AKAMAI TECHNOLOGIES INC
Form 10-Q
August 08, 2017
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, 2017

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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o	Emerging growth company o

(Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has not elected to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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 3, 2017: 171,423,149

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AKAMAI TECHNOLOGIES, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2017

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED BALANCE SHEETS

(in thousands, expect share data)	June 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$352,501	$324,169
Marketable securities	330,620	512,849
Accounts receivable, net of reserves of $1,389 and $6,145 at June 30, 2017, and December 31, 2016, respectively	395,865	368,596
Prepaid expenses and other current assets	159,371	104,303
Total current assets	1,238,357	1,309,917
Property and equipment, net	856,039	801,017
Marketable securities	731,781	779,311
Goodwill	1,356,623	1,228,503
Acquired intangible assets, net	184,041	149,463
Deferred income tax assets	7,448	8,982
Other assets	114,750	95,953
Total assets	$4,489,039	$4,373,146
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$91,741	$76,120
Accrued expenses	222,023	238,777
Deferred revenue	73,772	52,972
Other current liabilities	11,528	6,719
Total current liabilities	399,064	374,588
Deferred revenue	3,848	3,758
Deferred income tax liabilities	21,762	11,652
Convertible senior notes	651,400	640,087
Other liabilities	125,793	118,691
Total liabilities	1,201,867	1,148,776
Commitments and contingencies (Note 7)		
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; 175,148,684 shares issued and 172,027,173 shares outstanding at June 30, 2017, and 173,254,797 shares issued and outstanding at December 31, 2016	1,751	1,733
Additional paid-in capital	4,317,583	4,239,588
Accumulated other comprehensive loss	(32,520)	(56,222)
Treasury stock, at cost, 3,121,511 shares at June 30, 2017, and no shares at December 31, 2016	(177,615)	—
Accumulated deficit	(822,027)	(960,729)
Total stockholders' equity	3,287,172	3,224,370

Total liabilities and stockholders’ equity	$4,489,039	$4,373,146

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 June 30,		For the Six Months Ended June 30,	
(in thousands, except per share data)	2017	2016	2017	2016
Revenue	$608,908	$572,135	$1,218,145	$1,139,860
Costs and operating expenses:				
Cost of revenue (exclusive of amortization of acquired intangible assets shown below)	214,650	206,323	420,353	401,059
Research and development	53,373	37,690	105,535	78,532
Sales and marketing	119,432	103,223	232,998	205,434
General and administrative	123,518	107,538	238,527	209,821
Amortization of acquired intangible assets	7,753	6,711	15,322	13,427
Restructuring charges	2,971	470	2,971	7,288
Total costs and operating expenses	521,697	461,955	1,015,706	915,561
Income from operations	87,211	110,180	202,439	224,299
Interest income	4,281	3,393	8,905	6,713
Interest expense	(4,646)	(4,639)	(9,243)	(9,292)
Other income (expense), net	563	415	(121)	226
Income before provision for income taxes	87,409	109,349	201,980	221,946
Provision for income taxes	29,637	35,714	63,278	73,453
Net income	$57,772	$73,635	$138,702	$148,493
Net income per share:				
Basic	$0.33	$0.42	$0.80	$0.84
Diluted	$0.33	$0.42	$0.80	$0.84
Shares used in per share calculations:				
Basic	172,674	175,499	172,916	175,951
Diluted	173,439	176,420	174,305	176,980

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

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AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
(in thousands)	2017	2016	2017	2016
Net income	$57,772	$73,635	$138,702	$148,493
Other comprehensive income (loss):				
Foreign currency translation adjustments	13,073	(3,728)	22,572	5,925
Change in unrealized gain on investments, net of income tax provision of $193, $529, $681 and $2,311 for the three and six months ended June 30, 2017 and 2016, respectively	320	904	1,130	3,912
Other comprehensive income (loss)	13,393	(2,824)	23,702	9,837
Comprehensive income	$71,165	$70,811	$162,404	$158,330

