

AKAMAI TECHNOLOGIES INC

Form 10-Q

August 09, 2006

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, 2006
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)

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

04-3432319
*(I.R.S. Employer
Identification Number)*

8 Cambridge Center
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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated Filer Non-accelerated Filer

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

The number of shares outstanding of the registrant's common stock as of August 4, 2006: 155,638,489 shares.

AKAMAI TECHNOLOGIES, INC.
FORM 10-Q
For the quarterly period ended June 30, 2006
TABLE OF CONTENTS

| | | Page |
|---|---|-------------|
| <u>PART I. FINANCIAL INFORMATION</u> | | |
| <u>Item 1.</u> | <u>Financial Statements (unaudited)</u> | 1 |
| | <u>Condensed Consolidated Balance Sheets at June 30, 2006 and December 31, 2005</u> | 1 |
| | <u>Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2006 and 2005</u> | 2 |
| | <u>Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2006 and 2005</u> | 3 |
| | <u>Notes to Unaudited Condensed Consolidated Financial Statements for the three and six months ended June 30, 2006 and 2005</u> | 4 |
| <u>Item 2.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 24 |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 35 |
| <u>Item 4.</u> | <u>Controls and Procedures</u> | 35 |
| <u>PART II. OTHER INFORMATION</u> | | |
| <u>Item 1.</u> | <u>Legal Proceedings</u> | 36 |
| <u>Item 1A.</u> | <u>Risk Factors</u> | 36 |
| <u>Item 4.</u> | <u>Submission of Matters to a Vote of Security Holders</u> | 42 |
| <u>Item 5.</u> | <u>Other Information</u> | 42 |
| <u>Item 6.</u> | <u>Exhibits</u> | 42 |
| | <u>SIGNATURES</u> | 43 |
| | <u>EXHIBIT INDEX</u> | 44 |
| | <u>EX-10.35 Change of Control and Severance Agreement</u> | |
| | <u>EX-10.36 Executive Severance Pay Plan</u> | |
| | <u>EX-31.1 Section 302 Certification of C.E.O.</u> | |
| | <u>EX-31.2 Section 302 Certification of C.F.O.</u> | |
| | <u>EX-32.1 Section 906 Certification of C.E.O.</u> | |
| | <u>EX-32.2 Section 906 Certification of C.F.O.</u> | |

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

AKAMAI TECHNOLOGIES, INC.
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

| | June 30, 2006 | December 31, 2005 |
|---|--------------------------|------------------------------|
| (In thousands, except share data) | | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 73,502 | \$ 91,792 |
| Marketable securities (including restricted securities of \$330 at June 30, 2006 and \$730 at December 31, 2005) | 185,759 | 200,616 |
| Accounts receivable, net of reserves of \$9,193 at June 30, 2006 and \$7,994 at December 31, 2005 | 63,963 | 52,162 |
| Prepaid expenses and other current assets | 13,865 | 10,428 |
| Total current assets | 337,089 | 354,998 |
| Property and equipment, net | 63,243 | 44,885 |
| Marketable securities (including restricted securities of \$3,825 at June 30, 2006 and December 31, 2005) | 108,221 | 21,721 |
| Goodwill | 98,304 | 98,519 |
| Other intangible assets, net | 33,770 | 38,267 |
| Deferred tax assets, net | 324,064 | 328,308 |
| Other assets | 4,786 | 4,801 |
| Total assets | \$ 969,477 | \$ 891,499 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 17,081 | \$ 16,022 |
| Accrued expenses | 44,179 | 38,449 |
| Deferred revenue | 8,079 | 5,656 |
| Current portion of accrued restructuring | 1,418 | 1,749 |
| Total current liabilities | 70,757 | 61,876 |
| Accrued restructuring, net of current portion | 1,150 | 1,844 |
| Other liabilities | 3,464 | 3,565 |
| 1% convertible senior notes | 200,000 | 200,000 |
| Total liabilities | 275,371 | 267,285 |
| Commitments, contingencies and guarantees (Note 16) | | |
| Stockholders' equity: | | |
| Preferred stock, \$0.01 par value; 5,000,000 shares authorized; 700,000 shares designated as Series A Junior Participating Preferred | | |

Edgar Filing: AKAMAI TECHNOLOGIES INC - Form 10-Q

Stock; no shares issued or outstanding at June 30, 2006 and
December 31, 2005

| | | |
|---|----------------|----------------|
| Common stock, \$0.01 par value; 700,000,000 shares authorized; 155,295,649 shares issued and outstanding at June 30, 2006; 152,922,092 shares issued and outstanding at December 31, 2005 | 1,553 | 1,529 |
| Additional paid-in capital | 3,920,408 | 3,880,985 |
| Deferred stock compensation | | (7,537) |
| Accumulated other comprehensive income, net | 620 | 471 |
| Accumulated deficit | (3,228,475) | (3,251,234) |
| Total stockholders' equity | 694,106 | 624,214 |
| Total liabilities and stockholders' equity | \$ 969,477 | \$ 891,499 |

