AKAMAI TECHNOLOGIES INC
Form 10-Q
August 09, 2011
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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 June 30, 2011

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 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 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 (Do not check if a smaller reporting company)	Smaller reporting company o

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 August 4, 2011: 184,377,298 shares.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	June 30, 2011	December 31, 2010
	(In thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$205,629	$231,866
Marketable securities (including restricted securities of $51 and $272 at June 30, 2011 and December 31, 2010, respectively)	291,647	375,005
Accounts receivable, net of reserves of $4,914 and $5,232 at June 30, 2011 and December 31, 2010, respectively	178,260	175,366
Prepaid expenses and other current assets	47,348	48,029
Deferred income tax assets	28,069	28,201
Total current assets	750,953	858,467
Property and equipment, net	274,377	255,929
Marketable securities (including restricted securities of $45 at June 30, 2011 and December 31, 2010)	788,197	636,531
Goodwill	452,914	452,914
Other intangible assets, net	53,887	62,456
Deferred income tax assets	74,281	75,226
Other assets	9,540	11,153
Total assets	$2,404,149	$2,352,676
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$29,053	$26,375
Accrued expenses and other current liabilities	86,909	94,661
Deferred revenue	22,412	23,808
Accrued restructuring	334	307
Total current liabilities	138,708	145,151
Other liabilities	33,693	26,278
Deferred revenue	3,433	3,642
Total liabilities	175,834	175,071
Commitments, contingencies and guarantees (Note 15)		
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; 194,324,558 shares issued and 185,981,780 shares outstanding at June 30, 2011 and 192,383,121 shares issued and 186,603,380 outstanding at December 31, 2010	1,944	1,924
Additional paid-in capital	5,009,667	4,970,278
Accumulated other comprehensive income (loss)	298	(5,741)

Treasury stock, at cost, 8,342,778 shares at June 30, 2011 and 5,779,741 shares at December 31, 2010	(251,537)	(158,261)
Accumulated deficit	(2,532,057)	(2,630,595)
Total stockholders’ equity	2,228,315	2,177,605
Total liabilities and stockholders’ equity	$2,404,149	$2,352,676

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

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	2010	2011	2010
	(In thousands, except per share data)			
Revenues	$276,989	$245,318	$552,942	$485,347
Costs and operating expenses:				
Cost of revenues	89,647	71,840	178,715	139,314
Research and development	11,006	13,577	23,600	26,756
Sales and marketing	52,837	55,203	106,202	104,871
General and administrative	45,975	43,707	89,876	83,257
Amortization of other intangible assets	4,292	4,152	8,569	8,260
Total costs and operating expenses	203,757	188,479	406,962	362,458
Income from operations	73,232	56,839	145,980	122,889
Interest income	3,021	3,262	5,972	6,512
Interest expense	—	(618)	—	(1,327)
Other (expense) income, net	(107)	122	(1,142)	47
Gain on investments, net	75	127	84	248
Loss on early extinguishment of debt	—	(294)	—	(294)
Income before provision for income taxes	76,221	59,438	150,894	128,075
Provision for income taxes	28,300	21,315	52,356	49,074
Net income	$47,921	$38,123	$98,538	$79,001
Net income per weighted average share:				
Basic	$0.26	$0.22	$0.53	$0.46
Diluted	$0.25	$0.20	$0.52	$0.42
Shares used in per share calculations:				
Basic	186,612	173,317	186,731	172,209
Diluted	190,179	190,479	190,781	189,746

