AKAMAI TECHNOLOGIES INC
Form 10-Q
May 09, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2016
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 0-27275

Akamai Technologies, Inc.

(Exact name of registrant as specified in its charter)

Delaware	04-3432319
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

150 Broadway
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 x 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 x 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 x Accelerated filer o Non-accelerated filer o Smaller reporting company o
(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 x
The number of shares outstanding of the registrant’s common stock as of May 5, 2016: 175,591,774

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AKAMAI TECHNOLOGIES, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2016

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED BALANCE SHEETS

(in thousands, expect share data)	March 31, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$312,912	$289,473
Marketable securities	524,958	460,088
Accounts receivable, net of reserves of $9,380 and $7,364 at March 31, 2016, and December 31, 2015, respectively	365,103	380,399
Prepaid expenses and other current assets	127,855	123,228
Total current assets	1,330,828	1,253,188
Property and equipment, net	770,197	753,180
Marketable securities	685,362	774,674
Goodwill	1,152,376	1,150,244
Acquired intangible assets, net	149,379	156,095
Deferred income tax assets	3,490	4,700
Other assets	92,120	89,603
Total assets	$4,183,752	$4,181,684
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$63,822	$61,982
Accrued expenses	197,487	216,166
Deferred revenue	64,905	54,154
Other current liabilities	7,019	138
Total current liabilities	333,233	332,440
Deferred revenue	4,238	4,163
Deferred income tax liabilities	11,706	12,888
Convertible senior notes	623,485	618,047
Other liabilities	97,508	93,268
Total liabilities	1,070,170	1,060,806
Commitments and contingencies		
Stockholders' equity:		
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; 178,270,472 shares issued and 176,050,217 shares outstanding at March 31, 2016, and 177,212,181 shares issued and outstanding at December 31, 2015	1,783	1,772
Additional paid-in capital	4,451,319	4,437,420
Accumulated other comprehensive loss	(28,792)	(41,453)
Treasury stock, at cost, 2,220,255 shares at March 31, 2016, and no shares at December 31, 2015	(108,725)	—
Accumulated deficit	(1,202,003)	(1,276,861)
Total stockholders' equity	3,113,582	3,120,878

Total liabilities and stockholders’ equity	$4,183,752	$4,181,684

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

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AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF INCOME

	For the Three Months Ended March 31,	
(in thousands, except per share data)	2016	2015
Revenue	$567,725	$526,536
Costs and operating expenses:		
Cost of revenue (exclusive of amortization of acquired intangible assets shown below)	194,736	169,294
Research and development	40,842	35,828
Sales and marketing	102,211	103,479
General and administrative	102,283	89,592
Amortization of acquired intangible assets	6,716	6,780
Restructuring charges	6,818	42
Total costs and operating expenses	453,606	405,015
Income from operations	114,119	121,521
Interest income	3,320	3,001
Interest expense	(4,653)	(4,576)
Other expense, net	(189)	(301)
Income before provision for income taxes	112,597	119,645
Provision for income taxes	37,739	41,899
Net income	$74,858	$77,746
Net income per share:		
Basic	$0.42	$0.44
Diluted	$0.42	$0.43
Shares used in per share calculations:		
Basic	176,403	178,545
Diluted	177,539	180,825

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

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AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)	For the Three Months Ended March 31, 2016	2015
Net income	$74,858	$77,746
Other comprehensive income (loss):		
Foreign currency translation adjustments	9,653	(8,415)
Unrealized gains on investments, net of income tax provision of $1,783 and $1,213 for the three months ended March 31, 2016 and 2015, respectively	3,008	2,113
Other comprehensive income (loss)	12,661	(6,302)
Comprehensive income	$87,519	$71,444

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

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AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)	For the Three Months Ended March 31, 2016	2015
Cash flows from operating activities:		
Net income	$ 74,858	$ 77,746
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	80,669	70,460
Stock-based compensation	31,741	29,669
Excess tax benefits from stock-based compensation	(1,135)	(13,128)
Provision for deferred income taxes	1,072	8,305
Amortization of debt discount and issuance costs	4,653	4,576
Other non-cash reconciling items, net	2,752	443
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	15,906	(32,552)
Prepaid expenses and other current assets	(3,481)	(1,817)
Accounts payable and accrued expenses	(32,377)	(52,703)
Deferred revenue	10,653	6,947
Other current liabilities	6,876	42
Other non-current assets and liabilities	(1,949)	1,741
Net cash provided by operating activities	190,238	99,729
Cash flows from investing activities:		
Cash paid for acquired businesses, net of cash acquired	—	(16,062)
Purchases of property and equipment	(41,806)	(91,924)

