SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2001.**

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

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)**

500 Technology Square
Cambridge, MA 02139
(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 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

The number of shares outstanding of the registrant's common stock as of July 20, 2001: 15,130,774 shares.

AKAMAI TECHNOLOGIES, INC.

FORM 10-Q
For the Quarterly Period Ended June 30, 2001

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

AKAMAI TECHNOLOGIES, INC.

CONSOLIDATED BALANCE SHEETS

	June 30, 2001	December 31, 2000
	(in thousands, except share and per share data)	
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$ 120,254	$ 150,130
Marketable securities	146,849	159,522
Accounts receivable, net of allowance for doubtful accounts of $4,279 and $2,291 at June 30, 2001 and December 31, 2000, respectively	25,226	22,670
Prepaid expenses and other current assets	18,495	23,022
Total current assets	310,824	355,344
Property and equipment, net	150,824	143,041
Marketable securities	—	77,282
Goodwill and other intangible assets, net	30,811	2,186,157
Other assets	27,136	28,953
Total assets	$ 519,595	$2,790,777
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 38,112	$ 52,212
Accrued expenses	11,475	4,327
Accrued restructuring (Note 10)	8,646	—
Accrued interest payable	8,250	8,754
Accrued payroll and benefits	13,278	14,240
Deferred revenue	5,334	4,335
Current portion of obligations under capital lease and equipment loan	915	1,080
Total current liabilities	86,010	84,948
Obligations under capital leases and equipment loan, net of current portion	171	421
Accrued restructuring and other liabilities (Note 10)	16,373	1,009
Convertible notes	300,000	300,000
Total liabilities	402,554	386,378
Contingencies (Note 11)	—	—
Stockholders' equity:		
Preferred stock, $0.01 par value; 5,000,000 shares authorized; no shares issued or outstanding at June 30, 2001 and December 31, 2000	—	—
Common stock, $0.01 par value; 700,000,000 shares authorized; 115,070,779 shares issued and outstanding at June 30, 2001; 108,203,290 shares issued and outstanding at December 31, 2000	1,151	1,082
Additional paid-in capital	3,444,291	3,382,582
Deferred compensation	(63,005)	(22,313)
Notes receivable from officers for stock	(5,869)	(5,704)
Accumulated other comprehensive income (loss)	227	(6,882)
Accumulated deficit	(3,259,754)	(944,366)
Total stockholders' equity	117,041	2,404,399
Total liabilities and stockholders' equity	$ 519,595	$2,790,777

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

AKAMAI TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the three months ended June 30,		For the six months ended June 30,	
	2001	2000	2001	2000
	(in thousands, except per share data) (unaudited)			
Revenue:				
Service	$ 35,569	$ 18,144	$ 67,833	$ 25,366
License	2,322	—	5,822	—
Service and license from affiliates (Note 8)	5,250	—	9,695	—
Total revenue	43,141	18,144	83,350	25,366
Operating expenses:				
Cost of service (excludes $10,276, $4,016, $19,588 and $5,622, respectively, of network-related depreciation included in depreciation below)	13,622	8,631	29,782	13,661
Engineering and development (excludes $3,749, $590, $4,777 and $1,697, respectively, of equity-related compensation disclosed separately below)	16,737	12,931	35,369	19,846
Sales, general and administrative (excludes $7,289, $8,831, $10,775 and $9,913, respectively, of equity-related compensation disclosed separately below)	41,292	36,373	83,568	56,378
Depreciation	18,340	7,305	34,792	10,368
Amortization of goodwill and other intangible assets	5,392	189,080	244,330	198,080
Acquired in-process research and development	—	1,372	—	1,372
Equity-related compensation	11,038	9,421	15,552	11,610
Impairment of goodwill (Note 7)	—	—	1,912,840	—
Restructuring charge (Note 10)	26,194	—	26,194	—
Total operating expenses	132,615	265,113	2,382,427	311,315
Loss from operations	(89,474)	(246,969)	(2,299,077)	(285,949)
Interest (expense) income, net	(1,637)	3,803	(1,056)	7,428
Equity in losses of affiliate (Note 8)	(153)	—	(2,000)	—
Loss on investments (Note 6)	(1,000)	—	(12,747)	—
Loss before provision for income taxes	(92,264)	(243,166)	(2,314,880)	(278,521)
Provision for income taxes	344	70	508	112
Net loss	$(92,608)	$(243,236)	$(2,315,388)	$(278,633)
Basic and diluted net loss per share	$ (0.91)	$ (2.78)	$ (23.11)	$ (3.43)
Weighted average common shares outstanding	101,629	87,374	100,205	81,251

