expected term was based on management's estimate of future liquidity. As a result, as of June 30, 2010, we have estimated an aggregate loss of \$18.8 million, of which \$15.3 million related to the impairment of ARS deemed to be temporary and included in accumulated other comprehensive income (loss) within stockholders' equity and of which \$3.4 million was related to the impairment of ARS deemed other-than-temporary and included in gain (loss) on investments, net in the consolidated statements of operations. The impact for the three and six months ended June 30, 2010 was a pre-tax gain of \$5.0 million and \$5.4 million, respectively, included in accumulated other comprehensive loss within stockholders' equity related to ARS having impairments deemed to be temporary, as well as a net gain of \$4.9 million and \$6.2 million, respectively, included in gain (loss) on investments, net in our consolidated statement of operations related to the impairment of ARS deemed other-than-temporary. The aggregate gain in the fair value of ARS experienced in the six months ended June 30, 2010 was due primarily to a decrease in the weighted average discount rate used in the computation of fair values from 3.98% used as of December 31, 2009 to 3.53%.

Our valuation of the ARS is sensitive to market conditions and management's judgment and could change significantly based on the assumptions used. If, as of June 30, 2010, we assumed an expected term of three years or seven years and discount rate of 3.47%, the gross unrealized loss on the \$166.0 million in par value of ARS classified as available-for-sale would have been \$9.3 million or \$21.1 million, respectively. If we had assumed an expected term of five years and discount rate of 2.47% or 4.47%, the gross unrealized loss on the \$166.0 million in par value of ARS classified as available-for-sale would have been \$7.7 million or \$22.5 million, respectively.

---

**Table of Contents**

During November 2008, we entered into an agreement with one of our investment advisors providing for it to repurchase the ARS held through such advisor at par value beginning on June 30, 2010 if we cannot liquidate such ARS before that date. The ARS covered by this agreement had a par value of \$30.5 million at June 30, 2010. At any time during the period up until June 2010, our investment advisor could call the ARS at par value but did not do so. In early July 2010, we exercised the put option incorporated in the agreement, and \$30.5 million of ARS were redeemed at par value. We elected to apply the fair value option permitted under the relevant accounting standard to the put option. As of June 30, 2010, the \$3.4 million fair value of such put option was grouped with other short-term marketable securities on our consolidated balance sheet. The fair value of the put option was determined by comparing the fair values of the related ARS, as described above, to their par values and also considered the credit risk associated with our investment advisor. During the six months ended June 30, 2010, the fair value of the put option decreased by \$6.2 million to \$3.4 million with the resultant loss offsetting \$6.2 million of the related ARS gain included in gain (loss) on investments, net in our consolidated statement of operations.

Our 1% convertible senior notes are subject to changes in market value. Under certain conditions, the holders of our 1% convertible senior notes may require us to redeem the notes on or after December 15, 2010. As of June 30, 2010, the aggregate outstanding principal amount and the fair value of the 1% convertible senior notes were \$63.6 million and \$185.1 million, respectively.

We have operations in Europe, Asia, Australia and India. As a result, we are exposed to fluctuations in foreign exchange rates. Additionally, we may continue to expand our operations globally and sell to customers in foreign locations, which may increase our exposure to foreign exchange fluctuations. We do not have any foreign currency hedge contracts.

Concentrations of credit risk with respect to accounts receivable are limited to certain customers to which we make substantial sales. Our customer base consists of a large number of geographically dispersed customers diversified across numerous industries. To reduce risk, we routinely assess the financial strength of our customers. Based on such assessments, we believe that our accounts receivable credit risk exposure is limited. One customer accounted for 11% of accounts receivable as of June 30, 2010. No customers accounted for 10% or more of accounts receivable as of December 31, 2009. We believe that, at June 30, 2010, concentration of credit risk related to accounts receivable is not significant.

**Item 4. *Controls and Procedures***

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2010. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2010, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended June 30, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

See Item 3 of part I of our annual report on Form 10-K for the year ended December 31, 2009 for a discussion of legal proceedings. There were no material developments in such legal proceedings during the quarter ended June 30, 2010.

**Item 1A. Risk Factors**

The following are certain of the important factors, among others, that could cause our actual operating results to differ materially from those indicated or suggested by forward-looking statements made in this quarterly report on Form 10-Q or presented elsewhere by management from time to time. We have not made any material changes in the risk factors previously disclosed in our annual report on Form 10-K for the year ended December 31, 2009.