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

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AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the Six Months Ended June 30,	
	2011	2010
	(In thousands)	
Cash flows from operating activities:		
Net income	$98,538	$79,001
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	82,467	67,634
Stock-based compensation expense	27,324	39,384
Provision for deferred income taxes, net	—	44,611
Amortization of deferred financing costs	—	394
Provision for doubtful accounts	454	1,445
Excess tax benefits from stock-based compensation	(10,850)	(12,923)
Loss on investments and disposal of property and equipment, net	4	(245)
Non-cash portion of loss on early extinguishment of debt	—	294
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	456	(16,406)
Prepaid expenses and other current assets	841	(40,284)
Accounts payable, accrued expenses and other current liabilities	(5,713)	11,878
Deferred revenue	(2,182)	(1,319)
Accrued restructuring	(32)	(93)
Other non-current assets and liabilities	9,052	762
Net cash provided by operating activities	200,359	174,133
Cash flows from investing activities:		
Cash paid for acquisition of business, net of cash acquired	(550)	(12,010)
Purchases of property and equipment	(68,525)	(86,446)
Capitalization of internal-use software costs	(20,450)	(14,841)
Purchases of short- and long-term marketable securities	(578,135)	(614,679)
Proceeds from sales of short- and long-term marketable securities	272,709	274,620
Proceeds from maturities of short- and long-term marketable securities	238,428	230,102
Increase in other investments	—	(500)
Proceeds from the sale of property and equipment	88	38
Decrease in restricted investments held for security deposits	221	8
Net cash used in investing activities	(156,214)	(223,708)
Cash flows from financing activities:		
Proceeds from the issuance of common stock under stock option and employee stock purchase plans	12,122	20,993
Excess tax benefits from stock-based compensation	10,850	12,923
Employee taxes paid related to net share settlement of equity awards	(3,507)	—
Repurchases of common stock	(92,613)	(42,621)
Net cash used in financing activities	(73,148)	(8,705)
Effects of exchange rate changes on cash and cash equivalents	2,766	(2,519)
Net decrease in cash and cash equivalents	(26,237)	(60,799)
Cash and cash equivalents at beginning of period	231,866	181,305
Cash and cash equivalents at end of period	$205,629	$120,506
Supplemental disclosure of cash flow information:		

Cash paid for income taxes	$17,898	$22,130
Cash paid for interest	—	966
Non-cash financing and investing activities:		
Capitalization of stock-based compensation, net of impairments	$3,465	$3,679
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)

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

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, 2010, filed with the Securities and Exchange Commission on March 1, 2011.

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 December 2010, the Financial Accounting Standards Board ("FASB") issued an accounting standard update for business combinations specifically related to the disclosure of supplementary pro forma information for business combinations. This guidance specifies that pro forma disclosures should be reported as if the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period, and the pro forma disclosures must include a description of material, nonrecurring pro forma adjustments. This standard was effective for business combinations with an acquisition date of January 1, 2011 or later. The adoption of the guidance did not have an impact on the Company's financial position or results of operations.

In May 2011, the FASB issued amended guidance and disclosure requirements for fair value measurements. This guidance provides a consistent definition of fair value and ensures that the fair value measurement and disclosure requirements are similar between U.S. GAAP and international financial reporting standards. The guidance changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. This standard will be effective for interim and annual periods beginning after December 15, 2011 and will be applied prospectively. The adoption of the guidance is not expected to have a material impact on the Company's consolidated financial statements.

In June 2011, the FASB issued amended disclosure requirements for the presentation of comprehensive income. The amended guidance eliminates the option to present components of other comprehensive income ("OCI") as part of the statement of changes in equity. Under the amended guidance, all changes in OCI are to be presented either in a single continuous statement of comprehensive income or in two separate but consecutive financial statements. The changes will be effective January 1, 2012 and early adoption is permitted. There will be no impact to the Company's consolidated financial results as the amendments relate only to changes in financial statement presentation.

3. Business Acquisition

In June 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. In addition, the Company recorded a liability of $2.4 million for contingent consideration related to the expected achievement of certain post-closing milestones. During the three months ended June 30, 2011, the Company made a final payment of $0.4 million related to the contingent consideration. The acquisition of substantially all of the assets of Velocitude was intended to further Akamai's strategic position in the mobile market and was accounted for using the purchase 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.

4. Marketable Securities and Investments

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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.

The following is a summary of marketable securities held at June 30, 2011 and December 31, 2010 (in thousands):

		Gross Unrealized			Classification on Balance Sheet	
As of June 30, 2011	Cost	Gains	Losses	Aggregate Fair Value	Short-term Marketable Securities	Long-term Marketable Securities
Available-for-sale securities:						
Certificates of deposit	$96	$—	$—	$96	$51	$45
Commercial paper	9,998	1	—	9,999	9,999	—
U.S. corporate debt securities	741,009	2,270	(273)	743,006	270,470	472,536
U.S. government agency obligations	202,563	211	(135)	202,639	11,127	191,512
Auction rate securities	136,350	—	(12,246)	124,104	—	124,104
	$1,090,016	$2,482	$(12,654)	$1,079,844	$291,647	$788,197

		Gross Unrealized			Classification on Balance Sheet	
As of December 31, 2010	Cost	Gains	Losses	Aggregate Fair Value	Short-term Marketable Securities	Long-term Marketable Securities
Available-for-sale securities:						
Certificates of deposit	$96	$—	$—	$96	$51	$45
Commercial paper	59,912	34	(2)	59,944	59,944	—
U.S. corporate debt securities	651,855	1,416	(736)	652,535	301,625	350,910
U.S. government agency obligations	161,722	102	(119)	161,705	13,385	148,320
Auction rate securities	150,800	—	(13,544)	137,256	—	137,256
	$1,024,385	$1,552	$(14,401)	$1,011,536	$375,005	$636,531