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

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AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Six Months Ended June 30,	
(in thousands)	2017	2016
Cash flows from operating activities:		
Net income	$138,702	$148,493
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	175,739	165,783
Stock-based compensation	80,255	66,652
Provision for deferred income taxes	39,368	2,785
Amortization of debt discount and issuance costs	9,243	9,292
Other non-cash reconciling items, net	1,609	3,501
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(17,873)	17,786
Prepaid expenses and other current assets	(50,108)	(10,991)
Accounts payable and accrued expenses	(17,541)	12,282
Deferred revenue	10,406	12,126
Other current liabilities	5,901	6,971
Other non-current assets and liabilities	(8,450)	1,062
Net cash provided by operating activities	367,251	435,742
Cash flows from investing activities:		
Cash paid for acquired businesses, net of cash acquired	(197,201)	—
Purchases of property and equipment	(104,881)	(86,820)
Capitalization of internal-use software development costs	(83,305)	(73,661)
Purchases of short- and long-term marketable securities	(181,219)	(384,585)
Proceeds from sales of short- and long-term marketable securities	180,215	50,541
Proceeds from maturities of short- and long-term marketable securities	232,901	301,802
Other non-current assets and liabilities	(1,249)	(1,512)
Net cash used in investing activities	(154,739)	(194,235)
Cash flows from financing activities:		
Proceeds related to the issuance of common stock under stock plans	25,680	27,095
Employee taxes paid related to net share settlement of stock-based awards	(41,338)	(32,410)
Repurchases of common stock	(177,615)	(199,710)
Other non-current assets and liabilities	(1,096)	—
Net cash used in financing activities	(194,369)	(205,025)
Effects of exchange rate changes on cash and cash equivalents	10,189	689
Net increase in cash and cash equivalents	28,332	37,171
Cash and cash equivalents at beginning of period	324,169	289,473
Cash and cash equivalents at end of period	$352,501	$326,644
Supplemental disclosure of cash flow information:		
Cash paid for income taxes, net of refunds received in the six months ended June 30, 2017 and 2016 of $2,481 and $457, respectively	$54,146	$38,228
Non-cash investing activities:		
Purchases of property and equipment and capitalization of internal-use software development costs included in accounts payable and accrued expenses	46,988	28,113
Capitalization of stock-based compensation	14,026	11,424

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 more than 200,000 servers across 130 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, 2016, filed with the Securities and Exchange Commission on February 28, 2017.

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 March 2016, the Financial Accounting Standards Board ("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. In addition, this guidance impacts the presentation of cash flows related to excess tax benefits by no longer requiring separate presentation as a financing activity apart from other operating income tax cash flows.

This guidance was effective for the Company on January 1, 2017. Upon adoption, the Company began recognizing tax benefits related to stock-based compensation in its provision for income taxes rather than as additional paid-in capital. The Company elected to continue estimating forfeitures in determining the amount of compensation cost. The Company was not required to adjust beginning retained earnings as a result of these two items.

In addition, the Company adopted the presentation requirements related to the excess tax benefits in its statements of cash flows on a retrospective basis beginning January 1, 2015. The line items, included in both cash flows from operating activities and financing activities labeled excess tax benefits from stock-based compensation, were eliminated. This had the impact of increasing net cash provided by operating activities and net cash used in financing activities. Prior periods have been revised as follows (in thousands):

	Net Cash Provided by Operating Activities		Net Cash Used in Financing Activities	
	As Reported	As Adjusted	As Reported	As Adjusted
Year ended December 31, 2015	$764,151	$793,452	$(267,728)	$(297,029)
Three months ended March 31, 2016	190,238	191,373	(115,736)	(116,871)
Six months ended June 30, 2016	433,110	435,742	(202,393)	(205,025)
Nine months ended September 30, 2016	684,510	687,590	(288,008)	(291,088)
Year Ended December 31, 2016	866,298	871,812	(354,265)	(359,779)

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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 model for recognizing revenue from contracts with customers. 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. The new standard can be adopted using one of two methods: retrospectively to each prior period presented or a modified retrospective application by recognizing a cumulative-effect adjustment as a component of equity as of the date of adoption. This standard will be effective for the Company on January 1, 2018, and the Company has elected to adopt it retrospectively to each prior period presented.

The updated guidance impacts, or requires the Company to modify, certain judgments and estimates that the Company currently makes as it relates to recognizing revenue. Upon adoption of the new revenue standard, integration fee revenue that was previously recognized ratably over the estimated life of the customer arrangement will be recognized when integration has been completed, which will have the effect of accelerating revenue from integration fees. In addition, the Company currently establishes a reserve for cash basis customers if collectability is not reasonably assured and recognizes revenue as cash is collected. Upon adoption of the new standard, revenue will be recognized for those customers when collectability becomes probable and transfer of control for all performance obligations has occurred/all other revenue recognition criteria have been achieved, rather than when it is reasonably assured. The Company has quantified the impact that these changes would have had on revenue reported for the year ended December 31, 2016, and each of the quarters therein, and it would not have had a material impact on the Company's consolidated financial statements. The Company continues to assess the expected impact to the year ending December 31, 2017, and each of the quarters therein, but does not expect adoption to have a material impact on its consolidated financial statements for the year then ending.

The Company is also assessing the impact of capitalizing costs associated with obtaining customer contracts, specifically commission and incentive payments. Currently, these payments are expensed in the period they are incurred. Under the updated guidance, these payments will be deferred on the Company's consolidated balance sheets and amortized over the expected life of the customer contract. The Company is currently quantifying the impact that these changes would have had on sales and marketing expenses recorded in the consolidated statements of income for the year ended December 31, 2016, for the six months ended June 30, 2017, and for each of the quarters therein. The Company is also assessing the expected impact on the consolidated balance sheet as of December 31, 2017, particularly the impact on prepaid expenses and other current assets and retained earnings.