*The markets in which we operate are highly competitive, and we may be unable to compete successfully against new entrants with innovative approaches and established companies with greater resources.*

We compete in markets that are intensely competitive, highly fragmented and rapidly changing. We have experienced and expect to continue to experience increased competition. Many of our current competitors, as well as a number of our potential competitors, have longer operating histories, greater name recognition, broader customer relationships and industry alliances and substantially greater financial, technical and marketing resources than we do. Other competitors may attract customers by offering less-sophisticated versions of services than we provide at lower prices than those we charge. Given the relative ease with which some customers can potentially switch to another content delivery network provider, any differentiated offerings or lower pricing by competitors could lead to a rapid loss of customers and/or rapid changes in traffic patterns. Our competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements. In addition, current or potential competitors may bundle their offerings with other services, software or hardware in a manner that may discourage website owners from purchasing any service we offer or enable switching among content delivery providers. Some of our existing resellers are competitors. If one or more resellers that generate substantial revenues for us were to terminate our relationship and become a competitor or a reseller for a competitor, our business could be adversely affected.

In addition, potential customers may decide to purchase or develop their own hardware, software and other technology solutions rather than rely on an external provider like Akamai. As a result, our competitors include hardware manufacturers, software companies and other entities that offer Internet-related solutions that are not service-based. It is an important component of our growth strategy to educate enterprises and government agencies about our services and convince them to entrust their content and applications to an external service provider, and Akamai in particular. If we are unsuccessful in such efforts, our business could suffer.

Ultimately, increased competition of all types could result in price and revenue reductions, loss of customers and loss of market share, which could materially and adversely affect our business, financial condition and results of operations.

*Prices we have been charging for some of our services have declined in recent years. This decline may continue in the future as a result of, among other things, existing and new competition in the markets we serve.*

In recent quarters, we have lowered the prices we charge many of our customers for our content delivery services in order to remain competitive. This has been particularly true for digital media services. Consequently, our historical revenue rates may not be indicative of future revenues based on comparable traffic volumes. In addition, our operating expenses have increased on an absolute basis in each of 2007, 2008 and 2009. If we are

## **Table of Contents**

unable to sell our services at acceptable prices relative to our costs or if we are unsuccessful with our strategy of selling additional services and features to new or existing content delivery customers, our revenues and gross margins will decrease, and our business and financial results will suffer.

***Failure to increase our revenues and keep our expenses consistent with revenues could prevent us from maintaining profitability at recent levels or at all.***

Our revenue growth rate declined in 2009 as compared to recent prior years due to a number of factors including increasing competition, the inevitable decline in growth rates as our revenues increase to higher levels and macroeconomic factors affecting certain aspects of our business. Although we have seen our revenue growth increase during the first two quarters of 2010, we may not be able to maintain or accelerate our revenue growth rate during the second half of 2010 or future years. In addition, we have experienced, and may experience in the future quarter-over-quarter sequential revenue declines. We also believe our operating margins will decrease in 2010 because we have large fixed expenses and expect to continue to incur significant bandwidth, sales and marketing, product development, administrative and other expenses. As a result, we may not be able to continue to maintain our current level of profitability in 2010 or on a quarterly or annual basis thereafter.

There are numerous factors that could, alone or in combination with other factors, impede our ability to increase revenues and/or moderate expenses, including:

market pressure to decrease our prices;

significant increases in bandwidth costs or other operating expenses;

failure to increase sales of our core services;

increased competition including from much larger companies;

any failure of our current and planned services and software to operate as expected;

loss of any significant customers or loss of existing customers at a rate greater than we increase our number of, and sales to, new customers or our sales to existing customers;

unauthorized use of or access to content delivered over our network or network failures;

failure of a significant number of customers to pay our fees on a timely basis or at all or failure to continue to purchase our services in accordance with their contractual commitments; and

inability to attract high-quality customers to purchase and implement our current and planned services.

