AKAMAI TECHNOLOGIES INC
Form 10-Q
November 09, 2012

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 September 30, 2012

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 November 6, 2012: 177,467,846

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FORM 10-Q
For the quarterly period ended September 30, 2012
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	September 30, 2012	December 31, 2011
	(In thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$182,650	$559,197
Marketable securities (including restricted securities of $54 at September 30, 2012)	282,579	290,029
Accounts receivable, net of reserves of $5,778 and $4,555 at September 30, 2012 and December 31, 2011, respectively	236,232	210,936
Prepaid expenses and other current assets	45,784	55,414
Deferred income tax assets	6,444	6,444
Total current assets	753,689	1,122,020
Property and equipment, net	331,218	293,043
Marketable securities (including restricted securities of $44 and $42 at September 30, 2012 and December 31, 2011, respectively)	593,105	380,729
Goodwill	721,601	452,914
Other intangible assets, net	82,375	45,386
Deferred income tax assets	42,101	43,485
Other assets	15,365	7,924
Total assets	$2,539,454	$2,345,501
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$52,749	$38,247
Accrued expenses and other current liabilities	131,616	85,371
Deferred revenue	27,927	21,344
Accrued restructuring	628	3,430
Total current liabilities	212,920	148,392
Other liabilities	64,499	38,389
Deferred revenue	2,097	2,470
Total liabilities	279,516	189,251
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; 198,954,007 shares issued and 177,331,901 shares outstanding at September 30, 2012 and 195,561,243 shares issued and 177,504,624 shares outstanding at December 31, 2011	2,000	1,959
Additional paid-in capital	5,146,092	5,068,235
Accumulated other comprehensive income (loss)	483	(1,259)
Treasury stock, at cost, 21,622,106 shares at September 30, 2012 and 18,056,619 shares at December 31, 2011	(594,643)	(482,994)

Accumulated deficit	(2,293,994)	(2,429,691)
Total stockholders’ equity	2,259,938	2,156,250
Total liabilities and stockholders’ equity	$2,539,454	$2,345,501

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 September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands, except per share data)			
Revenues	$345,321	$281,856	$996,075	$834,798
Costs and operating expenses:				
Cost of revenues	109,995	93,284	320,018	271,999
Research and development	19,351	13,542	54,373	37,142
Sales and marketing	75,924	54,520	219,096	160,722
General and administrative	54,511	50,834	168,214	140,710
Amortization of other intangible assets	5,381	4,185	15,611	12,754
Restructuring charge	—	158	14	158
Total costs and operating expenses	265,162	216,523	777,326	623,485
Income from operations	80,159	65,333	218,749	211,313
Interest income	1,568	2,703	4,823	8,675
Other (expense) income, net	(241)	(188)	449	(1,330)
Gain on investments, net	25	299	42	383
Income before provision for income taxes	81,511	68,147	224,063	219,041
Provision for income taxes	33,280	25,862	88,366	78,218
Net income	$48,231	$42,285	$135,697	$140,823
Net income per weighted average share:				
Basic	$0.27	$0.23	$0.76	$0.76
Diluted	$0.27	$0.23	$0.75	$0.74
Shares used in per share calculations:				
Basic	177,455	183,085	178,040	185,515
Diluted	181,053	185,704	181,738	189,089

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

AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
Net income	$48,231	$42,285	$135,697	$140,823
Other comprehensive income:				
Foreign currency translation adjustments	3,770	(5,588)	740	(1,200)
Change in unrealized gain (loss) on investments, net	1,246	(6,517)	1,540	(3,840)
Income tax (expense) benefit related to unrealized gain (loss) on investments, net	(425)	2,507	(538)	1,482
Other comprehensive income (loss)	4,591	(9,598)	1,742	(3,558)
Comprehensive income	$52,822	$32,687	$137,439	$137,265