Capitalization of internal-use software development costs	(40,534)	(45,145)
Purchases of short- and long-term marketable securities	(95,843)	(97,304)
Proceeds from sales of short- and long-term marketable securities	—	2,008
Proceeds from maturities of short- and long-term marketable securities	125,109	305,647
Other non-current assets and liabilities	(2,354)	(82)
Net cash (used in) provided by investing activities	(55,428)	57,138
Cash flows from financing activities:		
Proceeds related to the issuance of common stock under stock plans	18,350	24,440
Excess tax benefits from stock-based compensation	1,135	13,128
Employee taxes paid related to net share settlement of stock-based awards	(26,496)	(31,101)
Repurchases of common stock	(108,725)	(62,680)
Net cash used in financing activities	(115,736)	(56,213)
Effects of exchange rate changes on cash and cash equivalents	4,365	(6,747)
Net increase in cash and cash equivalents	23,439	93,907
Cash and cash equivalents at beginning of period	289,473	238,650
Cash and cash equivalents at end of period	$ 312,912	$ 332,557

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AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS, continued

(in thousands)	For the Three Months Ended March 31, 2016	2015
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$28,010	$24,131
Non-cash investing activities:		
Purchases of property and equipment and capitalization of internal-use software development costs included in accounts payable and accrued expenses	19,518	31,565
Capitalization of stock-based compensation	5,203	4,144

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

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AKAMAI TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Business and Basis of Presentation

Akamai Technologies, Inc. (the “Company”) provides cloud services for delivering, optimizing and securing content and business applications over the Internet. The Company's globally-distributed platform comprises over 216,000 servers in more than 1,500 networks in approximately 120 countries. The Company was incorporated in Delaware in 1998 and is headquartered in Cambridge, Massachusetts. The Company currently operates in one industry segment: providing cloud services for delivering, optimizing and securing content and business 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 the Company 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 in, or omitted from, 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 the Company’s annual report on Form 10-K for the year ended December 31, 2015, filed with the Securities and Exchange Commission (the "Commission") on February 29, 2016.

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, consisting only of normal recurring adjustments, that are necessary for a fair statement of the results of all interim periods reported herein.

Newly-Adopted Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board (“FASB”) issued updated guidance to simplify the presentation of debt issuance costs on the balance sheet. This guidance moved debt issuance costs from the assets section of the balance sheet to the liabilities section as a direct deduction from the carrying amount of the debt issued. The Company retrospectively adopted the guidance on January 1, 2016. The prior period consolidated balance sheet presented, as of December 31, 2015, was revised to reclassify $6.2 million of debt issuance costs included in other assets to convertible senior notes. This had the impact of reducing the Company's total assets and total liabilities by $6.2 million, as of December 31, 2015. The revision had no impact on the Company's results of operations, financial position or cash flows.

In September 2015, the FASB issued updated guidance that eliminates the requirement to restate prior period financial statements for measurement period adjustments. In an effort to reduce complexity in financial reporting, the new guidance requires that the cumulative impact of a measurement period adjustment, including the impact on prior periods, be recognized in the reporting period in which the adjustment is identified. The standard was effective for and adopted by the Company on January 1, 2016. This guidance did not have an impact on the Company's results of operations, financial condition or cash flows as the measurement periods for the Company's 2015 acquisitions were closed as of December 31, 2015.

Recent Accounting Pronouncements

In May 2014, the FASB issued updated guidance and disclosure requirements for recognizing revenue. The new revenue recognition standard provides a five-step analysis of transactions to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This standard will be effective for the Company on January 1, 2018, and may be applied retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is evaluating the potential impact of adopting this new accounting guidance.

In February 2016, the FASB issued guidance that requires companies to present assets and liabilities arising from leases on the consolidated balance sheets. This new standard establishes a right-of-use model that requires a lessee to record a right-of-use asset and a corresponding lease liability on the consolidated balance sheets for all leases with terms longer than 12 months. This standard will be effective for the Company on January 1, 2019, and is to be applied using a modified retrospective

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approach. Early adoption is permitted. The Company is evaluating the potential impact of adopting this new accounting guidance.

In March 2016, the FASB issued guidance that is intended to simplify aspects of how share-based payments are accounted for and presented in financial statements. This guidance requires that entities record all tax effects of share-based payments at settlement or expiration through the income statement. The standard also amends how windfall tax benefits are recognized, the minimum statutory tax withholding requirements and how entities elect to recognize share-based payment forfeitures. This guidance will be effective for the Company on January 1, 2017, and portions will be required to be applied on a retrospective or modified retrospective basis. Early adoption is permitted. The Company is evaluating the potential impact of adopting this new accounting guidance.