***General global market and economic conditions may have an adverse impact on our operating performance and results of operations.***

Our business has been and could continue to be affected by general global economic and market conditions. Weakness in the United States and/or worldwide economy has had and could continue to have a negative effect on our operating results, including decreases in revenues and operating cash flows. In particular, weakness in the online advertising market has affected and could continue to affect the success of our Internet advertising-related initiatives and could have a negative impact on our media and other customers. To the extent customers are unable to

## Edgar Filing: AKAMAI TECHNOLOGIES INC - Form 10-Q

profitably monetize the content we deliver on their behalf, they may reduce or eliminate the traffic we deliver on their behalf. Such reductions in traffic would lead to a reduction in our revenues. Additionally, in a down-cycle economic environment, we may experience the negative effects of increased competitive pricing pressure, customer loss, slow down in commerce over the Internet and corresponding decrease in traffic delivered over our network and failures by customers to pay amounts owed to us on a timely basis or at all. Suppliers on which we rely for servers, bandwidth, co-location and other services could also be negatively impacted by economic conditions which, in turn, could have a negative impact on our operations or expenses. There can be no assurance, therefore, that current economic conditions or worsening economic conditions or a prolonged or recurring recession will not have a significant adverse impact on our operating results.



## **Table of Contents**

### ***Our failure to manage expected growth, diversification and changes to our business could harm us.***

We have continued to grow, diversify and evolve our business both in the United States and internationally. It is unclear, however, whether such growth will continue. In the event of a slowing or decline in our rate of growth, we must also address the challenges of establishing an appropriate organizational size while maintaining the quality of our services. As a result of the diversification of our business, personnel growth, acquisitions and international expansion in recent years, many of our employees are now based outside of our Cambridge, Massachusetts headquarters. If we are unable to effectively manage a large and geographically dispersed group of employees or to anticipate our future personnel needs, our business may be adversely affected.

As our business evolves, we must also expand and adapt our operational infrastructure. Our business relies on our data systems, billing systems, and other operational and financial reporting and control systems. All of these systems have become increasingly complex in the recent past due to the diversification and complexity of our business, acquisitions of new businesses with different systems and increased regulation over controls and procedures. To effectively manage our technical support infrastructure, we will need to continue to upgrade and improve our data systems, billing systems and other operational and financial systems, procedures and controls. These upgrades and improvements will require a dedication of resources and in some cases are likely to be complex. If we are unable to adapt our systems and organization in a timely and cost-effective manner to accommodate changing circumstances, our business may be adversely affected.

### ***Because our services are complex and are deployed in complex environments, they may have errors or defects that could seriously harm our business.***

Our services are highly complex and are designed to be deployed in and across numerous large and complex networks that we do not control. From time to time, we have needed to correct errors and defects in our software. In the future, there may be additional errors and defects in our software that may adversely affect our services. We may not have in place adequate quality assurance procedures to ensure that we detect errors in our software in a timely manner. If we are unable to efficiently and cost-effectively fix errors or other problems that may be identified, or if there are unidentified errors that allow persons to improperly access our services, we could experience loss of revenues and market share, damage to our reputation, increased expenses and legal actions by our customers.

### ***Any unplanned interruption in the functioning of our network or services or attacks on our internal information technology systems could lead to significant costs and disruptions that could reduce our revenues and harm our business, financial results and reputation.***

Our business is dependent on providing our customers with fast, efficient and reliable distribution of applications and content over the Internet. For our core services, we currently provide a standard guarantee that our networks will deliver Internet content 24 hours a day, 7 days a week, 365 days a year. If we do not meet this standard, affected customers will be entitled to credits. Our network or services could be disrupted by numerous events, including natural disasters, unauthorized access to our servers, failure or refusal of our third-party network providers to provide the necessary capacity, power losses and intentional disruptions of our services, such as disruptions caused by software viruses or attacks by unauthorized users. In addition, there have been and in the future may be attempts to gain unauthorized access to our information technology systems in order to steal information about our technology, financial data or other information or take other actions that would be damaging to us. Although we have taken steps to prevent such disruptions and security breaches, there can be no assurance that attacks by unauthorized users will not be attempted in the future, that our security measures will be effective, or that a successful attack would not be damaging. Any widespread interruption of the functioning of our network or services would reduce our revenues and could harm our business, financial results and reputation. Any successful breach of the security of our information systems could lead to the unauthorized release of valuable confidential information, including trade secrets, material nonpublic information about our financial condition and sensitive data that others could use to compete against us. Such consequences would likely harm our business and reputation.