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. Realized gains and losses and gains and losses on other-than-temporary impairments on investments are reflected in the income statement as gain (loss) on investments, net. As of June 30, 2011, the Company had recorded $136.4 million of auction rate securities ("ARS") at cost with gross unrealized 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, 2011 and December 31, 2010 (in thousands):

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	Total Fair Value at June 30, 2011	Fair Value Measurements at Reporting Date Using Level 1	Level 2	Level 3
Money market funds	$ 31,495	$31,495	$—	$—
Certificates of deposit	96	96	—	—
Commercial paper	9,999	—	9,999	—
U.S. corporate debt securities	743,006	—	743,006	—
U.S. government agency obligations	202,639	—	202,639	—
Auction rate securities	124,104	—	—	124,104
	$ 1,111,339	$31,591	$955,644	$124,104

	Total Fair Value at December 31, 2010	Fair Value Measurements at Reporting Date Using Level 1	Level 2	Level 3
Money market funds	$ 55,648	$55,648	$—	$—
Certificates of deposit	96	96	—	—
Commercial paper	59,944	—	59,944	—
U.S. corporate debt securities	652,535	—	652,535	—
U.S. government agency obligations	161,705	—	161,705	—
Auction rate securities	137,256	—	—	137,256
	$ 1,067,184	$55,744	$874,184	$137,256

The following tables reflect the activity for the Company’s major classes of financial assets measured at fair value using Level 3 inputs, consisting solely of ARS, for the six month periods ended June 30, 2011 and 2010 (in thousands):

	Auction Rate Securities
Balance as of December 31, 2010	$137,256
Redemptions of securities	(14,450)
Unrealized gain included in accumulated other comprehensive income (loss), net	1,298
Balance as of June 30, 2011	$124,104

	Auction Rate Securities	Put Option Related to Auction Rate Securities	Total
Balance as of December 31, 2009	$244,505	$9,614	$254,119
Redemptions 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, 2011, 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, 2011, 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, 2011, the Company’s assets grouped using a Level 3 valuation consisted of ARS.
Historically, the carrying value (par value) of the Company’s ARS holdings approximated fair market value due to the

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resetting of variable interest rates in a “Dutch auction” process. Beginning in mid-February 2008 and continuing throughout the period ended June 30, 2011, 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, 2011 assumed a weighted average discount rate of 2.97% and expected term of five years. The discount rate was determined using a proxy based upon the current market rates for recent debt offerings. The expected term was based on management’s estimate of future liquidity. As a result, as of June 30, 2011, the Company has estimated an aggregate loss of $12.2 million, which was related to the impairment of ARS deemed to be temporary and included in accumulated other comprehensive income (loss) within stockholders’ equity. The discounted cash flow analysis performed as of December 31, 2010 for ARS assumed a weighted average discount rate of 3.21% and expected term of five years. As a result, as of that date, the Company estimated an aggregate loss of $13.5 million, which was related to the impairment of ARS deemed to be temporary and included in accumulated other comprehensive income (loss) within stockholders’ equity.

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, the Company does not believe it will 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, cash equivalents and other marketable securities on-hand and from expected operating cash flows to fund its operations.

As of June 30, 2011 and December 31, 2010, the Company classified $124.1 million and $137.3 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 succeeding twelve months.

Contractual maturities of the Company’s marketable securities held at June 30, 2011 and December 31, 2010 were as follows (in thousands):

	June 30, 2011	December 31, 2010
Available-for-sale securities:		
Due in 1 year or less	$291,647	$375,005
Due after 1 year through 5 years	664,093	499,275
Due after 10 years	124,104	137,256
	$1,079,844	$1,011,536

5. Accounts Receivable

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

	June 30, 2011	December 31, 2010
Trade accounts receivable	$124,235	$116,212
Unbilled accounts	58,939	64,386
Gross accounts receivable	183,174	180,598
Allowance for doubtful accounts	(1,382)	(1,329)
Reserve for cash-basis customers	(3,532)	(3,903)
Total accounts receivable reserves	(4,914)	(5,232)
Accounts receivable, net	$178,260	$175,366