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

Table of Contents

AKAMAI TECHNOLOGIES, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|--|---|------------------|---|------------------|
| | 2006 | 2005 | 2006 | 2005 |
| (In thousands, except per share data) | | | | |
| Revenues: | | | | |
| Services | \$ 100,279 | \$ 63,676 | \$ 191,078 | \$ 123,256 |
| Software and software-related | 370 | 973 | 396 | 1,489 |
| Total revenues | 100,649 | 64,649 | 191,474 | 124,745 |
| Costs and operating expenses: | | | | |
| Cost of revenues | 21,195 | 12,752 | 40,511 | 24,276 |
| Research and development | 8,373 | 4,507 | 15,099 | 8,136 |
| Sales and marketing | 29,720 | 18,363 | 56,015 | 35,108 |
| General and administrative | 21,870 | 11,341 | 40,413 | 23,180 |
| Amortization of other intangible assets | 2,198 | 520 | 4,494 | 532 |
| Total costs and operating expenses | 83,356 | 47,483 | 156,532 | 91,232 |
| Income from operations | 17,293 | 17,166 | 34,942 | 33,513 |
| Interest income | 4,109 | 804 | 7,539 | 1,402 |
| Interest expense | (773) | (1,574) | (1,545) | (3,185) |
| Other income (expense), net | 475 | 77 | 661 | (649) |
| Gain on investments, net | 2 | | 259 | |
| Income before provision for income taxes | 21,106 | 16,473 | 41,856 | 31,081 |
| Provision for income taxes | 9,842 | 573 | 19,097 | 1,102 |
| Net income | \$ 11,264 | \$ 15,900 | \$ 22,759 | \$ 29,979 |
| Net income per weighted average share: | | | | |
| Basic | \$ 0.07 | \$ 0.12 | \$ 0.15 | \$ 0.23 |
| Diluted | \$ 0.07 | \$ 0.11 | \$ 0.14 | \$ 0.21 |
| Shares used in per weighted average share calculations: | | | | |
| Basic | 154,702 | 130,119 | 154,260 | 128,585 |
| Diluted | 175,612 | 149,986 | 175,001 | 148,607 |

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

Table of Contents

AKAMAI TECHNOLOGIES, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

| | For the Six Months Ended June 30, | |
|--|--|--------------|
| | 2006 | 2005 |
| | (In thousands) | |
| Cash flows from operating activities: | | |
| Net income | \$ 22,759 | \$ 29,979 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 18,260 | 8,662 |
| Amortization of deferred financing costs | 421 | 552 |
| Stock-based compensation | 20,250 | 884 |
| Utilization of tax net operating loss carryforward | 17,942 | |
| Deferred taxes | | 158 |
| Provision for doubtful accounts | 597 | 454 |
| Excess tax benefits from stock-based compensation | (10,866) | |
| (Gain) loss on investments, property and equipment and foreign currency, net | (609) | 546 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (10,741) | (6,598) |
| Prepaid expenses and other current assets | (4,319) | (1,149) |
| Accounts payable, accrued expenses and other current liabilities | 6,421 | 3,032 |
| Deferred revenue | 2,039 | 326 |
| Accrued restructuring | (1,048) | (691) |
| Other non-current assets and liabilities | (199) | (529) |
| Net cash provided by operating activities | 60,907 | 35,626 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (24,289) | (15,182) |
| Capitalization of internal-use software costs | (6,112) | (4,342) |
| Purchases of short and long-term available for sale securities | (191,928) | (26,085) |
| Proceeds from sales and maturities of short and long-term available for sale securities | 119,731 | 19,434 |
| Cash acquired in business acquisition, net | | 1,717 |
| Decrease in restricted investments held for security deposits | 400 | |
| Net cash used in investing activities | (102,198) | (24,458) |
| Cash flows from financing activities: | | |
| Payments on capital leases | | (227) |
| Excess tax benefits from stock-based compensation | 10,866 | |
| Proceeds from the issuance of common stock under stock options and employee stock purchase plans | 11,465 | 5,788 |
| Net cash provided by financing activities | 22,331 | 5,561 |

Edgar Filing: AKAMAI TECHNOLOGIES INC - Form 10-Q

| | | |
|--|-----------|-----------|
| Effects of exchange rate changes on cash and cash equivalents | 670 | (1,019) |
| Net (decrease) increase in cash and cash equivalents | (18,290) | 15,710 |
| Cash and cash equivalents at beginning of period | 91,792 | 35,318 |
| Cash and cash equivalents at end of period | \$ 73,502 | \$ 51,028 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | \$ 1,003 | \$ 2,573 |
| Cash paid for income taxes | 540 | 243 |
| Non-cash financing and investing activities: | | |
| Capitalization of stock-based compensation | \$ 1,734 | \$ |
| Acquisition of equipment through capital leases | | 441 |
| Common stock and vested stock options issued and accrued transaction costs for acquisition of a business | | 131,250 |
| Value of deferred compensation recorded for issuance of deferred stock units | | 750 |