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

AKAMAI TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the six months ended June 30, 2001	2000
	(in thousands) (unaudited)	
Cash flows from operating activities:		
Net loss	$(2,315,388)	$(278,633)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	279,122	208,448
Equity-related compensation	15,552	11,610
Amortization of prepaid advertising acquired in business acquisition	2,403	—
Accrued interest on notes receivable from officers for stock	(165)	(171)
Amortization of deferred financing costs	695	—
Loss on investments	12,747	—
Equity in losses of affiliate	2,000	—
Impairment of goodwill	1,912,840	—
Acquired in-process research and development	—	1,372
Changes in operating assets and liabilities, net of effects of acquired businesses:		
Accounts receivable, net	(4,491)	(3,991)
Prepaid expenses and other current assets	904	(7,638)
Accounts payable and accrued expenses	(993)	15,670
Deferred revenue	998	3,076
Other noncurrent assets and liabilities	19,362	1,065
Net cash used in operating activities	(74,414)	(49,192)
Cash flows from investing activities:		
Purchases of property and equipment	(42,548)	(55,624)
Purchase of investments	(64,673)	(277,588)
Cash acquired from the acquisition of businesses, net of cash paid	—	17,466
Proceeds from sales and maturities of investments	147,393	147,777
Net cash provided by (used in) investing activities	40,172	(167,969)
Cash flows from financing activities:		
Proceeds from the issuance of 5½% convertible subordinated notes, net of financing costs	—	290,200
Payments on capital leases and equipment financing loan	(609)	(273)
Payment on senior subordinated notes	—	(2,751)
Proceeds from the issuance of common stock under stock option and employee stock purchase plans	4,931	14,987
Net cash provided by financing activities	4,322	302,163
Effects of exchange rate translation on cash and cash equivalents	44	(16)
Net (decrease) increase in cash and cash equivalents	(29,876)	84,986
Cash and cash equivalents, beginning of period	150,130	269,554
Cash and cash equivalents, end of period	$ 120,254	$ 354,540

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

AKAMAI TECHNOLOGIES, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Business:

Akamai Technologies, Inc. ("Akamai" or the "Company") was formed in August 1998 and is a provider of globally distributed application and Internet content delivery services. Akamai's services improve the speed, quality, availability, reliability and scalability of Web sites by delivering customers' Internet content, streaming media and applications through a distributed worldwide network of servers that locate content and applications geographically closer to users.

2. Basis of Presentation and Principles of Consolidation:

The accompanying interim consolidated financial statements, together with the related notes, are unaudited and reflect all adjustments, consisting only of normal recurring adjustments, that in the opinion of management are necessary for a fair presentation of the Company's financial position, results of operations and cash flows as of the dates and for the periods presented. The interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Consequently, these interim financial statements do not include all disclosures normally required by generally accepted accounting principles for annual financial statements. Accordingly, reference should be made to the Company's Annual Report on Form 10-K for the year ended December 31, 2000 for additional disclosures. Results of the interim periods are not necessarily indicative of results for the entire year.

The interim consolidated financial statements include the accounts of Akamai and its wholly-owned subsidiaries. All intercompany transactions have been eliminated in consolidation. Certain reclassifications of prior period amounts have been made to conform with current period presentation.