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

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

	For the Nine Months Ended September 30,	
	2012	2011
	(In thousands)	
Cash flows from operating activities:		
Net income	$135,697	$140,823
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	149,203	124,228
Stock-based compensation expense	69,180	42,465
Provision for doubtful accounts	(61)	1,236
Excess tax benefits from stock-based compensation	(17,589)	(11,460)
Provision for deferred income taxes, net	826	20,906
Gain on investments and disposal of property and equipment, net	(62)	(172)
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(21,587)	(7,821)
Prepaid expenses and other current assets	11,103	(78)
Accounts payable, accrued expenses and other current liabilities	54,732	(5,268)
Deferred revenue	5,542	(1,386)
Accrued restructuring	(2,897)	(180)
Other non-current assets and liabilities	(536)	13,355
Net cash provided by operating activities	383,551	316,648
Cash flows from investing activities:		
Cash paid for acquisition of businesses, net of cash acquired	(306,030)	(550)
Purchases of property and equipment	(119,256)	(105,769)
Capitalization of internal-use software costs	(39,921)	(30,523)
Purchases of short- and long-term marketable securities	(554,303)	(727,453)
Proceeds from sales of short- and long-term marketable securities	135,993	545,568
Proceeds from maturities of short- and long-term marketable securities	214,159	354,552
Proceeds from the sale of property and equipment	12	135
Decrease in restricted investments held for security deposits	—	221
Net cash (used in) provided by investing activities	(669,346)	36,181
Cash flows from financing activities:		
Proceeds from the issuance of common stock under stock option plans and employee stock purchase plans	28,635	13,305
Excess tax benefits from stock-based compensation	17,589	11,460
Employee taxes paid related to net share settlement of equity awards	(26,566)	(5,680)
Repurchases of common stock	(111,649)	(247,738)
Net cash used in financing activities	(91,991)	(228,653)
Effects of exchange rate changes on cash and cash equivalents	1,239	(443)
Net (decrease) increase in cash and cash equivalents	(376,547)	123,733
Cash and cash equivalents at beginning of period	559,197	231,866
Cash and cash equivalents at end of period	$182,650	$355,599
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$51,822	$26,530
Non-cash financing and investing activities:		

Capitalization of stock-based compensation, net of impairments	$6,694	$5,406

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 80 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, 2011, filed with the Securities and Exchange Commission on February 29, 2012.

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 May 2011, the Financial Accounting Standards Board ("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. The Company adopted this guidance during the first quarter of 2012. The adoption of the guidance did not 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 Company adopted this guidance during the first quarter of 2012. There is no impact to the Company's consolidated financial results as the amendments relate only to changes in financial statement presentation.

In September 2011, the FASB issued amended guidance that simplifies how entities test goodwill for impairment. Under the amended guidance, after assessment of certain qualitative factors, if an entity determines that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the entity must perform the quantitative analysis of the goodwill impairment test. Otherwise, the quantitative test(s) are optional. The Company adopted this guidance during the first quarter of 2012. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements.

In July 2012, the FASB issued amended guidance on the periodic testing of indefinite-lived intangible assets for impairment. This guidance will allow companies to assess qualitative factors to determine if it is more likely than not that the indefinite-lived intangible asset might be impaired and whether it is necessary to perform the quantitative impairment test required under current accounting standards. The updated accounting guidance is effective for interim and annual periods beginning after September 15, 2012 with early adoption permitted. The Company will adopt the updated guidance in the fourth quarter of fiscal year 2012. The adoption of the guidance is not expected to have a material impact on the Company's consolidated financial statements.

3. Business Acquisitions

In September 2012, the Company acquired FastSoft, Inc. ("FastSoft"). In February and March 2012, the Company acquired Blaze Software, Inc. ("Blaze") and Cotendo, Inc. ("Cotendo"), respectively. The consolidated financial statements include the operating results of each business from the date of acquisition. Pro forma results of operations for these acquisitions have not been presented because the effects of the acquisitions, individually or in the aggregate, were not material to the Company's consolidated financial results. The total amount of acquisition-related costs for the acquisitions of FastSoft, Blaze and Cotendo was $5.1 million for the nine months ended September 30, 2012. These costs were included in general and administrative costs in the consolidated statements of operations.

The acquisitions of FastSoft, Blaze and Cotendo were accounted for using the purchase method of accounting. The total purchase consideration was allocated to the assets acquired and liabilities assumed at their estimated fair values as of the date of each acquisition, as determined by management and, with respect to identified intangible assets, by management with the assistance of an appraisal provided by a third-party valuation firm. The excess of the purchase price over the amounts allocated to assets acquired and liabilities assumed has been recorded as goodwill. Goodwill associated with these acquisitions will not be amortized and will be tested for impairment at least annually as required by the accounting guidance for goodwill and other intangible assets. (See Note 10).

FastSoft

On September 13, 2012, the Company acquired all of the outstanding common and preferred stock of FastSoft in exchange for $14.4 million in cash. Akamai acquired FastSoft with a goal of complementing Akamai's cloud infrastructure solutions with technology for optimizing the throughput of video and other digital content across IP networks. The Company allocated $12.2 million of the cost of the acquisition to goodwill and $3.7 million to other intangible assets. The allocation of the purchase price is preliminary. The total weighted average useful life of the intangible assets acquired from FastSoft is 9.0 years. The value of the goodwill from the acquisition can be attributed to a number of business factors including a trained technical workforce in place in the United States and cost synergies. The total amount of goodwill related to the acquisition of FastSoft expected to be deducted for tax purposes is $2.9 million.