The Company continues to evaluate the impact this updated guidance has on disclosure requirements related to revenue.

In February 2016, the FASB issued guidance that requires companies to present assets and liabilities arising from leases with terms greater than 12 months on the consolidated balance sheets. The updated standard aims to increase transparency and comparability among organizations by requiring lessees to recognize right-of-use assets and lease liabilities on the balance sheet and requiring disclosure of key information about leasing arrangements. This will impact all leases, including leases for real estate and co-location facilities, among other arrangements currently under evaluation. The Company plans to adopt this standard in the first quarter of 2019 and expects to record significant right-of-use assets and lease liabilities on its consolidated balance sheets.

In June 2016, the FASB issued guidance that introduces a new methodology for accounting for credit losses on financial instruments, including available-for-sale debt securities. The guidance establishes a new "expected loss model" that requires entities to estimate current expected credit losses on financial instruments by using all practical and relevant information. Any expected credit losses are to be reflected as allowances rather than reductions in the amortized cost of available-for-sale debt securities. This guidance will be effective for the Company on January 1, 2020. The Company is evaluating the potential impact on its consolidated financial statements of adopting this new accounting guidance.

In October 2016, the FASB issued guidance that requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. This guidance will be effective for the Company on January 1, 2018 and is to be applied on a modified retrospective basis through recognizing a cumulative-effect adjustment as a component of equity as of the date of adoption. The Company is evaluating the potential impact on its consolidated financial statements of adopting this new accounting guidance.

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In January 2017, the FASB issued guidance that changes the definition of a business to assist entities with evaluating whether transactions should be accounted for as transfers of assets or business combinations. This guidance will be effective for the Company on January 1, 2018 and is to be applied prospectively. The Company is evaluating the potential impact on its consolidated financial statements of adopting this new accounting guidance.

2. Fair Value Measurements

The following is a summary of available-for-sale marketable securities held as of June 30, 2017 and December 31, 2016 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Aggregate Fair Value	Classification on Balance Sheet Short-Term Marketable Securities	Classification on Balance Sheet Long-Term Marketable Securities
As of June 30, 2017						
Commercial paper	$6,873	$—	$(2)	$6,871	$6,871	$—
Corporate bonds	832,072	243	(2,143)	830,172	308,482	521,690
U.S. government agency obligations	220,014	—	(1,238)	218,776	15,076	203,700
	$1,058,959	$243	$(3,383)	$1,055,819	$330,429	$725,390
As of December 31, 2016						
Commercial paper	$40,965	$—	$(45)	$40,920	$40,920	$—
Corporate bonds	984,650	123	(3,697)	981,076	418,495	562,581
U.S. government agency obligations	267,473	35	(1,366)	266,142	53,157	212,985
	$1,293,088	$158	$(5,108)	$1,288,138	$512,572	$775,566

The Company offers certain eligible 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 consolidated statements of income. As of June 30, 2017, the Company held for investment corporate bonds with a fair value of $63.7 million, which are classified as available-for-sale marketable securities and have been in a continuous unrealized loss position for more than 12 months. The unrealized losses related to these corporate bonds included in accumulated other comprehensive loss as of June 30, 2017 were $0.2 million. The losses are attributable to changes in interest rates. Based on the evaluation of available evidence, the Company does not believe any unrealized losses represent other than temporary impairments.

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The following table details the fair value measurements within the fair value hierarchy of the Company's financial assets and liabilities as of June 30, 2017 and December 31, 2016 (in thousands):

	Total Fair Value	Fair Value Measurements at Reporting Date Using		
		Level 1	Level 2	Level 3
As of June 30, 2017				
Cash Equivalents and Marketable Securities:				
Money market funds	$4,574	$ 4,574	$ —	$ —
Commercial paper	6,871	—	6,871	—
Corporate bonds	830,172	—	830,172	—
U.S. government agency obligations	218,776	—	218,776	—
Mutual funds	6,582	6,582	—	—
	$1,066,975	$ 11,156	$ 1,055,819	$ —
Liabilities:				
Contingent consideration obligations related to completed acquisitions	$(5,400)	$ —	$ —	$ (5,400)
As of December 31, 2016				
Cash Equivalents and Marketable Securities:				
Money market funds	$8,726	$ 8,726	$ —	$ —
Commercial paper	40,920	—	40,920	—
Corporate bonds	981,076	—	981,076	—
U.S. government agency obligations	266,142	—	266,142	—
Mutual funds	4,022	4,022	—	—
	$1,300,886	$ 12,748	$ 1,288,138	$ —
Liabilities:				
Contingent consideration obligations related to completed acquisitions	$(7,100)	$ —	$ —	$ (7,100