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

Table of Contents

**AKAMAI TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS**

1. Nature of Business, Basis of Presentation and Principles of Consolidation

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 more than 20,000 servers in more than 930 networks in 71 countries. The Company was incorporated in Delaware in 1998 and is headquartered in Cambridge, Massachusetts. Akamai currently operates in one business segment: providing services for accelerating and improving delivery of content and applications over the Internet.

The accompanying interim condensed consolidated financial statements are unaudited and have been prepared in accordance with the accounting principles generally accepted in the United States of America for interim financial information. The accompanying condensed consolidated financial statements include the accounts of Akamai and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. Certain information and footnote disclosures normally included in the Company s annual consolidated financial statements have been condensed or omitted. Accordingly, these condensed consolidated financial statements 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, 2005.

The results of operations presented in this Quarterly Report on Form 10-Q are not necessarily indicative of the results that may be expected for future periods. In the opinion of management, these unaudited condensed 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. New Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN No. 48). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN No. 48 prescribes a two-step process to determine the amount of tax benefit to be recognized. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon external examination. If the tax position is deemed more-likely-than-not to be sustained, the tax position is then assessed to determine the amount of benefit to recognize in the financial statements. The amount of the benefit that may be recognized is the largest amount that has a greater than 50 percent likelihood of being realized upon ultimate settlement. FIN No. 48 will be effective for the Company beginning in 2007. Management is currently evaluating the potential impact of FIN No. 48 on the Company s financial position and results of operations.

3. Restricted Marketable Securities

As of June 30, 2006, \$4.2 million of the Company s marketable securities were classified as restricted. These securities primarily represent collateral for irrevocable letters of credit in favor of third-party beneficiaries, mostly related to facility leases; \$3.8 million of these securities are classified as long-term and \$330,000 are classified as short-term on the unaudited condensed consolidated balance sheet as of June 30, 2006. The restrictions on these marketable securities lapse as the Company fulfills its obligations or as such obligations expire as provided by the letters of credit. These restrictions are expected to lapse at various times through May 2011.

Table of Contents

AKAMAI TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (Continued)

4. Accounts Receivable

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

| | As of June 30, 2006 | As of December 31, 2005 |
|------------------------------------|---------------------------|-------------------------------|
| Trade accounts receivable | \$ 61,044 | \$ 51,019 |
| Unbilled accounts | 12,112 | 9,137 |
| Total gross accounts receivable | 73,156 | 60,156 |
| Allowance for doubtful accounts | (2,777) | (2,277) |
| Reserve for cash basis customers | (2,625) | (2,539) |
| Reserve for service credits | (3,791) | (3,178) |
| Total accounts receivable reserves | (9,193) | (7,994) |
| Total accounts receivable, net | \$ 63,963 | \$ 52,162 |

5. Accrued Expenses

Accrued expenses consist of the following (in thousands):

| | As of June 30, 2006 | As of December 31, 2005 |
|------------------------------------|---------------------------|-------------------------------|
| Payroll and other related benefits | \$ 18,389 | \$ 14,374 |
| Property, use and other taxes | 15,037 | 13,314 |
| Bandwidth and co-location | 8,781 | 7,781 |
| Legal professional fees | 392 | 679 |
| Interest | 83 | 83 |
| Other | 1,497 | 2,218 |
| Total | \$ 44,179 | \$ 38,449 |

6. Stock-Based Compensation

Effective January 1, 2006, the Company adopted, on a modified prospective basis, the provisions of FASB Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment (SFAS No. 123(R)), which requires the measurement and recognition of compensation expense based on estimated fair values for all share-based payment awards made to employees and directors including employee stock options, restricted stock units, restricted stock awards, deferred stock units and employee stock purchases related to Akamai's 1999 Employee Stock Purchase Plan (the 1999 ESPP). Accordingly, stock-based compensation costs are measured at the grant date, based on the fair value of the award, and are recognized as expense over the employee's requisite service period. Additionally, in

applying SFAS No. 123(R), the Company applies the provisions of Securities and Exchange Commission (the SEC) Staff Accounting Bulletin No. 107 (SAB 107) on share-based payments.