Blaze

On February 7, 2012, the Company acquired all of the outstanding common and preferred stock, including vested and unvested stock options, of Blaze in exchange for $19.3 million in cash and assumption of unvested options. Akamai acquired Blaze with a goal of complementing Akamai's site acceleration solutions with technology designed to optimize the speed at which a web page is rendered. The Company allocated $15.1 million of the cost of the acquisition to goodwill and $5.1 million to other intangible assets. The allocation of the purchase price is preliminary. The total weighted average useful life of the intangible assets acquired from Blaze is 5.3 years. The value of the goodwill from this acquisition can be attributed to a number of business factors including a trained technical workforce in place in Canada and cost synergies expected to be realized. The total amount of goodwill related to the acquisition of Blaze expected to be deducted for tax purposes is $13.5 million.

Cotendo

On March 6, 2012, the Company acquired all of the outstanding common and preferred stock, including vested and unvested stock options, of Cotendo in exchange for $278.9 million in cash and assumption of unvested options. Akamai acquired Cotendo with the intention of increasing Akamai's pace of innovation in the areas of cloud and mobile optimization.

The value of the goodwill from the acquisition of Cotendo can be attributed to a number of business factors including potential sales opportunities to provide Akamai services to Cotendo customers; a trained technical workforce in place in the United States and Israel; an existing sales pipeline and a trained sales force; and cost synergies expected to be realized.

The following table presents the preliminary allocation of the purchase price for Cotendo (in thousands):

Total purchase consideration	$278,877
Allocation of the purchase consideration	
Current assets, including cash and cash equivalents of $6,405	$6,751
Trade receivables	2,920
Property and equipment	5,812
Indemnification assets	6,200
Long-term assets	75
Identifiable intangible assets	43,800
Goodwill	241,386
Deferred tax liabilities	(22,934)
Other liabilities assumed	(5,133)
	$278,877

The following were the identified intangible assets acquired and the respective estimated periods over which such assets will be amortized (in thousands except for years):

	Gross Carrying Amount	Weighted Average Useful Life
Completed technology	$24,100	6
Customer relationships	13,400	9
Non-compete agreements	3,900	6
Trademarks and trade names	2,400	10
Total	$43,800	

In determining the purchase price allocation, the Company considered, among other factors, its intention to use the acquired assets and the historical and estimated future demand for Cotendo services. The fair value of intangible assets was based upon the income approach. In applying this approach, the values of the intangible assets acquired were determined using projections of revenues and expenses specifically attributed to the intangible assets. The income streams were then discounted to present value using estimated risk-adjusted discount rates. The rate used to discount the expected future net cash flows from the intangible assets to their present values was based upon a weighted average cost of capital of 15%. The discount rate was determined after consideration of market rates of return on debt and equity capital, the weighted average return on invested capital and the risk associated with achieving forecasted sales related to the technology and assets acquired from Cotendo.

The relief-from-royalty method was used to value the completed technologies acquired from Cotendo. The relief-from-royalty method estimates the cost savings that accrue to the owner of an intangible asset that would otherwise be required to pay royalties or license fees on revenues earned through the use of the asset. The royalty rate used is based on an analysis of empirical, market-derived royalty rates for guideline intangible assets. Typically, revenue is projected over the expected remaining useful life of the completed technology. The market-derived royalty rate is then applied to estimate the royalty savings. The key assumptions used in valuing the completed technologies are as follows: royalty rate of 15%, discount rate of 16%, tax rate of 39% and estimated average economic life of six years.

The customer relationships were valued using the excess earnings method of income approach. The key assumptions used in valuing the customer relationships were as follows: discount rate of 16%, tax rate of 39% and estimated average economic life of nine years.

The lost-profits method was used to value the non-compete agreements Akamai entered into with certain members of Cotendo's management team. The lost-profits method recognizes that the current value of an asset may be premised upon the expected receipt of future economic benefits protected by clauses within an agreement. These benefits are generally considered to be higher income resulting from the avoidance of a loss in revenue that would likely occur without an agreement. The key assumptions used in valuing the non-compete agreements were as follows: discount rate of 16%, tax rate of 39% and estimated average economic life of six years.

The relief-from-royalty method was used to value trade names. The relief-from-royalty method recognizes that the current value of an asset may be premised upon the expected receipt of future economic benefits from the use of trade names. These benefits are generally considered to be higher income resulting from the avoidance of a loss in revenue that would likely occur without the specific trade names. The key assumptions used in valuing trade names were as follows: royalty rate of 1%, discount rate of 16%, tax rate of 39% and estimated average economic life of ten years.

The total weighted average amortization period for the intangible assets acquired from Cotendo is 7.1 years. The intangible assets are being amortized based upon the pattern in which the economic benefits of the intangible assets are being utilized. The total amount of goodwill related to the acquisition of Cotendo expected to be deducted for tax purposes is $55.8 million.