## **Table of Contents**

***We may have insufficient transmission and server capacity, which could result in interruptions in our services and loss of revenues.***

Our operations are dependent in part upon transmission capacity provided by third-party telecommunications network providers. In addition, our distributed network must be sufficiently robust to handle all of our customers' traffic particularly in the event of unexpected surges in high definition, or HD, video traffic. We believe that, absent extraordinary circumstances, we have access to adequate capacity to provide our services; however, there can be no assurance that we are adequately prepared for unexpected increases in bandwidth demands by our customers. In addition, the bandwidth we have contracted to purchase may become unavailable for a variety of reasons, including payment disputes or network providers going out of business. Any failure of these network providers to provide the capacity we require, due to financial or other reasons, may result in a reduction in, or interruption of, service to our customers. If we do not have access to third-party transmission capacity, we could lose customers. If we are unable to obtain transmission capacity on terms commercially acceptable to us or at all, our business and financial results could suffer. We may not be able to deploy on a timely basis enough servers to meet the needs of our customer base or effectively manage the functioning of those servers. In addition, damage or destruction of, or other denial of access to, a facility where our servers are housed could result in a reduction in, or interruption of, service to our customers.

***As part of our business strategy, we have entered into and may enter into or seek to enter into business combinations and acquisitions that may be difficult to integrate, disrupt our business, dilute stockholder value and divert management attention.***

We have completed numerous acquisitions in recent years. If attractive acquisition opportunities arise in the future, we may seek to enter into additional business combinations or purchases. Acquisitions and combinations are accompanied by a number of risks, including the difficulty of integrating the operations and personnel of the acquired companies, the potential disruption of our ongoing business, the potential distraction of management, expenses related to the acquisition and potential unknown liabilities associated with acquired businesses. Any inability to integrate completed acquisitions or combinations in an efficient and timely manner could have an adverse impact on our results of operations. In addition, we may not be able to recognize any expected synergies or benefits in connection with a future acquisition or combination. If we are not successful in completing acquisitions or combinations that we may pursue in the future, we may incur substantial expenses and devote significant management time and resources without a successful result. In addition, future acquisitions could require use of substantial portions of our available cash or result in dilutive issuances of securities.

***Our stock price has been volatile.***

The market price of our common stock has been volatile. Trading prices may continue to fluctuate in response to a number of events and factors, including the following:

quarterly variations in operating results and announcements of innovations;

introduction of new products, services and strategic developments by us or our competitors;

business combinations and investments by us or our competitors;

variations in our revenue, expenses or profitability;

changes in financial estimates and recommendations by securities analysts;

failure to meet the expectations of public market analysts;

disruptions to our services or unauthorized access to our information technology systems;

unfavorable media coverage;

macro-economic factors;

repurchases of shares of our common stock;

## **Table of Contents**

our customers inability to access equity and credit markets;

performance by other companies in our industry; and

geopolitical conditions such as acts of terrorism or military conflicts.

Any of these events may cause the price of our common stock to fall. In addition, the stock market in general, and the market prices for technology companies in particular, have experienced significant volatility that often has been unrelated to the operating performance of such companies. These broad market and industry fluctuations may adversely affect the market price of our common stock, regardless of our operating performance.

***If we are unable to continue to innovate and respond to emerging technological trends and customers changing needs, our operating results may suffer.***

The market for our services is characterized by rapidly changing technology, evolving industry standards and new product and service introductions. For example, individuals are increasingly using mobile devices to access Internet content. Our ability to provide new and innovative solutions to address challenges posed by mobile users and other developments is important to our future growth; other companies are also looking to offer Internet-related solutions, such as cloud computing, to generate growth. These other companies may develop technological or business model innovations in the markets we seek to address that are, or are perceived to be, equivalent or superior to our services or that change the way customers use our services in a manner that is disadvantageous to us. In addition, our customers business models may change in ways that we do not anticipate and these changes could reduce or eliminate our customers needs for our services. Our operating results depend on our ability to adapt to market changes and develop and introduce new services into existing and emerging markets. The process of developing new technologies is complex and uncertain; we must commit significant resources to developing new services or enhancements to our existing services before knowing whether our investments will result in services the market will accept. Furthermore, we may not execute successfully our technology initiatives because of errors in planning or timing, technical hurdles that we fail to overcome in a timely fashion, misunderstandings about market demand or a lack of appropriate resources. In 2009, we launched the Akamai HD Network, a new approach to delivering HD video over the Internet that we view as important to our future success. If our services utilizing the Akamai HD Network or other new services do not operate as expected or there is a lack of, or delay, in market acceptance of such services, we could experience increased expenses, loss of market share and decreasing revenues and earnings.