3. Recent Accounting Pronouncements:

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141 ("SFAS 141"), "Business Combinations." SFAS 141 requires the purchase method of accounting for business combinations initiated after June 30, 2001 and eliminates the pooling-of-interests method. The Company does not believe that the adoption of SFAS 141 will have a significant impact on its financial statements.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets", which is effective January 1, 2002. SFAS 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the standard includes provisions for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the identification of reporting units for purposes of assessing potential future impairments of goodwill. SFAS 142 also requires the Company to complete a transitional goodwill impairment test six months from the date of adoption. The Company is currently assessing but has not yet determined the impact of SFAS 142 on its financial position and results of operations.

4. Net Loss per Share:

Basic net loss per share is computed using the weighted average number of common shares outstanding during the period. Diluted net loss 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 stock options, warrants, unvested restricted common stock, convertible subordinated notes and contingently issuable common stock. All potential common stock has been excluded from diluted net loss per share as its inclusion would be anti-dilutive for all periods presented.

The following table sets forth potential common stock excluded from the calculation of earnings per share:

	As of June 30,	
	2001	2000
Stock options	9,346,644	19,235,704
Warrants	1,052,694	2,283,732
Unvested restricted common stock	12,316,176	14,360,695
Convertible subordinated notes	2,598,074	2,598,074
Contingently issuable common stock	1,089,325	44,477

5. Comprehensive Loss:

The following table presents the calculation of comprehensive loss and its components for the three and six months ended June 30, 2001 and 2000 (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2001	2000	2001	2000
Net loss	$(92,608)	$(243,236)	$(2,315,388)	$(278,633)
Other comprehensive income (loss):				
Foreign currency translation adjustment	—	(10)	—	(15)
Unrealized gain (loss) on investments	1,108	(5,977)	(1,528)	743
Reclassification adjustment for investment losses included in net loss	—	—	8,637	—
Comprehensive loss	$(91,500)	$(249,223)	$(2,308,279)	$(277,905)

6. Loss on Investments:

The Company reviews its investment holdings for reductions in market value below cost basis that, in the opinion of the Company, represent a permanent or other-than-temporary impairment. The Company recorded a loss of approximately $9.0 million in the consolidated statement of operations for the three months ended March 31, 2001 to adjust the cost basis of the investments to fair value as of March 31, 2001. Loss on investments for the six months ended June 30, 2001 also includes a realized loss of $2.7 million on an exchange of an equity holding in a private company as a result of its merger with an unrelated company and a $1.0 million impairment of an investment in a private company.

7. Impairment of Goodwill:

The Company reviews goodwill and other long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may exceed their fair value. The Company considers several factors in determining whether an impairment may have occurred, including the Company's market capitalization compared to its book value per share, the overall business climate and current estimates for operating results of acquired businesses. A review of these factors as of March 31, 2001 indicated that an impairment assessment was required for long-lived assets of acquired businesses. The Company grouped all long-lived assets for acquired businesses, including goodwill and other intangible assets, and estimated the future discounted cash flows related to these long-lived assets. The discount rate used was based on the risks associated with the acquired businesses. As a result of this analysis, the Company recorded an impairment charge of $1,912.8 million for the three months ended March 31, 2001 to adjust the carrying amount of goodwill arising from the acquisitions of Network*24* Communications, Inc. ("Network*24*") and InterVU Inc. ("InterVu") to its fair value as of March 31, 2001.

8. Related Party Transactions:

(a) In the fourth quarter of 2000, Akamai formed Sockeye Networks, Inc., formerly known as Arriva! Networks, Inc. ("Sockeye"), as a wholly-owned subsidiary and contributed certain technology in exchange for all outstanding capital stock of Sockeye. Sockeye provides intelligent Internet routing services. In January 2001, Akamai deconsolidated Sockeye concurrently with the sale by Sockeye of a majority interest in its equity to outside investors in return for $28 million in cash. Akamai received no cash proceeds from Sockeye's sale of its capital stock, and Akamai's equity interest in Sockeye was reduced to approximately 40%. In addition, Akamai entered into a five-year renewable license agreement with Sockeye for additional technology that requires Sockeye to pay to Akamai a minimum monthly license fee of $1 million plus royalties based on the level of Sockeye's revenues derived from using the technology. During the six months ended June 30, 2001, licensing fees payable by Sockeye to Akamai were $5.2 million. This amount is included in accounts receivable on the consolidated balance sheet as of June 30, 2001 and was fully paid in cash in July 2001. In addition, during the six months ended June 30, 2001, Sockeye paid Akamai $3.7 million for technology development work performed by Akamai.