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

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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, 2011	December 31, 2010
Payroll and other related benefits	$23,083	$51,591
Bandwidth and co-location	20,299	21,787
Property, use and other taxes	36,748	15,849
Professional service fees	5,505	2,678
Contingent consideration	—	990
Other	1,274	1,766
Total	$86,909	$94,661

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

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	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	2010	2011	2010
Numerator:				
Net income	$47,921	$38,123	$98,538	$79,001
Add back of interest expense on 1% convertible senior notes (net of tax)	—	396	—	818
Numerator for diluted net income per common share	$47,921	$38,519	$98,538	$79,819
Denominator:				
Denominator for basic net income per common share	186,612	173,317	186,731	172,209
Effect of dilutive securities:				
Stock options	2,810	3,992	3,081	3,717
Effect of escrow contingencies	—	339	—	339
RSUs and deferred stock units	757	1,396	969	1,299
Assumed conversion of 1% convertible senior notes	—	11,435	—	12,182
Denominator for diluted net income per common share	190,179	190,479	190,781	189,746
Basic net income per common share	$0.26	$0.22	$0.53	$0.46
Diluted net income per common share	$0.25	$0.20	$0.52	$0.42

Outstanding options to acquire an aggregate of 2.5 million and 1.1 million shares of common stock for the three months ended June 30, 2011 and 2010, 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. As a result, the effect of including these options would be anti-dilutive. Similarly, outstanding options to acquire an aggregate of 2.1 million and 1.6 million shares of common stock for the six months ended June 30, 2011 and 2010, respectively, were excluded from the calculation of diluted earnings per share because the exercise prices of the stock options were greater than the average market price of the Company's common stock during the respective periods. Additionally, 2.9 million and 3.0 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, 2011, respectively, and 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, 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 $150.0 million of the Company’s common stock from time to time over the next twelve months commencing in May 2010 on the open market or in privately negotiated transactions. The unused balance from the May 2010 extension was not carried forward for future purchases. On April 19, 2011, the Company’s Board of Directors authorized a new program authorizing up to an additional $150.0 million of repurchases over the next twelve months commencing in May 2011. On August 8, 2011, the Company's Board of Directors authorized an additional $250.0 million of stock repurchases over the twelve month period that commenced in May 2011. The total authorized funding for stock repurchases in that twelve month period is now $400.0 million. 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. Repurchases may also be made under a Rule 10b5-1 plan, which would permit the Company to repurchase shares when the Company might otherwise be precluded from doing so under insider trading laws. Subject to applicable securities laws, the Company may choose to suspend or discontinue the repurchase program at any time.

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During the three and six months ended June 30, 2011, the Company repurchased 1.5 million and 2.6 million shares, respectively, of its common stock for $50.5 million and $93.3 million, respectively. During the three and six months ended June 30, 2010, the Company repurchased 0.5 million and 1.4 million shares, respectively, of its common stock for $20.4 million and $42.3 million, respectively. As of June 30, 2011, the Company had $111.1 million remaining available for future purchases of shares under the current repurchase program.

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, 2011 and 2010 (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	2010	2011	2010
Stock-based compensation expense by type of award:				
Stock options	$3,420	$3,628	$7,206	$7,397
Deferred stock units	1,885	1,885	1,885	1,885
RSUs	6,528	15,909	18,648	31,593
Shares issued under the Employee Stock Purchase Plan	1,420	1,056	3,050	2,188
Amounts capitalized as internal-use software	(1,641)	(2,202)	(3,465)	(3,679)
Total stock-based compensation before income taxes	11,612	20,276	27,324	39,384
Less: Income tax benefit	(4,311)	(7,271)	(9,373)	(14,999)
Total stock-based compensation, net of taxes	$7,301	$13,005	$17,951	$24,385
Effect of stock-based compensation on income by line item:				
Cost of revenues	$590	$707	$1,145	$1,408
Research and development expense	2,124	3,542	4,886	7,535
Sales and marketing expense	5,315	8,776	12,161	17,800
General and administrative expense	3,583	7,251	9,132	12,641
Provision for income taxes	(4,311)	(7,271)	(9,373)	(14,999)
Total cost related to stock-based compensation, net of taxes	$7,301	$13,005	$17,951	$24,385

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, 2011 also included stock-based compensation reflected as a component of amortization of capitalized internal-use software; such additional stock-based compensation was $1.9 million and $4.0 million, respectively, before tax. 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.