4. Marketable Securities and Investments

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

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

Level 2 — Observable inputs, other than Level 1 prices, such as quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in markets that are inactive, 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 September 30, 2012 and December 31, 2011 (in thousands):

		Gross Unrealized			Classification on Balance Sheet	
As of September 30, 2012	Cost	Gains	Losses	Aggregate Fair Value	Short-term Marketable Securities	Long-term Marketable Securities
Available-for-sale securities:						
Certificates of deposit	$98	$—	$—	$98	$54	$44
Commercial paper	9,975	2	—	9,977	9,977	—
Corporate debt securities	682,983	1,769	(167)	684,585	272,548	412,037
U.S. government agency obligations	180,883	143	(2)	181,024	—	181,024
	$873,939	$1,914	$(169)	$875,684	$282,579	$593,105

		Gross Unrealized			Classification on Balance Sheet	
As of December 31, 2011	Cost	Gains	Losses	Aggregate Fair Value	Short-term Marketable Securities	Long-term Marketable Securities
Available-for-sale securities:						
Certificates of deposit	$42	$—	$—	$42	$—	$42
Corporate debt securities	524,515	873	(580)	524,808	285,012	239,796
U.S. government agency obligations	145,995	78	(165)	145,908	5,017	140,891
	$670,552	$951	$(745)	$670,758	$290,029	$380,729

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 are reflected in the income statement as gain (loss) on investments, net. As of September 30, 2012, the Company did not hold any investment-related assets that have been in a continuous loss position for more than 12 months.

The following tables detail the fair value measurements within the fair value hierarchy of the Company's financial assets, including investments and cash equivalents, at September 30, 2012 and December 31, 2011 (in thousands):

	Total Fair Value at September 30, 2012	Fair Value Measurements at Reporting Date Using		
		Level 1	Level 2	Level 3
Money market funds	$ 5,685	$5,685	$—	$—
Certificates of deposit	4,577	4,577	—	—
Commercial paper	9,977	—	9,977	—
Corporate debt securities	684,585	—	684,585	—
U.S. government agency obligations	181,024	—	181,024	—
	$ 885,848	$10,262	$875,586	$—

	Total Fair Value at December 31, 2011	Fair Value Measurements at Reporting Date Using		
		Level 1	Level 2	Level 3
Money market funds	$ 302,507	$302,507	$—	$—
Certificates of deposit	42	42	—	—
Commercial paper	57,498	—	57,498	—
Corporate debt securities	524,808	—	524,808	—
U.S. government agency obligations	145,908	—	145,908	—
	$ 1,030,763	$302,549	$728,214	$—

As of September 30, 2012 and December 31, 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 September 30, 2012 and December 31, 2011, the Company had grouped commercial paper, U.S. government agency obligations and corporate debt securities using a Level 2 valuation because quoted prices for identical or similar assets are available in markets that are inactive. As of September 30, 2012 and December 31, 2011, the Company had no assets grouped using a Level 3 valuation.

Contractual maturities of the Company's marketable securities held at September 30, 2012 and December 31, 2011 were as follows (in thousands):

	September 30, 2012	December 31, 2011
Available-for-sale securities:		
Due in 1 year or less	$282,579	$290,029
Due after 1 year through 5 years	593,105	380,729
	$875,684	$670,758

5. Accounts Receivable

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

	September 30, 2012	December 31, 2011
Trade accounts receivable	$170,963	$142,166
Unbilled accounts	71,047	73,325
Gross accounts receivable	242,010	215,491
Allowance for doubtful accounts	(1,791)	(1,627)
Reserve for cash-basis customers	(3,987)	(2,928)
Total accounts receivable reserves	(5,778)	(4,555)
Accounts receivable, net	$236,232	$210,936

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

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

6. Accrued Expenses and Other Current Liabilities

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

	September 30, 2012	December 31, 2011
Payroll and other related benefits	$58,158	$39,920
Bandwidth and co-location	31,535	29,291
Property, use and other taxes	35,573	9,923
Professional service fees	4,238	4,162
Other	2,112	2,075
Total	$131,616	$85,371

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 and restricted stock units ("RSUs") issued by the Company.

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Numerator:				
Net income	$48,231	$42,285	$135,697	$140,823
Denominator:				
Shares used for basic net income per common share	177,455	183,085	178,040	185,515
Effect of dilutive securities:				
Stock options	2,101	1,928	2,207	2,698
RSUs and deferred stock units	1,497	691	1,491	876
Shares used for diluted net income per common share	181,053	185,704	181,738	189,089
Basic net income per common share	$0.27	$0.23	$0.76	$0.76
Diluted net income per common share	$0.27	$0.23	$0.75	$0.74

For the three and nine months ended September 30, 2012 and 2011 certain potential outstanding stock options and service-based RSUs were excluded from the computation of diluted earnings per share because the effect of including these options and RSUs would be anti-dilutive. Additionally, certain performance-based RSUs were excluded from the computation of diluted net income per share because the underlying performance conditions for such RSUs had not been met as of these dates. The potentially outstanding shares excluded from the computation of diluted earnings per share is as follows (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Options	2,438	4,508	2,735	3,265
Service-based RSUs	1,321	1,481	1,401	787
Performance-based RSUs	1,518	2,836	1,536	2,973
Total shares excluded from computation	5,277	8,825	5,672	7,025