Subsequent to the deconsolidation, Akamai has adopted the equity method to account for its investment in Sockeye. For the six months ended June 30, 2001, Akamai's share of Sockeye's losses was $2.0 million, which is recorded in equity in losses of affiliates on the consolidated statement of operations. The Company discontinued recognizing its equity interest in Sockeye's losses during the three months ended June 30, 2001 because the carrying amount of its investment in Sockeye had been reduced to zero.

(b) In the first quarter of 2001, the Company invested $5.0 million in a company in which a senior manager of Akamai is an officer and holds a significant ownership interest. The investment has been recorded in other assets on the consolidated balance sheet. Akamai purchased approximately $600,000 of bandwidth and co-location space from this company during the six months ended June 30, 2001.

(c) In April 2001, Akamai and SOFTBANK Broadmedia Corporation ("SBBM"), a subsidiary of SOFTBANK Group, formed a joint venture to create Akamai Technologies Japan KK ("Akamai Japan"). Akamai Japan acts as the exclusive provider of Akamai's services in Japan. Akamai Japan is owned 60% by SBBM and 40% by Akamai. Akamai Japan's board of directors is comprised of seven seats, four of which are controlled by SBBM and three of which are controlled by Akamai. Akamai accounts for its investment in Akamai Japan using the equity method. Akamai recognized $750,000 of revenue from Akamai Japan during the three months ended June 30, 2001. This amount is included in accounts receivable at June 30, 2001.

9. Stock Plans:

(a) In April 2001, the Company communicated to its employees an offer to exchange (the "Exchange Offer") certain employee stock options having an exercise price of more than $13 per share previously granted to them in return for restricted shares of Akamai common stock at an exchange ratio of two stock options for one share of restricted stock. Certain stock options granted in February 2001 were eligible to be exchanged at a ratio of one stock option for two shares of restricted stock. Employees who accepted the Exchange Offer were required to exchange any stock option granted to them after November 3, 2000 (whether or not the exercise price of any such stock option was more than $13 per share) and to forfeit certain stock options granted to them in October 2000. Until the restricted stock vests, such shares are subject to forfeiture for up to three years in the event the employee leaves the Company. Generally, 25% of the shares vest after six months and the remaining 75% of the shares vest quarterly thereafter until the third anniversary date of the effective date of the Exchange Offer. The Company filed the Exchange Offer as a tender offer with the Securities and Exchange Commission in accordance with Rule 13e-4 of the Securities Exchange Act of 1934, as amended, on April 4, 2001. The Exchange Offer was effective on May 5, 2001, and the Company accepted all stock options tendered.

In connection with the Exchange Offer, stock options to purchase approximately 6.6 million shares of Akamai common stock were exchanged for approximately 3.4 million shares of restricted stock. In accordance with FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation — an Interpretation of APB Opinion No. 25," the Company recorded approximately $36.1 million as deferred compensation for the intrinsic value of the restricted stock on the effective date the Exchange Offer. The deferred compensation will be amortized to equity-related compensation expense over the vesting period of the restricted stock.

(b) During the six months ended June 30, 2001, the Company issued approximately 2.2 million shares of restricted common stock to employees under the 1998 Stock Incentive Plan. The restricted stock was sold to employees at a price of $0.01 per share and vests over a two-year period. The Company recorded deferred compensation of $14.8 million for the intrinsic value of the shares of restricted stock on the date of issuance. The deferred compensation will be amortized to equity-related compensation over the vesting period of the restricted stock.

(c) In May 2001, the shareholders of the Company voted to increase the number of shares of common stock reserved for issuance under the 1998 Stock Incentive Plan from 37,755,600 to 41,255,600. The shareholders also voted to increase the number of shares of common stock authorized for issuance under the 1999 Employee Stock Purchase Plan from 600,000 to 3,100,000.