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,	
	2011	2010	2011	2010
Net income	$47,921	$38,123	$98,538	$79,001
Other comprehensive income (loss):				
Foreign currency translation adjustments	1,782	(3,094)	4,388	(4,880)
Change in unrealized gain (loss) on investments, net	1,580	3,980	2,677	3,989
Income tax expense related to unrealized gain (loss) on investments, net	(605)	(1,542)	(1,025)	(1,545)
Other comprehensive income (loss)	2,757	(656)	6,040	(2,436)

Comprehensive income	$50,678	$37,467	$104,578	$76,565

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

	June 30, 2011	December 31, 2010
Foreign currency translation adjustment	$6,491	$2,103
Net unrealized gain (loss) on investments, net of tax of $3,979 at June 30, 2011 and $5,005 at December 31, 2010	(6,193)	(7,844)
Total accumulated other comprehensive income (loss)	$298	$(5,741)

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. 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):

	June 30, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Completed technology	$36,731	$(19,599)	$17,132
Customer relationships	88,700	(55,660)	33,040
Non-compete agreements	8,340	(4,670)	3,670
Trademarks and trade names	800	(755)	45
Acquired license rights	490	(490)	—
Total	$135,061	$(81,174)	$53,887

	December 31, 2010		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Completed technology	$36,731	$(16,520)	$20,211
Customer relationships	88,700	(50,832)	37,868
Non-compete agreements	8,340	(4,070)	4,270
Trademarks and trade names	800	(693)	107
Acquired license rights	490	(490)	—
Total	$135,061	$(72,605)	$62,456

Aggregate expense related to amortization of other intangible assets for the three months ended June 30, 2011 and 2010 was $4.3 million and $4.2 million, respectively. For the six months ended June 30, 2011 and 2010, aggregate expense related to the amortization of other intangible assets was $8.6 million and $8.3 million, respectively. Based on the Company’s other intangible assets as of June 30, 2011, aggregate expense related to amortization of other intangible assets is expected to be $8.3 million for the remainder of 2011, and $15.9 million, $13.1 million, $7.6 million and $5.1 million for fiscal years 2012, 2013, 2014 and 2015, 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, 2011 and December 31, 2010, the Company held ARS, with an estimated fair value of $124.1 million and $137.3 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 2011. As of June 30, 2011, the Company had recorded a pre-tax cumulative unrealized loss of $12.2 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

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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. No customer accounted for more than 10% of the Company's accounts receivable as of June 30, 2011. As of December 31, 2010, one customer had an account receivable balance that represented greater than 10% of the Company's accounts receivable. The Company believes that, at June 30, 2011, concentration of credit risk related to accounts receivable is not significant.

12. 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, 2011, 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, 2011, the Company had $180.2 million and $94.2 million of property and equipment, net of accumulated depreciation, located in the United States and in foreign locations, respectively. As of December 31, 2010, the Company had $174.9 million and $81.0 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 located both domestically and abroad. For the each of the three and six month periods ended June 30, 2011 and 2010 approximately 30% and 28%, respectively, of the Company's revenues were derived from operations located outside of the United States, including 18% derived from Europe during each of such periods. No single country outside the United States accounted for 10% or more of revenues during these periods. For each of the three and six month periods ended June 30, 2011 and 2010, no customer accounted for 10% or more of total revenues.

13. Income Taxes

The Company's effective income tax rate, including discrete items, was 34.7% and 38.3% for the six months ended June 30, 2011 and 2010, respectively. The effective income tax rate is based upon 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 the Company's Employee Stock Purchase Plan. For the six months ended June 30, 2011, the effective income tax rate was lower than the federal statutory tax rate mainly due to the composition of income in foreign jurisdictions that is taxed at lower rates compared to the statutory tax rates in the United States. For the six months ended June 30, 2010, the effective income tax rate was 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.

14. Forward Currency Contracts

Substantially all of the Company's foreign subsidiaries use the local currency of its respective countries as its functional currency. Assets and liabilities are translated at exchange rates prevailing at the balance sheet dates. Revenues, costs and expenses are translated at the average exchange rates for the reported period. Gains and losses resulting from translation are recorded as a component of accumulated other comprehensive income (loss) within stockholders' equity. Gains and losses resulting from foreign currency transactions are recognized as other (expense) income, net within the statement of operations.

The Company enters into short-term foreign currency forward contracts to offset the foreign exchange gains and losses generated by the re-measurement of certain assets and liabilities recorded in non-functional currencies. Changes in the fair value of these derivatives, as well as re-measurement gains and losses, are recognized in current earnings in other (expense) income, net. The fair value of the forward currency contracts are included on the balance sheet in prepaid expenses and other current assets. For the three and six months ended June 30, 2011, the underlying net loss was deemed to be immaterial.