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 28, 2010, the Company announced that its Board of Directors had authorized a $150.0 million stock repurchase program of the Company’s common stock from time to time, over the twelve months commencing in May 2010, on the open market or in privately negotiated transactions. On April 19, 2011, the Company’s Board of Directors authorized an extension of the stock repurchase program authorizing up to an additional $150.0 million of repurchases over the twelve months commencing in May 2011. The unused balance from the May 2010 repurchase program was not carried forward for future purchases. 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. As a result, the total authorized funding for stock repurchases during that twelve-month period increased to $400.0 million. On April 25, 2012, the Company announced that its Board of Directors had authorized an extension of its share repurchase program. Under this extension, the Company may purchase up to $150.0 million of its common stock during the twelve-month period beginning in May 2012. The unused balance from the May and August 2011 extensions was not carried forward for future purchases. 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.

During the three and nine months ended September 30, 2012, the Company repurchased 1.2 million and 3.6 million shares, respectively, of its common stock for $36.5 million and $111.6 million, respectively. During the three and nine months ended September 30, 2011, the Company repurchased 6.8 million and 9.4 million shares of its common stock, respectively, for $155.1 million and $248.4 million, respectively. As of September 30, 2012, the Company had $68.4 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 nine months ended September 30, 2012 and 2011 (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Stock-based compensation by type of award:				
Stock options	$3,579	$3,312	$11,045	$10,518
Deferred stock units	—	—	1,885	1,885
RSUs	20,159	12,628	58,621	31,276
Shares issued under the Employee Stock Purchase Plan	1,458	1,142	4,323	4,192
Amounts capitalized as internal-use software	(2,561)	(1,941)	(6,694)	(5,406)
Total stock-based compensation before income taxes	22,635	15,141	69,180	42,465
Less: Income tax benefit	(9,242)	(5,746)	(27,114)	(15,119)
Total stock-based compensation, net of taxes	$13,393	$9,395	$42,066	$27,346
Effect of stock-based compensation on income by line item:				
Cost of revenues	$684	$634	$2,251	$1,779
Research and development expense	4,427	2,629	13,258	7,515
Sales and marketing expense	10,896	6,951	32,024	19,112
General and administrative expense	6,628	4,927	21,647	14,059
Provision for income taxes	(9,242)	(5,746)	(27,114)	(15,119)
Total cost related to stock-based compensation, net of taxes	$13,393	$9,395	$42,066	$27,346

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 nine months ended September 30, 2012 include stock-based compensation reflected as a component of amortization of capitalized internal-use software of $2.0 million and $5.7 million, respectively, before taxes. The Company's consolidated statements of operations for the three and nine months ended September 30, 2011 also include stock-based compensation reflected as a component of amortization of capitalized internal-use software of $1.6 million and $5.6 million, respectively, before taxes.

9. Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) is reported as a component of stockholders' equity and consisted of the following (in thousands):

	September 30, 2012	December 31, 2011
Foreign currency translation adjustments	$(710)	$(1,450)
Net unrealized gain on investments, net of taxes of $(552) at September 30, 2012 and $(14) at December 31, 2011	1,193	191
Total accumulated other comprehensive income (loss)	$483	$(1,259)

10. Goodwill and Other Intangible Assets

The Company has recorded goodwill and other intangible assets as a result of business acquisitions that occurred between 2000 and 2012. The Company also acquired license rights from the Massachusetts Institute of Technology in 1999. In February 2012, the Company recorded goodwill of $15.1 million and acquired other intangible assets of $5.1

million as a result of the acquisition of Blaze. In March 2012, the Company recorded goodwill of $241.4 million and acquired other intangible assets of $43.8 million as a result of the acquisition of Cotendo. In September 2012, the Company recorded goodwill of $12.2 million and acquired other intangible assets of $3.7 million as a result of the acquisition of FastSoft. (See Note 3). In accordance with current accounting standards, goodwill will not be amortized as it does not qualify as an amortizable intangible asset. The Company will test goodwill for impairment at least annually as required by the accounting guidance for goodwill and other intangible assets.