10. Restructuring:

In April 2001, management approved, announced and committed the Company to a restructuring plan (the "Restructuring Plan"). The Company recorded a restructuring charge of $26.2 million during the three months ended June 30, 2001 as described below.

Under the Restructuring Plan, the Company recorded a $1.9 million charge for the termination of approximately 150 employees, which represented approximately 12% of the Company's employee base and included employees from all areas of the Company. As of June 30, 2001, the Company had paid $1.7 million against the severance liability. The Company expects to pay the remaining severance costs over the next three to six months. In connection with the reduction in current and anticipated headcount, the Company concluded that its office lease commitments exceeded its needs. Therefore, as part of the Restructuring Plan, the Company will consolidate and sublease certain of its facilities. The Company recorded a $24.3 million charge for expected losses on subleases and lease terminations. The consolidation and subleasing of office space is expected to be completed as soon as possible, subject to market conditions. In estimating the amount of the restructuring charge, management made certain assumptions including the amount and timing of sublease income and the rate at which the office space will be vacated. As of June 30, 2001, the accrued real estate restructuring liability was $14.7 million and is included in long-term liabilities, net of current portion of $8.6 million. To date, the Company has recorded $1.0 million in net rent payments against the restructuring liability.

11. Contingencies:

The Company is subject to legal proceedings, claims and litigation arising in the ordinary course of business. Management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

On September 13, 2000, the Company, together with the Massachusetts Institute of Technology, filed suit in Massachusetts federal court against Digital Island, Inc. for infringing an MIT patent licensed exclusively to Akamai (the "Massachusetts Action"). On September 19, 2000, that suit was amended to include a count seeking a declaratory judgment that Akamai did not infringe a Digital Island patent. The Company is seeking monetary damages and injunctive relief. On September 19, 2000, Digital Island filed suit against the Company in federal court in California alleging infringement of the same patent (the "California Action"). The California Action was dismissed in March 2001 and will be heard with the suit filed by the Company against Digital Island. The Massachusetts Action has also been amended to include a count that Digital Island infringes a patent the Company acquired as a result of its acquisition of InterVu. Digital Island is seeking monetary damages and injunctive relief. The Company intends to aggressively defend against the allegation that it infringes Digital Island's patent.

On September 21, 2000, the Company filed a lawsuit against Digital Island in federal court in California for false advertising, unfair competition, intentional interference with contractual relationships and intentional interference with business advantage. Akamai is seeking damages and injunctive relief. On October 26, 2000, Digital Island filed a counterclaim against the Company alleging that distribution of certain marketing materials and statements constituted false advertising, unfair competition, intentional interference with contractual relationships and intentional interference with business advantage. Digital Island is seeking monetary damages and injunctive relief. Akamai intends to aggressively defend the counterclaim and to prosecute vigorously the false advertising suit that it had previously filed against Digital Island.

Although the Company cannot be assured that it will prevail in these actions, it believes that it has meritorious defenses to the claims asserted by Digital Island. The Company does not believe that the resolution of these claims will have a material adverse effect on its financial condition or results of operations.

In January 2000, a former employee of InterVu filed an action against InterVu alleging that InterVu had breached two restricted stock purchase agreements by failing to deliver certain shares of stock after the employee's resignation. The plaintiff sought specific performance and monetary damages. A bench trial was held in March 2001, and in April 2001 the court ruled in favor of the plaintiff. The court directed the plaintiff to prepare a Statement of Decision but has yet to assess damages. Although the exact amount of damages is not determinable at this time, the Company has accrued a reasonable estimate of the potential loss, which has been included in the purchase price allocation of InterVu. The Company is considering an appeal of the trial court's decision in this case.

In October 2000, a former employee of InterVu filed an action against InterVu and the Company, as InterVu's successor-in-interest, alleging breach of contract and breach of fiduciary duty. The plaintiff asserts that he is entitled to stock options that he claims should have vested upon his resignation from InterVu in November 1999. The Company believes that the plaintiff's assertions against the Company are without merit; however, given the inherent uncertainty of litigation, there can be no assurance that the Company will prevail in this action.