The Company's foreign currency forward contracts include credit risk to the extent that its counterparties may be unable to meet the terms of the agreements. The Company minimizes counterparty credit (or repayment) risk by entering into transactions only with major financial institutions of investment grade credit rating.

15. Commitments, Contingencies and Guarantees

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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, 2011 were as follows (in thousands):

	Operating Leases
Remaining 2011	$12,239
2012	23,177
2013	21,418
2014	20,356
2015	19,632
Thereafter	56,419
Total	$153,241

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 2011 and for the years ending December 31, 2012, 2013 and 2014, the minimum commitments pursuant to these contracts in effect as of June 30, 2011, are $52.9 million, $27.6 million, $2.1 million and $0.2 million, respectively. In addition, as of June 30, 2011, the Company had entered into purchase orders with various vendors for aggregate purchase commitments of $80.4 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 lead plaintiffs filed a motion for final approval of a new 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 the lead 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 by certain objecting plaintiffs. 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, 2011.

In addition, on or about October 3, 2007, a purported Akamai shareholder, Vanessa Simmonds, 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 Securities 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). The Company 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. Ms. Simmonds appealed. On December 2, 2010, the Ninth Circuit Court of Appeals affirmed the District Court's decision to dismiss the moving issuers' cases (including the Company's) on the grounds that plaintiff's demand letters were insufficient to put the issuers on notice of the claims asserted against them and further ordered that the dismissals be made with prejudice. The Ninth Circuit, however, reversed and remanded the District Court's decision on the underwriters' motion to dismiss as to the claims arising from the non-moving issuers' IPOs, finding plaintiff's claims were not time-barred under the applicable statute of limitations. On January 18, 2011, the Ninth Circuit denied various parties' petitions for rehearing and for rehearing en banc but stayed its rulings to allow for appeals to the United States Supreme Court. On April 5, 2011, Ms. Simmonds filed a Petition for Writ of Certiorari with the U.S. Supreme Court seeking reversal of the Ninth Circuit's decision relating to the adequacy of the pre-suit demand. On April 15, 2011, underwriter defendants filed a Petition for Writ of Certiorari with the U.S. Supreme Court seeking reversal of the Ninth Circuit's decision relating to the statute of limitation issue. On June 27, 2011, the Supreme Court denied Simmonds' petition regarding the demand issue and granted the underwriters' petition relating to the statute of limitations issue. 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, 2011.

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 a 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 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, 2011 was determined to be immaterial.

16. Subsequent Event

On August 8, 2011, the Company's Board of Directors authorized an additional $250.0 million of stock repurchases over the twelve month period that commenced in May 2011. The total authorized funding for stock repurchases in that twelve month period is now $400.0 million.

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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 i 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 that apply to actual usage above the monthly minimum. In recent years, however, we have also entered into 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 limiting the impact of price reductions reflected in contract renewals 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.

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,	
	2011	2010	2011	2010
Revenues	100.0 %	100.0 %	100.0 %	100.0 %
Cost of revenues	32.4	29.3	32.3	28.7
Research and development expense	4.0	5.5	4.3	5.5
Sales and marketing expense	19.1	22.5	19.2	21.6
General and administrative expense	16.6	17.8	16.3	17.2
Amortization of other intangible assets	1.5	1.7	1.5	1.7
Total cost and operating expenses	73.6	76.8	73.6	74.7
Income from operations	26.4	23.2	26.4	25.3
Interest income	1.1	1.3	1.1	1.3
Interest expense	—	(0.3)	—	(0.2)
Other (expense) income, net	—	—	(0.2)	—
Gain on investments, net	—	0.1	—	0.1
Loss on early extinguishment of debt	—	(0.1)	—	(0.1)
Income before provision for income taxes	27.5	24.2	27.3	26.4
Provision for income taxes	10.2	8.7	9.5	10.1
Net income	17.3 %	15.5 %	17.8 %	16.3 %

We were profitable for the fiscal year 2010 and for the six months ended June 30, 2011; however, we cannot guarantee continued profitability or profitability for any period in the future at the levels we have recently experienced. 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 2011, we were able to offset lost committed recurring revenue due to customer cancellations, terminations or price reductions by adding new customers and increasing the number of services, features

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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 further declines in the prices we charge. If we do not offset lost committed revenue in this manner, our revenues will decrease.