Equity Plans

In 1998, the Company's Board of Directors (the Board of Directors) adopted the 1998 Stock Incentive Plan (the 1998 Plan) for the issuance of incentive and nonqualified stock options, restricted stock awards

Table of Contents

AKAMAI TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (Continued)

and other types of equity awards. Options to purchase common stock and other equity awards are granted at the discretion of the Board of Directors or a committee thereof. In October 2005, the Board of Directors delegated to the Company's Chief Executive Officer the authority to grant equity incentive awards to employees of the Company below the level of Vice President, subject to certain specified limitations. In December 2001, the Board of Directors adopted the 2001 Stock Incentive Plan (the "2001 Plan") for the issuance of nonqualified stock options, restricted stock and other types of equity awards. In March 2006, the Board of Directors adopted the Akamai Technologies, Inc. 2006 Stock Incentive Plan (the "2006 Plan") for the issuance of incentive and nonqualified stock options, restricted stock awards, restricted stock units and other types of equity awards. The stockholders of the Company approved the adoption of the 2006 Plan in May 2006. The total number of shares of common stock reserved for issuance under the 1998 Plan, the 2001 Plan and the 2006 Plan is 48,255,600, 5,000,000 and 7,500,000 shares, respectively. Equity incentive awards may not be issued to the Company's directors or executive officers under the 2001 Plan.

Under the terms of the 1998 Plan and the 2006 Plan, the exercise price of incentive stock options may not be less than 100% (110% in certain cases) of the fair market value of the common stock on the date of grant. Incentive stock options may not be issued under the 2001 Plan. The exercise price of nonqualified stock options issued under the 1998 Plan, the 2001 Plan and the 2006 Plan may be less than the fair market value of the common stock on the date of grant, as determined by the Board of Directors, but in no case may the exercise price be less than the statutory minimum. Stock option vesting is typically four years, and options are granted at the discretion of the Board of Directors. Under the 1998 Plan and 2001 Plan the term of options granted may not exceed ten years, or five years for incentive stock options granted to holders of more than 10% of the Company's voting stock. Under the 2006 Plan, the term of options granted may not exceed seven years.

The Company has assumed certain stock option plans and the outstanding stock options of companies that it has acquired ("Assumed Plans"). Stock options outstanding as of the date of acquisition under the Assumed Plans have been exchanged for the Company's stock options and adjusted to reflect the appropriate conversion ratio as specified by the applicable acquisition agreement, but are otherwise administered in accordance with the terms of the Assumed Plans. Stock options under the Assumed Plans generally vest over four years and expire ten years from the date of grant. No additional stock options have been or will be granted under the Assumed Plans.

In August 1999, the Board of Directors adopted the 1999 ESPP. The Company reserved 3,100,000 shares of common stock for issuance under the 1999 ESPP. In May 2002, the stockholders of the Company approved an amendment to the 1999 ESPP that allows for an automatic increase in the number of shares of common stock available under the 1999 ESPP each June 1 and December 1 to restore the number of shares available for issuance to 1,500,000 shares, provided that the aggregate number of shares issuable under the 1999 ESPP shall not exceed 20,000,000. In April 2005, the Company's Board of Directors approved amendments to the 1999 ESPP as follows: the duration of the offering periods was decreased from 24 months to six months; the number of times a participant may elect to change his or her percentage was changed from four times to two times; the definition of "compensation" was amended to clarify that it includes cash bonuses and other cash incentive programs; and a provision was added to clarify that upon termination of an offering period, each eligible participant will be automatically enrolled in the next offering period. These amendments became effective in June 2005. The 1999 ESPP allows participants to purchase shares of common stock at a 15% discount from the fair market value of the stock as determined on specific dates at six-month intervals. During the six-month periods ended June 30, 2006 and 2005, the Company issued 165,934 and 279,926 shares under the 1999 ESPP, respectively. As of June 30, 2006, \$816,000 had been withheld from employees for future purchases under the 1999 ESPP.

Table of Contents

**AKAMAI TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (Continued)**

Impact of the Adoption of SFAS No. 123(R)

The Company adopted SFAS No. 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of Akamai's fiscal year 2006. Under the modified prospective transition method, stock-based compensation expense recognized during the three and six months ended June 30, 2006 includes: shares issued under the 1999 ESPP during the offering period commencing on December 1, 2005, based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123; shares issued under the 1999 ESPP during the offering period commencing on June 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R); stock options and deferred stock units granted prior to, but not yet vested as of December 31, 2005, based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123; and stock options, deferred stock units, restricted stock and restricted stock units granted after December 31, 2005, based on the grant-date fair value, in accordance with the provisions of SFAS No. 123(R). Under the modified prospective transition method, results for prior periods are not restated; accordingly, the results of operations for the three and six months ended June 30, 2006 and future periods will not be comparable to the Company's historical results.

For stock options, Akamai has selected the Black-Scholes option pricing model to determine the fair value of the Company's stock option awards. The estimated fair value of Akamai's stock-based awards, less expected forfeitures, is amortized over the awards' vesting period on a straight-line basis. Deferred compensation related to awards granted prior to January 1, 2006 has been included in additional paid-in capital; as of and prior to December 31, 2005, it was carried as a separate line in stockholder's equity. SFAS No. 123(R) also changes the reporting of tax-related amounts within the statement of cash flows. The gross amount of windfall tax benefits resulting from stock-based compensation will be reported as financing inflows.