Item 2. ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

This Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. For this purpose, statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects" and similar expressions are intended to identify forward-looking statements. These forward-looking statements involve risks and uncertainties and are not guarantees of future performance. Actual results may differ materially from those indicated in such forward-looking statements as a result of certain factors including, but not limited to, those set forth under the heading "Factors Affecting Future Operating Results."

Overview

Akamai provides globally distributed application and Internet content delivery services. We were formed in August 1998 and began selling our services commercially in April 1999. We market our services worldwide through a direct sales force and a reseller channel. Our services improve the speed, quality, availability, reliability and scalability of Web sites and deliver our customers' Internet content, streaming media and applications through a distributed worldwide network of over 11,600 servers in 62 countries, which locates content geographically closer to users.

For each of the six-month periods ended June 30, 2001 and 2000, over 90% of our revenue was derived from customers located in the United States. For the six months ended June 30, 2001, one customer, Sockeye Networks, Inc., or Sockeye, accounted for 11% of total revenue. For the same period in the prior year, one customer, Apple Computer, accounted for 18% of total revenue. No other customer accounted for more than 10% of revenue for these periods. We expect that revenue from Sockeye will decline as a percentage of total revenue in the future. In April 2001, we re-signed Apple Computer to a one-year contract. We do not expect that revenue from Apple Computer will exceed 10% of total revenue for the current fiscal year.

Although our revenue has consistently increased from quarter to quarter, we have incurred significant costs to develop our technology, build out our worldwide network, sell and market our services and support our operations. We have also incurred significant amortization expense from the acquisition of businesses. Since our inception, we have incurred significant losses and negative cash flows from operations. We have not achieved profitability on a quarterly or annual basis, and we anticipate that we will continue to incur net losses in the future. We believe that our success is dependent on increasing our customer base, developing new services and expanding our worldwide network. In order to achieve these goals, we expect to incur significant sales, marketing, engineering and development and general and administrative costs in the future. In addition, we will incur significant non-cash expenses in the future, including the amortization of deferred compensation and goodwill and other intangible assets.

Restructuring

In April 2001, management approved, announced and committed us to a restructuring plan, which we refer to as the Restructuring Plan. We recorded a restructuring charge of $26.2 million during the three months ended June 30, 2001 as described below.

Under the Restructuring Plan, we recorded a $1.9 million charge for the termination of approximately 150 employees, which represented approximately 12% of our employee base and included employees from all areas of our operations. As of June 30, 2001, we had paid $1.7 million against the severance liability. We expect to pay the remaining severance costs over the next three to six months and expect annual savings of approximately $15 million as a result of the severance. In connection with the reduction in current and anticipated headcount, we concluded that our office lease commitments exceeded our needs. Therefore, as part of the Restructuring Plan, we will consolidate and sublease certain of our facilities. We recorded a $24.3 million charge for expected losses on subleases and lease terminations. The consolidation and subleasing of office space is expected to be completed as soon as possible, subject to market conditions. In estimating the amount of the restructuring charge, management made certain assumptions including the amount and timing of sublease income and the rate at which the office space will be either vacated or occupied. As of June 30, 2001, the accrued real estate restructuring liability was $14.7 million and is included in long-term liabilities, net of current portion of $8.6 million. To date, we have recorded $1.0 million in net rent payments against the restructuring liability.

Results of Operations

Revenue. We derive revenue primarily from the sale of our services under contracts with typical terms of 12 to 24 months. We also provide streaming services on an individual live-event basis. In addition, we recognize revenue from licensed technology, streaming-related services and professional services. During the six months ended June 30, 2001, we recognized revenue under a technology license and a technology development agreement with Sockeye, an affiliate of Akamai. See Note 8 to our interim consolidated financial statements included in this Form 10-Q for further discussion of Sockeye.