- During each of the first two quarters of 2011, unit prices offered to some new and existing customers declined, primarily as a result of competition from new and established competitors. These price reductions primarily impacted customers for which we deliver high volumes of traffic over our network, such as digital media customers. 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 or increased sales of value-added services to customers, our revenues and profit margins could decrease.
- 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.
- In the first two quarters of 2011, we experienced a moderation in the rate of traffic growth in our volume-driven solutions as compared to the second half of 2010. If this trend continues, our ability to generate revenue growth could be impacted.
- During the first two quarters of 2011, 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 the first two quarters of 2011 as compared to the same periods in 2010. We believe that our overall bandwidth costs will continue to increase 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 2011.
- In recent quarters, we have seen co-location costs increase and become a higher percentage of total cost of revenues due to the expansion of our network. Continuation of this trend may negatively impact our profitability.
- During each of the first two quarters of 2011, revenues derived from customers outside the United States accounted for 30% of our total revenues. For the remainder 2011, we anticipate revenues from such customers as a percentage of our total revenues to be consistent with each of the first two quarters.
- Depreciation and amortization expense related to our network equipment and internal-use software development costs increased during each of the first two quarters of 2011 as compared to the same quarters in 2010. Due to expected future purchases of network equipment during 2011, we believe that depreciation expense, as well as co-location costs, related to our network equipment will continue to increase in 2011. We expect to continue to enhance and add functionality to our service offerings and capitalize stock-based compensation expense attributable to employees working on such projects, which would increase the amount of capitalized internal-use software costs. As a result, we believe that the amortization of internal-use software development costs, which we include in cost of revenues, will be higher in 2011 as compared to 2010. All of these increased costs could negatively affect our profitability.
- For the three and six months ended June 30, 2011, our stock-based compensation expense was $11.6 million and $27.3 million, respectively, as compared to $20.3 million and $39.4 million, respectively, for the three and six months ended June 30, 2010. The decrease in stock-based compensation expense for the three and six months ended June 30, 2011 as compared to the same periods in 2010 was primarily due to management's assessment, as of June 30, 2011, that certain outstanding restricted stock units, or RSUs, with performance-based vesting conditions will not vest because the associated performance targets are unlikely to be met. We expect that stock-based compensation expense for 2011 will decrease as compared to 2010, related to this change in management's assessment of the expected vesting of the RSUs granted in prior periods. As of June 30, 2011, our total pre-tax unrecognized compensation costs for stock-based awards

were $108.0 million, which we expect to recognize as expense over a weighted average period of 1.3 years through 2015.

- As of June 30, 2011, we held $136.4 million in par value of auction rate securities, which we refer to as ARS. Based upon our cash, cash equivalents and marketable securities balance of $1.3 billion at June 30, 2011 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 2011. 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, 2011, our effective income tax rate was 34.7%. We expect our annual effective income tax rate in 2011 to remain relatively consistent in the remaining quarters of 2011; this expectation does not take into consideration the effect of discrete items such as those relating to stock-based compensation. In 2010, due to our continued utilization of available net operating losses, or NOLs, and tax credit carryforwards, our tax payments were significantly lower than our recorded income tax provision. We expect to utilize substantially all of our tax credit

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carryforwards in 2011. Once we have done so, the amount of cash tax payments we make will 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 2011; however, our future results are likely to be affected by the factors discussed in the paragraphs above as well as those 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 and co-location 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 we have prepared 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 are 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, 2010 for further discussion of our critical accounting policies and estimates.

Recent Accounting Pronouncements

In December 2010, the Financial Accounting Standards Board ("FASB") issued an accounting standard update for business combinations specifically related to the disclosure of supplementary pro forma information for business combinations. This guidance specifies that pro forma disclosures should be reported as if the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period, and the pro forma disclosures must include a description of material, nonrecurring pro forma adjustments. This standard was effective for business combinations with an acquisition date of January 1, 2011 or later. The adoption of the guidance did not have an impact on our financial position or results of operations.

In May 2011, the FASB issued amended guidance and disclosure requirements for fair value measurements. This guidance provides a consistent definition of fair value and ensures that the fair value measurement and disclosure requirements are similar between U.S. GAAP and international financial reporting standards. The guidance changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. This standard will be effective for interim and annual periods beginning after December 15, 2011 and will be applied prospectively. The adoption of the guidance is not expected to have a material impact on our consolidated financial statements.

In June 2011, the FASB issued amended disclosure requirements for the presentation of comprehensive income. The amended guidance eliminates the option to present components of other comprehensive income ("OCI") as part of the statement of changes in equity. Under the amended guidance, all changes in OCI are to be presented either in a single continuous statement of comprehensive income or in two separate but consecutive financial statements. The changes will be effective January 1, 2012 and early adoption is permitted. There will be no impact on our consolidated financial results as the amendments relate only to changes in financial statement presentation.