The changes in the carrying amount of goodwill for the three and nine months ended September 30, 2012 were as follows (in thousands):

Balance as of December 31, 2011	$452,914
Purchase price allocation associated with Blaze acquisition	15,068
Purchase price allocation associated with Cotendo acquisition	241,646
Balance as of March 31, 2012	709,628
Purchase price adjustment associated with Cotendo acquisition	40
Balance as of June 30, 2012	709,668
Purchase price allocation associated with FastSoft acquisition	12,233
Purchase price adjustment associated with Cotendo acquisition	(300)
Balance as of September 30, 2012	$721,601

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

	September 30, 2012			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Amortization period in years
Completed technology	$66,931	$(30,229)	$36,702	6
Customer relationships	102,100	(66,657)	35,443	9
Non-compete agreements	14,440	(6,999)	7,441	5
Trademarks and trade names	3,700	(911)	2,789	9
Acquired license rights	490	(490)	—	10
Total	$187,661	$(105,286)	$82,375	

	December 31, 2011			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Amortization period in years
Completed technology	$36,731	$(22,913)	$13,818	6
Customer relationships	88,700	(60,202)	28,498	9
Non-compete agreements	8,340	(5,270)	3,070	4
Trademarks and trade names	800	(800)	—	4
Acquired license rights	490	(490)	—	10
Total	$135,061	$(89,675)	$45,386	

Aggregate expense related to amortization of other intangible assets for the three months ended September 30, 2012 and 2011 was $5.4 million and $4.2 million, respectively. For the nine months ended September 30, 2012 and 2011, aggregate expense related to the amortization of other intangible assets was $15.6 million and $12.8 million, respectively. Based on the Company’s other intangible assets as of September 30, 2012, aggregate expense related to amortization of other intangible assets is expected to be $5.4 million for the remainder of 2012, and $23.6 million, $18.2 million, $14.5 million and $10.1 million for 2013, 2014, 2015 and 2016, 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 with major financial institutions that the Company believes are of high credit standing. Concentrations of credit risk with respect to accounts receivable are primarily limited to certain customers to which the Company makes substantial sales. The Company’s customer base consists of a large number of geographically dispersed customers diversified across several 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. As of September 30, 2012 and December 31, 2011, one customer accounted for 10% of the Company's accounts receivable. The Company believes that, at September 30, 2012, concentration of credit risk related to accounts receivable was 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 its Chief Executive Officer and executive management team. As of September 30, 2012, 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 September 30, 2012, the Company had $235.7 million and $95.5 million of property and equipment, net of accumulated depreciation, located in the United States and in foreign locations, respectively. As of December 31, 2011, the Company had $194.0 million and $99.0 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 and through channel partners located both in the United States and abroad. The following table summarizes the percentage of the Company's revenues derived from operations outside of the United States:

	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			
	2012		2011		2012		2011	
Revenues derived from outside of the United States	29	%	29	%	28	%	29	%
Revenues derived from Europe	16	%	18	%	17	%	18	%

No single country outside the United States accounted for 10% or more of revenues during these periods. For each of the three- and nine-month periods ended September 30, 2012 and 2011, no customer accounted for 10% or more of total revenues.
13. Income Taxes
The Company’s effective income tax rate, including discrete items, was 39.4% and 35.7% for the nine months ended September 30, 2012 and 2011, 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 include the tax effect of certain stock options, interest and penalties related to uncertain tax positions, and return to provision adjustments. For each of the nine months ended September 30, 2012 and September 30, 2011, the effective income tax rate was higher than the federal statutory tax rate mainly due to the effect of accounting for stock-based compensation in accordance with the authoritative guidance for share-based payments and state income tax expense.

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14. Forward Currency Contracts

The assets and liabilities of the Company's international subsidiaries are translated at the applicable exchange rate as of the balance sheet date, and revenues and expenses are translated at an average rate over the period. Resulting currency translation adjustments are recorded as a component of accumulated other comprehensive income (loss), a separate component of stockholders’ equity. Gains and losses on inter-company and other non-functional currency transactions are recorded in other (expense) income, net. For the three and nine months ended September 30, 2012, the Company recorded net foreign currency losses of $0.3 million and net foreign currency gains of $0.2 million, respectively, in the consolidated statement of operations. For the three and nine months ended September 30, 2011, the Company recorded net foreign currency losses of $0.2 million and $1.3 million, respectively, in the consolidated statement of operations.

Since 2011, the Company has entered into short-term foreign currency forward contracts to offset 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. As of September 30, 2012 and 2011, the fair value of the forward currency contracts and the underlying net loss for the three and nine months ended September 30, 2012 and 2011 were deemed to be immaterial.

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

15. Commitments, Contingencies and Guarantees

Operating Lease Commitments

The Company leases its facilities under non-cancelable operating leases. These operating leases expire at various dates through May 2022 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 September 30, 2012 were as follows (in thousands):

	Operating Leases
Remaining 2012	$7,746
2013	28,659
2014	25,436
2015	22,825
2016	14,813
Thereafter	40,034
Total	$139,513

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 2012 and for the years ending December 31, 2013, 2014, 2015 and 2016, the minimum commitments pursuant to these contracts in effect as of September 30, 2012 were approximately $38.6 million, $57.3 million, $4.4 million, $0.3 million and $0.1 million, respectively. In addition, as of September 30, 2012, the Company had entered into purchase orders with various vendors for aggregate purchase commitments of $62.5 million, most of which are expected to be paid over the next twelve months.