Table of Contents

AKAMAI TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (Continued)

The effect of recording stock-based compensation in accordance with SFAS No. 123(R) for the three and six month periods ended June 30, 2006 was as follows (in thousands):

| | For the Three Months Ended June 30, 2006 | For the Six Months Ended June 30, 2006 |
|---|---|---|
| Stock-based compensation expense by type of award: | | |
| Stock options | \$ 5,718 | \$ 10,801 |
| Deferred stock units | 277 | 519 |
| Restricted stock units | 8,090 | 9,848 |
| Shares issued under the 1999 ESPP | 332 | 828 |
| Amounts capitalized as internal-use software | (1,242) | (1,734) |
| Total stock-based compensation before income taxes | 13,175 | 20,262 |
| Less: Income tax benefit | (4,933) | (6,734) |
| Total stock-based compensation, net of tax | \$ 8,242 | \$ 13,528 |
| Effect of stock-based compensation on income by line item: | | |
| Cost of revenues | \$ 533 | \$ 806 |
| Research and development expense | 3,332 | 4,989 |
| Sales and marketing expense | 5,040 | 7,629 |
| General and administrative expense | 4,270 | 6,838 |
| Provision for income taxes | (4,933) | (6,734) |
| Total cost related to stock-based compensation | \$ 8,242 | \$ 13,528 |

The fair value of Akamai's stock option awards granted during the three and six months ended June 30, 2006 is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

| | For the Three Months Ended June 30, 2006 | For the Six Months Ended June 30, 2006 |
|---|---|---|
| Expected life (years) | 4.2 | 3.8 |
| Risk-free interest rate(%) | 5.0 | 4.7 |
| Expected volatility(%) | 68.4 | 66.9 |
| Dividend yield(%) | | |
| Weighted average fair value at grant date | \$ 17.93 | \$ 14.39 |

Table of Contents

AKAMAI TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (Continued)

The fair value of Akamai's ESPP awards granted during the three and six months ended June 30, 2006 is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

| | For the Three Months Ended June 30, 2006 | For the Six Months Ended June 30, 2006 |
|---|---|---|
| Expected life (years) | 0.5 | 0.5 |
| Risk-free interest rate(%) | 4.9 | 4.7 |
| Expected volatility(%) | 68.4 | 66.9 |
| Dividend yield(%) | | |
| Weighted average fair value of shares purchased | \$ 17.89 | \$ 17.89 |

Expected volatilities are based on the Company's historical volatility and implied volatility from traded options in its stock. The Company uses historical data to estimate the expected life of options granted within the valuation model. The risk-free interest rate for periods commensurate with the expected life of the option is based on the U.S. Treasury yield rate in effect at the time of grant.

As of June 30, 2006, total unrecognized compensation costs for stock options, restricted stock units, deferred stock units and the 1999 ESPP was \$112.2 million. This non-cash expense will be recognized through 2009 over a weighted average period of 1.6 years. Nearly all of the Company's employees have received grants through these equity compensation programs.

As a result of adopting SFAS No. 123(R), the Company's income before taxes for the three and six months ended June 30, 2006 was \$3.0 million and \$6.7 million lower, respectively, than if the Company had continued to account for share-based compensation under Accounting Principles Bulletin No. 25, Accounting for Stock Issued to Employees (APB No. 25). Net income for the three and six months ended June 30, 2006 was \$1.6 million and \$3.7 million lower, respectively, than if the Company had continued to account for share-based compensation under APB No. 25. Basic earnings per share for the three and six months ended June 30, 2006 would have been \$0.08 and \$0.17, respectively, had the Company not adopted SFAS No. 123(R), compared to reported basic earnings per share of \$0.07 and \$0.15, respectively, for such periods. Diluted earnings per share for the three and six months ended June 30, 2006 would have been \$0.08 and \$0.16, respectively, had the Company not adopted SFAS No. 123(R), compared to reported diluted earnings per share of \$0.07 and \$0.14 for such periods.

Prior to the adoption of SFAS No. 123(R), the Company presented all tax benefits of deductions resulting from exercises of stock options as operating cash flows in the consolidated statement of cash flows. SFAS No. 123(R) requires the cash flows resulting from excess windfall tax benefits to be classified as financing cash flows, rather than as operating cash flows. The \$10.9 million in excess windfall tax benefit classified as a financing cash inflow would have been classified as an operating cash inflow had the Company not adopted SFAS No. 123(R).

Prior to the Adoption of SFAS No. 123(R)

For periods prior to 2006, the Company elected to apply APB No. 25 and related interpretations in accounting for its stock-based compensation.