2. Fair Value Measurements

The following is a summary of available-for-sale marketable securities held as of March 31, 2016 and December 31, 2015 (in thousands):

		Gross Unrealized			Classification on Balance Sheet	
	Amortized Cost	Gains	Losses	Aggregate Fair Value	Short-Term Marketable Securities	Long-Term Marketable Securities
As of March 31, 2016						
Commercial paper	$2,495	$—	$(1)	$2,494	$2,494	$—
Corporate bonds	962,932	1,203	(506)	963,629	479,400	484,229
U.S. government agency obligations	241,315	289	(26)	241,578	43,064	198,514
	$1,206,742	$1,492	$(533)	$1,207,701	$524,958	$682,743
As of December 31, 2015						
Commercial paper	$2,491	$—	$(4)	$2,487	$2,487	$—
Corporate bonds	995,100	73	(3,365)	991,808	432,585	559,223
U.S. government agency obligations	239,587	41	(575)	239,053	25,016	214,037
	$1,237,178	$114	$(3,944)	$1,233,348	$460,088	$773,260

The Company offers certain qualified employees the ability to participate in a non-qualified deferred compensation plan. The mutual funds held by the Company that are associated with this plan are classified as restricted trading securities. These securities are not included in the available-for-sale securities table above but are included in marketable securities in the consolidated balance sheets.

Unrealized gains and unrealized temporary losses on investments classified as available-for-sale are included within accumulated other comprehensive loss in the consolidated balance sheets. Upon realization, those amounts are reclassified from accumulated other comprehensive loss to interest income in the statements of income. As of March 31, 2016, the Company held for investment corporate bonds with a fair value of $76.4 million, which are classified as available-for-sale marketable securities and had been in a continuous unrealized loss position for more than 12 months. The unrealized losses are not significant and are attributable to changes in interest rates. The Company does not believe any unrealized losses represent other than temporary impairments based on the evaluation of available evidence. As of December 31, 2015, the Company held for investment corporate bonds with a fair value of $71.4 million that had been in a continuous unrealized loss position for more than 12 months.

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The following table details the fair value measurements within the fair value hierarchy of the Company's financial assets at March 31, 2016 and December 31, 2015 (in thousands):

	Total Fair Value	Fair Value Measurements at Reporting Date Using		
		Level 1	Level 2	Level 3
As of March 31, 2016				
Cash Equivalents and Marketable Securities:				
Money market funds	$22,035	$ 22,035	$ —	$ —
Commercial paper	2,494	—	2,494	—
Corporate bonds	963,629	—	963,629	—
U.S. government agency obligations	241,578	—	241,578	—
Mutual funds	2,619	2,619	—	—
	$1,232,355	$ 24,654	$ 1,207,701	$ —
As of December 31, 2015				
Cash Equivalents and Marketable Securities:				
Money market funds	$1,250	$ 1,250	$ —	$ —
Commercial paper	2,487	—	2,487	—
Corporate bonds	991,808	—	991,808	—
U.S. government agency obligations	239,053	—	239,053	—
Mutual funds	1,414	1,414	—	—
	$1,236,012	$ 2,664	$ 1,233,348	$ —

As of March 31, 2016 and December 31, 2015, the Company grouped money market funds and mutual funds using a Level 1 valuation because market prices for such investments are readily available in active markets. As of March 31, 2016 and December 31, 2015, the Company grouped commercial paper, corporate bonds and U.S. government agency obligations using a Level 2 valuation because quoted prices for identical or similar assets are available in markets that are inactive. The Company did not have any transfers of assets between Level 1, Level 2 or Level 3 of the fair value measurement hierarchy during the three months ended March 31, 2016.

When developing fair value estimates, the Company maximizes the use of observable inputs and minimizes the use of unobservable inputs. When available, the Company uses quoted market prices to measure fair value. The valuation technique used to measure fair value for the Company's Level 1 and Level 2 assets is a market approach, using prices and other relevant information generated by market transactions involving identical or comparable assets. If market prices are not available, the fair value measurement is based on models that use primarily market-based parameters including yield curves, volatilities, credit ratings and currency rates. In certain cases where market rate assumptions are not available, the Company is required to make judgments about assumptions market participants would use to estimate the fair value of a financial instrument.