Litigation

The Company is party to various 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 impact on the Company’s business, results of operations, financial condition or cash flows.

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 incurred 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 September 30, 2012 was determined to be immaterial.

16. Restructuring

In December 2011, the Company implemented a workforce reduction of approximately 70 employees from all areas of the Company. The Company recorded $4.2 million as a restructuring charge for the amount of one-time benefits provided to affected employees. Included in these costs was a net increase in non-cash, stock-based compensation of $0.4 million reflecting a modification of certain stock-based awards previously granted to the affected employees. Additionally, during 2011, in connection with excess and vacated facilities under long-term non-cancelable leases, the Company recorded $0.7 million as a restructuring charge for the estimated future lease payments, less estimated sublease income, for these vacated facilities.

The following table summarizes the accrual and usage of the restructuring charges (in thousands):

	Leases	Severance	Total
Ending Balance, December 31, 2011	$593	$3,311	$3,904
Restructuring charge	—	60	60
Cash payments	(28)	(2,116)	(2,144)
Ending Balance, March 31, 2012	565	1,255	1,820
Restructuring charge	—	(46)	(46)
Cash payments	(28)	(697)	(725)
Ending Balance, June 30, 2012	537	512	1,049
Cash payments	(28)	—	(28)
Ending Balance, September 30, 2012	$509	$512	$1,021
Current portion of accrued restructuring	$116	$512	$628
Long-term portion of accrued restructuring	$393	$—	$393

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 in 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 sales 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 an increasing number of customer contracts that have minimum usage commitments that are based on quarterly, twelve-month or longer periods. Having a consistent and predictable base level of revenue 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 September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues	100.0 %	100.0 %	100.0 %	100.0 %
Cost of revenues	31.8	33.1	32.1	32.6
Research and development expense	5.6	4.8	5.4	4.4
Sales and marketing expense	22.0	19.3	22.0	19.3
General and administrative expense	15.8	18.0	16.9	16.9
Amortization of other intangible assets	1.6	1.5	1.6	1.5
Restructuring charge	—	0.1	—	—
Total costs and operating expenses	76.8	76.8	78.0	74.7
Income from operations	23.2	23.2	22.0	25.3
Interest income	0.5	1.0	0.5	1.0
Other (expense) income, net	(0.1)	(0.1)	—	(0.2)
Gain on investments, net	—	0.1	—	0.1
Income before provision for income taxes	23.6	24.2	22.5	26.2
Provision for income taxes	9.6	9.2	8.9	9.4
Net income	14.0 %	15.0 %	13.6 %	16.8 %

We were profitable in 2011 and for the three and nine months ended September 30, 2012; 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, results of operations or cash flows in the foreseeable future:

Revenues and Customers

- During each of the first three quarters of 2012, we were able to offset lost committed recurring revenues by adding new customers and increasing sales of incremental services to our existing customers. A continuation of this trend could lead to increased revenues. Overall revenues are also impacted favorably by amounts we are paid for items such as traffic usage in excess of committed amounts and one-time events but negatively impacted by price declines.
- Our unit prices offered to some customers have declined as a result of increased competition. 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 and are unable to offset such reductions with increased traffic, enhanced efficiencies in our network, lower co-location and bandwidth expenses, or increased sales of incremental services to existing customers, our revenues and profit margins would decrease.
- During each of the first three quarters of 2012, we experienced an increase in the rate of traffic growth in our video and software download solutions as compared to the fourth quarter of 2011. If this trend does not continue, our ability to generate revenue growth could be adversely impacted.
- Although our revenues in the second and third quarters of 2012 were higher than our revenues in the fourth quarter of 2011, we have historically experienced seasonal variations of higher revenues in the fourth quarter of the year and lower revenues during the summer months. We primarily attribute such variations to patterns of usage of e-commerce services by our retail customers. If this trend continues, our ability to generate quarterly revenue growth on a sequential basis could be impacted.
- For the nine months ended September 30, 2012, revenues derived from customers outside the United States accounted for 28% of our total revenues. For the remainder of 2012, we anticipate revenues from such customers as a percentage of our total revenues to be consistent with the first nine months of 2012.