Table of Contents

AKAMAI TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (Continued)

The following is a reconciliation of pro forma net income per weighted average share calculated as if the Company had adopted the fair value recognition provisions of SFAS No. 123 for the three and six months ended June 30, 2005 to the Company's reported net income per weighted average share (in thousands, except per share data):

| | For the Three Months Ended June 30, 2005 | For the Six Months Ended June 30, 2005 |
|---|---|---|
| Net income, as reported | \$ 15,900 | \$ 29,979 |
| Add: stock-based employee compensation costs, net of tax included in reported net income | 615 | 836 |
| Deduct: stock-based employee compensation costs, net of tax determined under fair value method for all awards | (6,555) | (14,082) |
| Incremental stock option expense per SFAS No. 123 | (5,940) | (13,246) |
| Pro forma net income | \$ 9,960 | \$ 16,733 |
| Net income per weighted average share, basic: | | |
| As reported | \$ 0.12 | \$ 0.23 |
| Pro forma | \$ 0.08 | \$ 0.13 |
| Net income per weighted average share, diluted: | | |
| As reported | \$ 0.11 | \$ 0.21 |
| Pro forma | \$ 0.07 | \$ 0.12 |
| Effect of employee stock-based compensation on income by line item: | | |
| Cost of revenues | \$ | \$ |
| Research and development expense | 124 | 124 |
| Sales and marketing expense | 129 | 176 |
| General and administrative expense | 362 | 536 |
| Total cost related to stock-based compensation | \$ 615 | \$ 836 |

The fair value of Akamai's stock options issued prior to the adoption of SFAS No. 123(R) was estimated using a Black-Scholes option pricing model. This model requires the input of subjective assumptions, including expected stock price volatility and estimated life of each award. The fair values of these options was estimated assuming no expected dividends and the estimated life of each award, volatility and risk-free interest rate at the time of grant.

Table of Contents

AKAMAI TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (Continued)

The fair value of Akamai's stock-option awards granted during the three and six months ended June 30, 2005 was estimated using the following weighted-average assumptions:

| | For the Three Months Ended June 30, 2005 | For the Six Months Ended June 30, 2005 |
|---|---|---|
| Expected life (years) | 5.0 | 5.0 |
| Risk-free interest rate(%) | 3.9 | 3.8 |
| Volatility(%) | 83.6 | 82.3 |
| Dividend yield(%) | | |
| Weighted average fair value at grant date | \$8.74 | \$8.26 |

The fair value of Akamai's ESPP awards granted during the three and six months ended June 30, 2005 was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

| | For the Three Months Ended June 30, 2005 | For the Six Months Ended June 30, 2005 |
|---|---|---|
| Expected life (years) | 0.5 | 0.5 |
| Risk-free interest rate(%) | 2.1 | 2.1 |
| Expected Volatility(%) | 101.9 | 101.9 |
| Dividend yield(%) | | |
| Weighted average fair value of shares purchased | \$ 8.13 | \$ 8.13 |

Stock Options

Options to purchase common stock are granted at the discretion of the Board of Directors or a committee thereof. Options granted to date generally have a contractual life of ten years and typically vest 25% one year from date of grant, and the remaining 75% vest in twelve equal quarterly installments so that all options are vested at the end of four years.

Table of Contents

AKAMAI TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (Continued)

The following tables summarize the stock option activity under all equity plans for the three and six months ended June 30, 2006 and 2005:

| | Shares | Weighted Average Exercise Price |
|--------------------------------|-------------|---------------------------------------|
| Outstanding at January 1, 2006 | 16,275,852 | \$ 8.65 |
| Granted | 773,650 | 25.36 |
| Exercised | (1,322,667) | 3.53 |
| Forfeited | (318,530) | 10.15 |
| Outstanding at March 31, 2006 | 15,408,305 | 9.93 |
| Granted | 248,360 | 31.73 |
| Exercised | (849,011) | 4.39 |
| Forfeited | (239,946) | 11.98 |
| Outstanding at June 30, 2006 | 14,567,708 | 10.62 |
| Exercisable at June 30, 2006 | 6,872,414 | 6.07 |
| | Shares | Weighted Average Exercise Price |
| Outstanding at January 1, 2005 | 14,126,204 | \$ 6.92 |
| Granted | 827,500 | 12.06 |
| Exercised | (628,255) | 2.62 |
| Forfeited | (366,166) | 15.34 |
| Outstanding at March 31, 2005 | 13,959,283 | 7.20 |
| Granted | 241,500 | 12.79 |
| Exercised | (505,953) | 3.69 |
| Forfeited | (228,919) | 10.14 |
| Outstanding at June 30, 2005 | 13,465,911 | 7.38 |
| Exercisable at June 30, 2005 | 7,173,332 | 6.04 |