Contractual maturities of the Company's available-for-sale marketable securities held as of March 31, 2016 and December 31, 2015 were as follows (in thousands):

	March 31, 2016	December 31, 2015
Due in 1 year or less	$524,958	$ 460,088
Due after 1 year through 5 years	682,743	773,260
	$1,207,701	$ 1,233,348

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3. Accounts Receivable

Net accounts receivable consisted of the following as of March 31, 2016 and December 31, 2015 (in thousands):

	March 31, 2016	December 31, 2015
Trade accounts receivable	$267,809	$ 262,885
Unbilled accounts receivable	106,674	124,878
Gross accounts receivable	374,483	387,763
Allowance for doubtful accounts	(1,189)	(906)
Reserve for cash-basis customers	(8,191)	(6,458)
Total accounts receivable reserves	(9,380)	(7,364)
Accounts receivable, net	$365,103	$ 380,399

4. Goodwill and Acquired Intangible Assets

The change in the carrying amount of goodwill for the three months ended March 31, 2016 was as follows (in thousands):

Balance as of January 1, 2016	$1,150,244
Foreign currency translation	2,132
Balance as of March 31, 2016	$1,152,376

The Company tests goodwill for impairment at least annually. Through the date the consolidated financial statements were issued, no triggering events had occurred that would indicate a potential impairment exists.

Acquired intangible assets that are subject to amortization consisted of the following as of March 31, 2016 and December 31, 2015 (in thousands):

	March 31, 2016			December 31, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Completed technology	$120,791	$ (61,792)	$58,999	$120,791	$ (58,633)	$62,158
Customer-related intangible assets	191,710	(105,705)	86,005	191,710	(102,872)	88,838
Non-compete agreements	6,540	(3,949)	2,591	6,540	(3,374)	3,166
Trademarks and trade names	3,700	(1,916)	1,784	3,700	(1,767)	1,933
Acquired license rights	490	(490)	—	490	(490)	—
Total	$323,231	$ (173,852)	$149,379	$323,231	$ (167,136)	$156,095

Aggregate expense related to amortization of acquired intangible assets for the three months ended March 31, 2016 and 2015 was $6.7 million and $6.8 million, respectively. Based on the Company’s acquired intangible assets as of March 31, 2016, aggregate expense related to amortization of acquired intangible assets is expected to be $19.8 million for the remainder of 2016, and $27.8 million, $23.7 million, $21.7 million and $17.7 million for 2017, 2018, 2019 and 2020, respectively.

5. Convertible Senior Notes

In February 2014, the Company issued $690.0 million in par value of convertible senior notes due 2019 (the "Notes"). The Notes are senior unsecured obligations of the Company, do not bear regular interest and mature on February 15, 2019, unless repurchased or converted prior to maturity.

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At their option, holders may convert their Notes prior to the close of business on the business day immediately preceding August 15, 2018 only under the following circumstances:

- during any calendar quarter commencing after the calendar quarter ended June 30, 2014 (and only during such calendar quarter), if the last reported sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during the period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day; or

- during the five business day period after any five consecutive trading day period in which the trading price per $1,000 principal amount of Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the conversion rate on each such trading day; or upon the occurrence of specified corporate events.

On or after August 15, 2018, holders may convert all or any portion of their Notes at any time prior to the close of business on the second scheduled trading day immediately preceding the maturity date, regardless of the foregoing circumstances.

Upon conversion, the Company, at its election, may pay or deliver to holders cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock. The initial conversion rate is 11.1651 shares of the Company's common stock per $1,000 principal amount, which is equivalent to an initial conversion price of approximately $89.56 per share, subject to adjustments in certain events, and represents a potential conversion into 7.7 million shares.

In accounting for the issuance of the Notes, the Company separated the Notes into liability and equity components. The carrying cost of the liability component was calculated by measuring the fair value of a similar debt obligation that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the par value of the Notes. The difference between the principal amount of the Notes and the proceeds allocated to the liability component (“debt discount”) is amortized to interest expense using the effective interest method over the term of the Notes. The equity component is recorded in additional paid-in capital in the consolidated balance sheet and will not be remeasured as long as it continues to meet the conditions for equity classification.

In accounting for the transaction costs related to the issuance of the Notes, the Company allocated the total transaction costs incurred to the liability and equity components based on their relative values. Transaction costs attributable to the liability component are being amortized to interest expense over the term of the Notes, and transaction costs attributable to the equity component are netted with the equity component of the Notes in stockholders’ equity.

The Notes consist of the following components (in thousands):

	March 31, 2016	December 31, 2015
Liability component:		
Principal	$ 690,000	