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

Our financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments about, among other things, taxes, revenue recognition, stock-based compensation costs, capitalization of internal-use software, investments, contingent obligations, allowance for doubtful accounts, intangible assets and restructuring charges. These estimates and judgments affect the reported amounts of our assets, liabilities, revenues and expenses, the amounts of charges accrued by us, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances and at the time they are made. If our estimates or the assumptions underlying them are not correct, actual results may differ materially from our estimates and we may need to, among other things, accrue additional charges that could adversely affect our results of operations, which in turn could adversely affect our stock price.

***Future changes in financial accounting standards may adversely affect our reported results of operations.***

A change in accounting standards can have a significant effect on our reported results. New accounting pronouncements and interpretations of accounting pronouncements have occurred and may occur in the future. These new accounting pronouncements may adversely affect our reported financial results.

## **Table of Contents**

***A substantial portion of our marketable securities are invested in auction rate securities. Continued failures in the auctions for these securities may affect our liquidity.***

We held \$196.5 million in par value of ARS as of June 30, 2010, which represented approximately 20% of our total short- and long-term marketable securities of \$991.8 million as of that date. ARS are securities that are structured to allow for short-term interest rate resets but with contractual maturities that can be well in excess of ten years. At the end of each reset period, which typically occurs every seven to 35 days, investors can sell or continue to hold the securities at par. Beginning in February 2008, the majority of ARS in the marketplace, including the ARS that we hold in our portfolio, failed auction due to sell orders exceeding buy orders. Such failures resulted in the interest rate on these ARS resetting to predetermined rates in accordance with the underlying loan agreement, which might be lower than the current market rate of interest. In the event we need to liquidate our investments in these types of securities including for purposes of funding our operations, we will not be able to do so until a future auction on these investments in which demand equals or exceeds the supply of such securities being offered, the issuer redeems the outstanding securities, a buyer is found outside the auction process, the securities mature or there is a default requiring immediate payment from the issuer. These alternative liquidation measures may require that we sell our ARS at a substantial discount to par value. In the future, should the ARS we hold be subject to prolonged auction failures and we determine that the decline in value of ARS is other-than-temporary, we would recognize a loss in our consolidated statement of operations, which could be material. In addition, any future failed auctions may adversely impact the liquidity of our investments and our ability to fund our operations. Furthermore, if one or more of the issuers of the ARS held in our portfolio are unable to successfully close future auctions and their credit ratings deteriorate, we may be required to adjust the carrying value of these investments through additional impairment charges, which could be material. We may also incur significant legal and related expenses in connection with efforts to require one or more of the investment advisors that sold us ARS to provide liquidity for these securities. There can be no assurance that any such efforts would be successful.

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

Our future success depends upon the continued services of our executive officers and other key technology, sales, marketing and support personnel who have critical industry experience and relationships. There is significant competition for talented individuals in the regions in which our primary offices are located. This affects both our ability to retain key employees and hire new ones. None of our officers or key employees is bound by an employment agreement for any specific term. We compensate our officers and employees in part through equity incentives, including stock options. A significant portion of these stock options held by our officers and employees have exercise prices in excess of the current market price of our common stock, which has diminished the retentive value of such options. The loss of the services of any of our key employees could hinder or delay the implementation of our business model and the development and introduction of, and negatively impact our ability to sell, our services.

***We may need to defend against patent or copyright infringement claims, which would cause us to incur substantial costs.***

Other companies or individuals, including our competitors, may hold or obtain patents or other proprietary rights that would prevent, limit or interfere with our ability to make, use or sell our services or develop new services, which could make it more difficult for us to increase revenues and improve or maintain profitability. Companies holding Internet-related patents or other intellectual property rights are increasingly bringing suits alleging infringement of such rights against both technology providers and customers that use such technology.

---

## **Table of Contents**

We have agreed to indemnify our customers if our services infringe specified intellectual property rights; therefore, we could become involved in litigation brought against customers if our services and technology are implicated. Any litigation or claims, whether or not valid, brought against us or pursuant to which we indemnify our customers could result in substantial costs and diversion of resources and require us to do one or more of the following:

cease selling, incorporating or using products or services that incorporate the challenged intellectual property;

pay substantial damages and incur significant litigation expenses;

obtain a license from the holder of the infringed intellectual property right, which license may not be available on reasonable terms or at all; or

redesign products or services.