The total pre-tax intrinsic value of options exercised during the three months ended June 30, 2006 and 2005 was \$23.8 million and \$4.6 million, respectively. For the six months ended June 30, 2006 and 2005, the total pre-tax intrinsic value of options exercised was \$51.7 million and \$10.5 million, respectively. The total fair value of options vested for the three months ended June 30, 2006 and 2005 was \$4.3 million and \$5.4 million, respectively; and for the six months ended June 30, 2006 and 2005 was \$8.6 million and \$12.0 million, respectively. The fair value of vested

stock options for the three and six months ended June 30, 2006 was calculated net of capitalized equity-related compensation of \$1.2 million and \$1.7 million, respectively. Cash proceeds from the exercise of stock options were \$3.9 million and \$1.9 million for the three months ended June 30, 2006 and 2005, respectively; and \$8.5 million and \$3.5 million for the six months ended June 30, 2006 and 2005, respectively. Income tax benefits realized from the exercise of stock options during the three months ended June 30, 2006 and 2005 were \$6.5 million and \$1.9 million, respectively. For the six months ended June 30, 2006 and 2005, income tax benefits realized from the exercise of stock options were \$13.5 million and \$3.7 million, respectively.

Table of Contents

AKAMAI TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (Continued)

The following table summarizes significant ranges of outstanding and exercisable options as of June 30, 2006:

| Range of Exercise Price (\$) | Options Outstanding and Expected to Vest | | | | Options Exercisable | | | |
|------------------------------|--|---|------------|---------------------------|---------------------|---|------------|---------------------------|
| | Number of Options | Weighted Average Remaining Contractual Life | | Aggregate Intrinsic Value | Number of Options | Weighted Average Remaining Contractual Life | | Aggregate Intrinsic Value |
| | | Exercise Price | (In years) | | | Exercise Price | (In years) | |
| 0.01-0.90 | 1,314,499 | 5.7 | \$ 0.59 | \$ 46,802 | 1,160,011 | 5.3 | \$ 0.63 | \$ 41,252 |
| 0.96-1.65 | 1,531,929 | 6.2 | 1.42 | 53,266 | 1,496,879 | 6.2 | 1.42 | 52,042 |
| 2.27-4.08 | 797,464 | 6.0 | 3.24 | 26,280 | 800,567 | 6.0 | 3.22 | 26,394 |
| 4.10-5.13 | 2,059,329 | 6.3 | 4.85 | 64,537 | 1,672,846 | 6.2 | 4.84 | 52,450 |
| 5.44-12.90 | 1,115,503 | 7.8 | 11.18 | 27,901 | 535,780 | 7.1 | 10.30 | 13,873 |
| 13.03-14.06 | 700,537 | 5.6 | 13.32 | 16,019 | 481,502 | 4.2 | 13.16 | 11,087 |
| 14.37 | 1,035,149 | 7.7 | 14.37 | 22,587 | | | | |
| 14.46-14.86 | 2,430,792 | 9.0 | 14.48 | 52,779 | 59,077 | 7.9 | 14.84 | 1,261 |
| 15.22-19.21 | 785,033 | 5.9 | 15.96 | 15,882 | 502,945 | 4.3 | 15.29 | 10,513 |
| 19.80-35.05 | 940,428 | 9.2 | 25.97 | 9,612 | 66,782 | 3.9 | 26.17 | 669 |
| 36.06-39.44 | 82,118 | 7.0 | 36.52 | 2 | 41,400 | 4.2 | 36.64 | 2 |
| 61.94-93.94 | 52,875 | 3.7 | 78.34 | | 52,875 | 3.7 | 78.34 | |
| 197.50 | 1,750 | 2.2 | 197.50 | | 1,750 | 2.2 | 197.50 | |
| | 12,847,406 | 7.1 | 10.26 | \$ 335,667 | 6,872,414 | 5.8 | 6.07 | \$ 209,543 |
| Expected forfeitures | 1,720,302 | | | | | | | |
| Total options outstanding | 14,567,708 | | | | | | | |

The aggregate intrinsic value in the preceding table represents the total intrinsic value, based on Akamai's closing stock price of \$36.19 on June 30, 2006, that would have been received by the option holders had all option holders exercised their options as of that date. The total number of shares related to in-the-money options exercisable as of June 30, 2006 was 6.8 million.

Deferred Stock Units

On May 23, 2006, the Company granted 33,545 deferred stock units (DSUs) under the Company's 1998 Plan to members of its Board of Directors. During 2003, 2004 and 2005, the Company granted an aggregate of 259,876 DSUs to non-employee members of its Board of Directors and to the Company's Executive Chairman. Each DSU represents the right to receive one share of the Company's common stock upon vesting. The holder may elect to defer receipt of

all or a portion of the vested shares of stock represented by the DSU for a period for at least one year but not more than ten years from the grant date. The DSUs typically vest 50% upon the first anniversary of grant date with the remaining 50% vesting in equal installments of 12.5% each quarter thereafter.