Results of Operations

Revenues. Total revenues increased 13%, or $31.7 million to $277.0 million for the three months ended June 30, 2011 as compared to $245.3 million for the three months ended June 30, 2010. For the six months ended June 30, 2011, revenues increased 14%, or $67.6 million, to $552.9 million as compared to $485.3 million for the six months ended June 30, 2010. The following

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table quantifies the contribution to growth in revenues during the periods presented from the different industry verticals in which we sell our services (in millions):

	For the Three Months Ended June 30, 2011 as compared to 2010	For the Six Months Ended June 30, 2011 as compared to 2010
Media & Entertainment	$11.2	$26.3
Commerce	10.1	21.9
Enterprise	8.2	16.8
High Tech	0.6	(1.0)
Public Sector	1.6	3.6
Total net increase	$31.7	$67.6

A significant portion of the increase in revenues for the three and six months ended June 30, 2011 as compared to the same periods in 2010 was driven by traffic growth from customers in our media and entertainment vertical. The revenues from this traffic growth were partially offset by reduced prices charged to our customers. The increase in revenues from our commerce and enterprise customers was principally due to increased purchases of value-added services. Revenues from our high tech vertical remained relatively flat as increased demand for value-added solutions offset the decline in software download revenues. The increase in revenues from public sector customers was primarily attributable to entering into new contracts with government agencies.

For each of the three and six month periods ended June 30, 2011 and 2010, approximately 30% and 28%, respectively, of our revenues were derived from our operations located outside of the United States, including 18% derived from Europe during each of the three and six month periods ended June 30, 2011 and June 30, 2010. 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 month periods ended June 30, 2011 and 2010, resellers accounted for 19% of revenues. For each of the three and six month periods ended June 30, 2011 and 2010, no customer accounted for 10% or more of revenues.

Cost of Revenues. Cost of revenues was comprised of the following (in millions) for the periods presented:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	2010	2011	2010
Bandwidth and service-related fees	$19.7	$18.6	$41.7	$37.1
Co-location fees	32.6	22.7	62.6	43.0
Payroll and related costs of network operations personnel	3.6	3.3	7.4	6.4
Stock-based compensation, including amortization of prior capitalized amounts	2.5	2.5	5.1	5.1
Depreciation and impairment of network equipment	23.5	18.3	46.4	34.9
Amortization of internal-use software	7.7	6.4	15.5	12.8
Total cost of revenues	$89.6	$71.8	$178.7	$139.3

Cost of revenues increased 25%, or $17.8 million, to $89.6 million for the three months ended June 30, 2011 as compared to $71.8 million for the three months ended June 30, 2010. For the six months ended June 30, 2011, cost of revenues increased 28%, or $39.4 million, to $178.7 million as compared to $139.3 million for the six months ended June 30, 2010. This increase was primarily due to:

- increases in co-location costs as we deployed more servers worldwide;
- an increase in depreciation expense of network equipment and amortization of internal-use software as we continued to invest in our infrastructure; and
- an increase in amounts paid to network providers for bandwidth due to higher traffic levels, partially offset by reduced bandwidth costs per unit.

Cost of revenues during the three and six months ended June 30, 2011 also included credits received of approximately $1.6 million and $2.9 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, 2010, cost of revenues included similar credits of

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approximately $1.1 million and $2.1 million, respectively. Credits of this nature may occur in the future; however, the timing and amount of future credits, if any, are 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 2011 and for the years ending December 31, 2012, 2013 and 2014, we estimate that the minimum commitments related to bandwidth usage and co-location services under agreements currently in effect are approximately $52.9 million, $27.6 million, $2.1 million and $0.2 million, respectively.

We believe that cost of revenues will increase during the remaining quarters of 2011 as compared to each of the first two quarters of 2011. We expect to deploy more servers and to deliver more traffic on our network, which would result in higher expenses associated with the increased traffic and co-location fees; however, such costs are likely to be partially offset by lower bandwidth costs per unit. Additionally, for the remainder of 2011, we anticipate increases in 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, 2011, we capitalized software development costs of $9.4 million and $19.3 million, respectively, net of impairments. 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. 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, 2011, we capitalized $1.6 million and $3.4 million of stock-based compensation, respectively, as compared to $2.1 million and $3.5 million during the three and six months ended June 30, 2010, 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 decreased 19%, or $2.6 million