If we are forced to take any of these actions, our business may be seriously harmed. In the event of a successful claim of infringement against us and our failure or inability to obtain a license to the infringed technology, our business and operating results could be materially adversely affected.

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

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. These legal protections afford only limited protection. We have previously brought lawsuits against entities that we believe are infringing our intellectual property rights but have not always prevailed. Such lawsuits can be expensive and require a significant amount of attention of our management and technical personnel, and the outcomes are unpredictable. Monitoring unauthorized use of our services is difficult, and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. Although we have licensed from other parties proprietary technology covered by patents, we cannot be certain that any such patents will not be challenged, invalidated or circumvented. Such licenses may also be non-exclusive, meaning our competition may also be able to access such technology. Furthermore, we cannot be certain that any pending or future patent applications will be granted, that any future patent will not be challenged, invalidated or circumvented, or that rights granted under any patent that may be issued will provide competitive advantages to us.

***If our license agreement with MIT terminates, our business could be adversely affected.***

We have licensed from MIT technology that is covered by various patents, patent applications and copyrights relating to Internet content delivery technology. Some of our core technology is based in part on the technology covered by these patents, patent applications and copyrights. Our license is effective for the life of the patents and patent applications; however, under limited circumstances, such as a cessation of our operations due to our insolvency or our material breach of the terms of the license agreement, MIT has the right to terminate our license. A termination of our license agreement with MIT could have a material adverse effect on our business.

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

Our business depends on our ability to deliver media content in all major formats. If our legal right or technical ability to store and deliver content in one or more popular proprietary content formats, such as Adobe® Flash® or Windows® Media®, was limited, our ability to serve our customers in these formats would be impaired and the demand for our content delivery services would decline by customers using these formats. Owners of

## **Table of Contents**

propriety content formats may be able to block, restrict or impose fees or other costs on our use of such formats, which could lead to additional expenses for us and for our customers, or which could prevent our delivery of this type of content altogether. Such interference could result in a loss of existing customers, increased costs and impairment of our ability to attract new customers, which would harm our revenue, operating results and growth.

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

We have operations in numerous foreign countries and may continue to expand our sales and support organizations internationally. Such expansion could require us to make significant expenditures. We are increasingly subject to a number of risks associated with international business activities that may increase our costs, lengthen our sales cycle and require significant management attention. These risks include:

increased expenses associated with marketing services in foreign countries;

currency exchange rate fluctuations;

unexpected changes in regulatory requirements resulting in unanticipated costs and delays;

interpretations of laws or regulations that would subject us to regulatory supervision or, in the alternative, require us to exit a country, which could have a negative impact on the quality of our services or our results of operations;

uncertainty regarding liability for content or services;

adjusting to different employee/employer relationships and different regulations governing such relationships;

longer accounts receivable payment cycles and difficulties in collecting accounts receivable; and

potentially adverse tax consequences.

### ***Any failure to meet our debt obligations would damage our business.***

As of June 30, 2010, we had outstanding \$63.6 million in principal amount of our 1% senior convertible notes due 2033. The holders of such notes will have the right to require the repayment of some or all of the principal amount of the notes on specified dates beginning in December 2010. Due to these repayment provisions, as of June 30, 2010 and December 31, 2009, the principal amount of the notes has been classified on our balance sheet as short-term. If we are unable to remain profitable or if we use more cash than we generate in the future, our level of indebtedness could adversely affect our future operations by increasing our vulnerability to adverse changes in general economic and industry conditions and by limiting or prohibiting our ability to obtain additional financing for future capital expenditures, acquisitions and general corporate and other purposes. If we are unable to make interest or principal payments on such notes or other indebtedness when due, we would be in default under the terms of our debt obligations, which would result in all principal and interest becoming due and payable which, in turn, would seriously harm our business. We may seek to refinance our 1% senior convertible notes; any such refinancing could be on less advantageous terms than those applying to our existing notes.

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

If we seek to acquire significant businesses or technologies or require more cash to fund our future plans, we may need to obtain funding from outside sources. The current economic environment makes it difficult for companies to obtain financing, particularly raising debt financing or implementing credit facilities. Therefore, we may not be able to raise additional capital, which could limit future actions we may want to take.