We recognize revenue from our distributed application and content delivery and streaming services as the services are provided based on the amount of data delivered through our network, including minimum monthly usage commitments. We record installation and set-up fees as deferred revenue and recognize these fees ratably over the life of the customer contract. We recognize revenue from licensed technology when delivery has occurred, the fee is fixed or determinable, collectibility is reasonably assured and a written license agreement has been signed by us and our customer. We recognize revenue from streaming-related services, such as encoding and production, when the services are performed. We recognize revenue from professional services when these services are performed.

Revenue increased 229% to $83.4 million for the six months ended June 30, 2001 compared to $25.4 million for the same period in 2000. Revenue increased 138% to $43.1 million for the three months ended June 30, 2001 compared to $18.1 million for the same period in 2000. Revenue increased in both periods primarily due to the significant growth of our content provider customer base, the introduction of new services and an increase in license revenue. Resellers accounted for 21% and 10% of total revenue for the six month periods ended June 30, 2001 and 2000, respectively. We expect revenue to increase in the future as we add new customers and introduce new services.

Cost of Service. Cost of service consists primarily of fees paid to network providers for bandwidth and monthly fees for housing our servers in third-party network data centers. We include the depreciation on our network equipment used to deliver our services under the heading "Depreciation" on the consolidated statement of operations included in this Form 10-Q. Cost of service also includes network storage costs; live event costs including costs for production, encoding and signal acquisition; and cost of professional services. We enter into contracts for bandwidth with third-party network providers with terms typically ranging from one to three years. These contracts commit us to minimum monthly fees plus additional fees for bandwidth usage above the contracted level and, in some instances, commit us to share with the third-party network providers a portion of the revenue recognized from customers that use these third-party networks. In some circumstances, Internet service providers, or ISPs, make available to us rack space for our servers and access to their bandwidth at little or no cost. In exchange, the ISPs' customers benefit by receiving content through a local Akamai server resulting in faster content delivery. We do not believe that these relationships represent the culmination of an earnings process. Accordingly, we do not recognize as revenue any value to the ISPs associated with the use of our servers and we do not expense the value of the rack space and bandwidth that we receive at no cost.

Cost of service, excluding network-related depreciation, increased 118% to $29.8 million for the six months ended June 30, 2001 compared to $13.7 million for the same period in 2000. Cost of service increased 58% to $13.6 million in the three months ended June 30, 2001 compared to $8.6 million in the same period in 2000. Cost of service increased in both periods primarily due to higher bandwidth costs as a result of the expansion of our network and an increased amount of content delivered over our network. Gross margins were 64.3% and 68.4% for the six and three months ended June 30, 2001, respectively, compared to 46.1% and 52.4%, respectively, in the same periods in 2000. Gross margins increased in both periods due to a decline in the ratio of bandwidth costs to our content-delivery prices and an increase in licensing revenue, which has a nominal cost of revenue.

Engineering and Development. Engineering and development expenses consist primarily of salaries and payroll-related expenses and other costs related to the design, development, testing, deployment and enhancement of our services and our network. To date, we have expensed engineering and development costs as incurred. We believe that product development is critical to our future objectives and we intend to continue to enhance our technology to meet the challenging requirements of market demand. Engineering and development expenses increased 78% to $35.4 million for the six months ended June 30, 2001 compared to $19.8 million for the same period in 2000. Engineering and development expenses increased 29% to $16.7 million in the three months ended June 30, 2001 compared to $12.9 million in the same period in 2000. Engineering and development expenses increased in both periods primarily due to increased personnel and payroll-related expenses as a result of increased headcount. We do not expect significant quarterly increases in engineering and development expenses during the remainder of 2001.

Sales, General and Administrative. Sales, general and administrative expenses consist primarily of salaries and payroll-related expenses for marketing, sales, operations and finance personnel, sales commissions, fees for professional services, advertising costs, provision for doubtful accounts and rent expense for leased properties. Sales, general and administrative expenses increased 48% to $83.6 million for the six months ended June 30, 2001 compared to $56.4 million for the same period in 2000. Sales, general and administrative expenses increased 14% to $41.3 million in the three months ended June 30, 2001 compared to $36.4 million in the same period in 2000. Sales, general and administrative expenses increased in both periods primarily due to higher personnel and payroll-related expenses due to increased head count, increased sales commissions and increased rent expense as a result of our office space expansion. We do not expect significant quarterly increases in sales, general and administrative expenses during the remainder of 2001.