Table of Contents

AKAMAI TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (Continued)

The following table summarizes the DSU activity for the three and six months ended June 30, 2006:

| | Units | Weighted Average Grant Date Fair Value |
|--------------------------------|---------|--|
| Outstanding at January 1, 2006 | 194,284 | \$ 9.34 |
| Granted | | |
| Vested and distributed | (932) | 15.38 |
| Outstanding at March 31, 2006 | 193,352 | 9.31 |
| Granted | 33,545 | 31.15 |
| Vested and distributed | (6,439) | 13.77 |
| Outstanding at June 30, 2006 | 220,458 | 12.50 |

The following table summarizes the DSU activity for the three and six months ended June 30, 2005:

| | Units | Weighted Average Grant Date Fair Value |
|--------------------------------|---------|--|
| Outstanding at January 1, 2005 | 189,062 | \$ 6.43 |
| Granted | | |
| Vested and distributed | | |
| Outstanding at March 31, 2005 | 189,062 | 6.43 |
| Granted | 58,366 | 12.85 |
| Vested and distributed | (3,728) | 15.38 |
| Outstanding at June 30, 2005 | 243,700 | 7.83 |

The total fair value of DSUs that vested during the six months ended June 30, 2005 and 2006 was \$505,000 and \$880,000, respectively. The grant date fair value is calculated based upon the Company's closing stock price on the date of grant. As of June 30, 2005, the Company had 243,700 outstanding DSUs. As of June 30, 2006, 125,178 shares of DSUs were unvested, with an aggregate intrinsic value of \$2.7 million and a weighted average remaining contractual life of approximately 8.5 years. These units are expected to vest through May 2008. All DSUs vest upon fulfilling service conditions.

Restricted Stock Units

During the three and six months ended June 30, 2006, the Company granted an aggregate of 0 and 822,281 restricted stock units (RSUs), respectively, to its employees. These RSUs generally vest in three equal annual installments over the three-year period following the grant date. Each RSU represents the right to receive one share of the Company's common stock upon vesting. The fair value of these RSUs was calculated based upon the Company's closing stock price on date of grant, and the equity-related compensation expense is being recognized over the vesting

period of three years.

Additionally, in connection with the original grant of RSUs noted above, the Company also granted performance-based RSUs to its employees. These performance-based RSUs will only vest to the extent that the Company exceeds specified cumulative revenue and earnings per share targets for fiscal years 2006, 2007 and 2008. The maximum number of performance-based RSUs that may vest is equal to 300% of the number of non-performance-based RSUs granted on the same date; such maximum vesting would only occur if the

Table of Contents

AKAMAI TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (Continued)

Company meets or exceeds 110% of both its cumulative revenue and earnings per share targets for fiscal years 2006, 2007 and 2008. No performance-based RSUs will vest if the Company fails to exceed the applicable targets. If the Company's cumulative revenue and/or earnings per share results for the applicable years is between 100% and 110% of the targets, the holder would receive between zero performance-based RSUs and the maximum deliverable amount set forth above. For the three and six months ended June 30, 2006, management measured compensation expense for these performance-based RSUs based upon a review of the Company's expected achievement of future cumulative performance. Such compensation cost is being recognized over three years. Management will continue to review the Company's expected performance and adjust the compensation cost, if needed, at such time.

The following table summarizes the RSU activity for the three and six months ended June 30, 2006:

| | Units | Weighted Average Grant Date Fair Value |
|-------------------------------|-----------|--|
| Granted | 3,214,124 | \$25.43 |
| Forfeited | (9,100) | 25.54 |
| Outstanding at March 31, 2006 | 3,205,024 | 25.43 |
| Forfeited | (38,500) | 25.54 |
| Outstanding at June 30, 2006 | 3,166,524 | 25.40 |

The grant date fair value of each RSU is calculated based upon the Company's closing stock price on the date of grant. As of January 1, 2005, June 30, 2005 and January 1, 2006 no RSUs were outstanding. As of June 30, 2006, 3,166,524 shares of RSUs were outstanding and unvested, with an aggregate intrinsic value of \$114.6 million and a weighted average remaining contractual life of approximately 9.62 years. These units are expected to vest through March 2009.

7. Net Income per Share

Basic net income per share is computed using the weighted average number of common shares outstanding during the applicable quarter. Diluted net income per share is computed using the weighted average number of common shares outstanding during the quarter, plus the dilutive effect of potential common stock. Potential common stock consists of stock options, DSUs, RSUs, unvested restricted common stock and convertible notes.

Table of Contents

**AKAMAI TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS (Continued)**

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, | |
|--|-------------|--|------------|
| 2006 | 2005 | 2006 | 200 |