## Edgar Filing: AKAMAI TECHNOLOGIES INC - Form 10-Q

Even if we were to find outside funding sources, we might be required to issue securities with greater rights than the securities we have outstanding today or issue debt that places restrictions on our future activities. We might also be required to take other actions that could lessen the value of our common stock, including borrowing money on terms that are not favorable to us.



## **Table of Contents**

### ***Changes in regulations or user concerns regarding privacy and protection of user data could adversely affect our business.***

Federal, state, foreign and international laws and regulations may govern the collection, use, retention, sharing and security of data that we receive from our customers, visitors to their websites and others. In addition, we have and post on our website our own privacy policy concerning the collection, use and disclosure of user data. Any failure, or perceived failure, by us to comply with our posted privacy policies or with any privacy-related laws, government regulations or directives, or industry self-regulatory principles could result in damage to our reputation or proceedings or actions against us by governmental entities or others, which could potentially have an adverse effect on our business.

A large number of legislative proposals pending before the U.S. Congress, various state legislative bodies and foreign governments concern data privacy and retention issues related to our business, particularly the advertising-related services we have begun to offer. It is not possible to predict whether, when, or the extent to which such legislation may be adopted. In addition, the interpretation and application of user data protection laws are currently unsettled. These laws may be interpreted and applied inconsistently from jurisdiction to jurisdiction and inconsistently with our current data protection policies and practices. Complying with these varying international requirements could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business.

### ***Internet-related and other laws could adversely affect our business.***

Laws and regulations that apply to communications and commerce over the Internet are becoming more prevalent. In particular, the growth and development of the market for online commerce has prompted calls for more stringent tax, consumer protection, anti-discrimination and privacy laws, both in the United States and abroad, that may impose additional burdens on companies conducting business online or providing Internet-related services such as ours. The adoption of any of these measures could negatively affect both our business directly as well as the businesses of our customers, which could reduce their demand for our services. In addition, Congress and the Federal Communications Commission have been contemplating net neutrality legislation and regulations. The scope and impact of any such legislation or regulations are unpredictable but could potentially have an adverse effect on our business and operations. Other domestic and international government attempts to regulate the operation of the Internet could also negatively impact our business.

Local tax laws that might apply to our servers, which are located in many different jurisdictions, could require us to pay additional taxes in those jurisdictions, which could adversely affect our continued profitability. We have recorded certain tax reserves to address potential exposures involving our sales and use and franchise tax positions. These potential tax liabilities result from the varying application of statutes, rules, regulations and interpretations by different jurisdictions. Our reserves, however, may not be adequate to cover our total actual liability. As a government contractor, we are also subject to numerous laws and regulations. If we fail to comply with applicable requirements, then we could face penalties, contract terminations and damage to our reputation. We also may be required to devote substantial resources to the development and improvement of procedures to ensure compliance with applicable regulations.

### ***Global climate change could adversely impact our business.***

Recent scientific studies and other news reports suggest the possibility of global climate change. In response, governments may adopt new regulations affecting the use of fossil fuels or requiring the use of alternative fuel sources. In addition, our customers may require us to take steps to demonstrate that we are taking ecologically responsible measures in operating our business. Our deployed network of tens of thousands of servers consumes significant energy resources, including those generated by the burning of fossil fuels. It is possible that future regulatory or legislative initiatives or customer demands could affect the costs of operating our network of servers and our other operations. Such costs and any expenses we incur to make our network more efficient could make us less profitable in future periods. Failure to comply with applicable laws and regulations or other requirements imposed on us could lead to fines, lost revenues and damage to our reputation.

## **Table of Contents**

*Provisions of our charter documents, our stockholder rights plan and Delaware law may have anti-takeover effects that could prevent a change in control even if the change in control would be beneficial to our stockholders.*

Provisions of our amended and restated certificate of incorporation, amended and restated by-laws and Delaware law could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. These provisions include:

A classified board structure so that only approximately one-third of our board of directors is up for re-election in any one year;

Our board of directors has the right to elect directors to fill a vacancy created by the expansion of the board of directors or the resignation, death or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors;

Stockholders must provide advance notice to nominate individuals for election to the board of directors or to propose matters that can be acted upon at a stockholders' meeting; such provisions may discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer's own slate of directors or otherwise attempting to obtain control of our company; and

Our board of directors may issue, without stockholder approval, shares of undesignated preferred stock; the ability to issue undesignated preferred stock makes it possible for our board of directors to issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to acquire us.