Costs and Expenses

- During the first three quarters of 2012, we continued to reduce our network bandwidth costs per unit and to invest in internal-use software development to improve the performance and efficiency of our network. Our total bandwidth costs increased during the first three quarters of 2012 as compared to the first three quarters of 2011 due to traffic growth on our network. 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 for the remainder of 2012.
- Co-location costs are a significant percentage of total cost of revenues. By improving our internal-use software and managing our hardware deployments to enable us to use servers more efficiently, we believe we can manage the growth of co-location costs by deploying fewer servers. If we are unable to achieve such cost reductions, our profitability will be negatively impacted.
- Depreciation and amortization expense related to our network equipment and internal-use software development costs increased by $20.1 million during the first three quarters of 2012 as compared to the first three quarters of 2011. Due to expected future purchases of network equipment during 2012, we believe that depreciation expense related to our network equipment will continue to increase during the remainder of 2012. We also expect to continue to enhance and add functionality to our service offerings, which would increase our internal-use software development costs attributable to employees working on such projects. 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 2012 as compared to 2011. All of these increased costs could negatively affect our profitability.
- We expect to continue to grant restricted stock units, or RSUs, to employees in the future; therefore, we anticipate that stock-based compensation expense will increase compared to 2011 levels. As of September 30,

2012, our total unrecognized compensation costs for stock-based awards were $141.0 million, which we expect to recognize as expense over a weighted average period of 1.3 years. We expect to recognize this expense through 2016.

- During the nine months ended September 30, 2012, our effective income tax rate was 39.4%. We expect our annual effective income tax rate in 2012 to remain relatively consistent in the remaining quarter of 2012; this expectation does not take into consideration the effect of discrete items recorded as a result of our compliance with the accounting guidance for stock-based compensation, any tax planning strategies or the effect of changes in tax laws and regulations.

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 2012; 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:

- innovate and respond to emerging technological trends and customers' changing needs;
- manage expected growth and other changes to our business;
- 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 is 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, 2011 for further discussion of our critical accounting policies and estimates.

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board, or 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. We adopted this guidance during the first quarter of 2012. The adoption of the guidance did not 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, or 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. We adopted this guidance during the first quarter of 2012. There was no impact on our consolidated financial results as the amendments relate only to changes in financial statement presentation.

In September 2011, the FASB issued amended guidance that simplifies how entities test goodwill for impairment. Under the amended guidance, after assessment of certain qualitative factors, if an entity determines that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the entity must perform the quantitative analysis of the goodwill impairment test. Otherwise, the quantitative tests are optional. We adopted this guidance during

the first quarter of 2012. The adoption of the guidance did not have a material impact on our financial condition or results of operations.

In July 2012, the FASB issued amended guidance on the periodic testing of indefinite-lived intangible assets for impairment. This guidance will allow entities to assess qualitative factors to determine if it is more likely than not that the indefinite-lived intangible asset might be impaired and whether it is necessary to perform the quantitative impairment test required under current accounting standards. The updated accounting guidance is effective for interim and annual periods beginning after September 15, 2012 with early adoption permitted. We will adopt the updated guidance in the fourth quarter of fiscal year 2012. The adoption of the guidance is not expected to have a material impact on our consolidated financial statements.

Results of Operations

Revenues. Total revenues increased 23%, or $63.5 million, to $345.3 million for the three months ended September 30, 2012 as compared to $281.9 million for the three months ended September 30, 2011. Total revenues increased 19%, or $161.3 million, to $996.1 million for the nine months ended September 30, 2012 as compared to $834.8 million for the nine months ended September 30, 2011. The following 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 September 30, 2012 as compared to 2011	For the Nine Months Ended September 30, 2012 as compared to 2011
Media & Entertainment	$31.0	$70.0
Commerce	12.6	37.5
Enterprise	8.4	21.5
High Tech	8.4	24.3
Public Sector	3.1	8.0
Total net increase	$63.5	$161.3

A significant portion of the increase in revenues attributable to our media and entertainment vertical was driven by traffic growth stemming from increased online media consumption. Revenues from our commerce and enterprise verticals increased due to growth in application and cloud performance solutions sold to customers in these verticals. Revenues from our high tech vertical grew due to increased demand for cloud performance solutions and higher software download volumes. Our revenues from the public sector vertical for the three and nine months ended September 30, 2012 as compared to the same periods in 2011 grew due to the timing of completion of certain elements of government agency contracts.

For the three and nine months ended September 30, 2012, approximately 29% and 28%, respectively, of our revenues were derived from our operations located outside of the United States, including 16% and 17%, respectively, derived from Europe. For each of the three- and nine-month periods ended September 30, 2011, approximately 29% and 29%, respectively, of our revenues were derived from operations outside of the United States, including 18% derived from Europe in each of these periods. No single country outside of the United States accounted for 10% or more of revenues during any of these periods. For each of the three- and nine-month periods ended September 30, 2012, resellers accounted for 22% and 21%, respectively, of revenues as compared to 19% of revenues for each of the three- and nine-month periods ended September 30, 2011. For each of the three- and nine-month periods ended September 30, 2012 and 2011, no single 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 September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Bandwidth and service-related fees	$28.4	$21.8	$84.4	$63.5
Co-location fees	32.9	33.7	99.7	96.3
Payroll and related costs of network operations personnel	5.1	3.9	14.5	