In addition, our Board of Directors has adopted a stockholder rights plan the provisions of which could make it more difficult for a potential acquirer of Akamai to consummate an acquisition transaction without the approval of our Board of Directors. Further, as a Delaware corporation, we are also subject to certain Delaware anti-takeover provisions. Under Delaware law, a corporation may not engage in a business combination with any holder of 15% or more of its capital stock unless the holder has held the stock for three years or, among other things, the board of directors has approved the transaction. Our board of directors could rely on Delaware law to prevent or delay an acquisition of us.

*A class action lawsuit has been filed against us and an adverse resolution of such action could have a material adverse effect on our financial condition and results of operations in the period in which the lawsuit is resolved.*

We are named as a defendant in a purported class action lawsuit filed in 2001 alleging that the underwriters of our initial public offering received undisclosed compensation in connection with our initial public offering of common stock in violation of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. We are also a nominal defendant in a related lawsuit alleging violations of Section 16 of the Securities Exchange Act of 1934, as amended, by such underwriters and our officers and directors. See Item 3 of our annual report on Form 10-K for the year ended December 31, 2009 for more information. Any conclusion of these matters in which we are a direct defendant in a manner adverse to us could have a material adverse effect on our financial position and results of operations.

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

## Issuer Purchases of Equity Securities

Period(1)		(a) Total Number of Shares Purchased(2)	(b) Average Price Paid per Share(3)	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(4)	(d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet be Purchased Under Plans or Programs(5)
April 1, 2010	April 30, 2010	160,970	\$ 32.98	160,970	156,483,199
May 1, 2010	May 31, 2010	209,800	\$ 38.54	209,800	148,398,017
June 1, 2010	June 30, 2010	166,155	\$ 42.25	166,155	141,377,355
Total		536,925	\$ 38.02	536,925	

- (1) Information is based on settlement dates of repurchase transactions.
- (2) Consists of shares of our common stock, par value \$0.01 per share. All repurchases were made pursuant to a previously-announced program (see note 4 below). All repurchases were made in open market transactions under the terms of a Rule 10b5-1 plan adopted by us.
- (3) Includes commissions paid.
- (4) In April 2009, we announced that our Board of Directors had authorized a stock repurchase program for up to \$100.0 million of our common stock from time to time on the open market or in privately negotiated transactions. In addition, in April 2010, the Board of Directors approved a \$150.0 million one-year extension of the stock repurchase program. See Note 8 to our unaudited consolidated financial statements included elsewhere in this quarterly report on Form 10-Q.
- (5) Dollar amounts represented reflect \$250.0 million minus the total aggregate amount purchased in such month and all prior months during which the repurchase program was in effect and aggregate commissions paid in connection therewith.

**Item 6. Exhibits**

The exhibits filed as part of this quarterly report on Form 10-Q are listed in the exhibit index immediately preceding the exhibits and are incorporated herein.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Akamai Technologies, Inc.

August 9, 2010

By: */s/* J. DONALD SHERMAN  
**J. Donald Sherman**  
**Chief Financial Officer**

**Table of Contents**

**EXHIBIT INDEX**

Exhibit 10.46	Employment Offer Letter Agreement between the Registrant and David Kenny dated July 22, 2010
Exhibit 10.47	Change in Control and Severance Agreement between the Registrant and David Kenny dated July 22, 2010
Exhibit 10.48	Amended Letter Agreement between the Registrant and Paul Sagan dated July 22, 2010
Exhibit 31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/ Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended
Exhibit 31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/ Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended
Exhibit 32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document.**
101.SCH	XBRL Taxonomy Extension Schema Document.**
101.CAL	XBRL Taxonomy Calculation Linkbase Document.**
101.DEF	XBRL Taxonomy Extension Definition Document.**
101.LAB	XBRL Taxonomy Label Linkbase Document.**
101.PRE	XBRL Taxonomy Presentation Linkbase Document.**

\*\* submitted electronically herewith

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2010 and June 30, 2009, (ii) Condensed Consolidated Balance Sheets at June 30, 2010 and December 31, 2009, (iii) Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2010 and June 30, 2009 and (iv) Notes to Condensed Consolidated Financial Statements.

In accordance with Rule 406T of Regulation S-T, the XBRL-related information in Exhibit 101 to this Quarterly Report on Form 10-Q is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act, is deemed not filed for purposes of section 18 of the Exchange Act, and otherwise is not subject to liability under these sections.