Depreciation. Depreciation expense consists of depreciation of our network equipment and of internal-use property and equipment. Depreciation increased 236% to $34.8 million for the six months ended June 30, 2001 compared to $10.4 million for the same period in 2000. Depreciation increased 151% to $18.3 million in the three months ended June 30, 2001 compared to $7.3 million in the same period in 2000. Depreciation expense increased primarily due to the expansion of our network. We expect depreciation expense to increase in the future as we continue to expand our network.

Amortization of Goodwill and Other Intangible Assets. Amortization of goodwill and other intangible assets consists primarily of the amortization of intangible assets, including goodwill, acquired in business combinations. Amortization of goodwill and other intangible assets increased to $244.3 million for the six months ended June 30, 2001 compared to $198.1 million in the same period in 2000. Amortization of goodwill and other intangible assets increased primarily due to the amortization of goodwill from the acquisition of InterVU Inc., or InterVu, which was acquired in April 2000. Amortization of goodwill and other intangible assets decreased to $5.4 million in the three months ended June 30, 2001 compared to $189.1 million in the same period in 2000. Amortization of goodwill and other intangible assets decreased due to an impairment to the balance of goodwill recorded in the first quarter of 2001. See *Impairment of Goodwill* below.

Equity-Related Compensation. Equity-related compensation consists of the amortization of deferred compensation resulting from the grant of stock options or shares of restricted stock to employees at exercise or sale prices deemed to be less than the fair value of the common stock on the grant date, and the intrinsic value of modified stock options or restricted stock awards, measured at the modification date, for the number of awards that, absent the modification, would have expired unexercisable. Equity-related compensation increased 34% to $15.6 million for the six months ended June 30, 2001 compared to $11.6 million for the same period in 2000. The increase was primarily due to the modification of vesting of stock options for terminated employees. Equity-related compensation increased 17% to $11.0 million for the three months ended June 30, 2001 compared to $9.4 million in the same period in 2000. The increase was primarily due to an increase in deferred compensation as a result of the Exchange Offer discussed below. As of June 30, 2001, the balance in deferred compensation, a component of stockholders equity, was $63.0 million. This amount will be amortized over the remaining vesting periods of the associated restricted stock awards or stock options. We expect to amortize deferred compensation on the balance sheet as of June 30, 2001 to equity-related compensation by approximately $15.6 million in the remainder of 2001, $25.3 million in 2002, $18.3 million in 2003 and $3.8 million in 2004.

As described in Note 9 to our interim consolidated financial statements included in this Form 10-Q, in April 2001, we communicated to our employees an offer to exchange, which we refer to as the Exchange Offer, employee stock options having an exercise price of more than $13 per share previously granted to them in return for restricted shares of Akamai common stock at an exchange ratio of two stock options for one share of restricted stock. Some stock options granted in February 2001 were eligible to be exchanged at a ratio of one stock option for two shares of restricted stock. Employees who accepted the Exchange Offer were required to exchange any stock option granted to them after November 3, 2000 (whether or not the exercise price of any such stock option was more than $13 per share) and to forfeit certain stock options granted to them in October 2000. Until the restricted stock vests, such shares are subject to forfeiture for up to three years in the event the employee leaves our company. Generally, 25% of the shares vest after six months and the remaining 75% of the shares vest quarterly thereafter until the third anniversary date of the effective date of the Exchange Offer. We filed the Exchange Offer as a tender offer with the Securities and Exchange Commission in accordance with Rule 13e-4 under the Securities Exchange Act of 1934, as amended, on April 4, 2001. The Exchange Offer was effective on May 5, 2001, and we accepted all stock options tendered.

In connection with the Exchange Offer, stock options to purchase approximately 6.6 million shares of our common stock were exchanged for approximately 3.4 million shares of restricted Akamai common stock. We recorded approximately $36.1 million as deferred compensation for the intrinsic value of the restricted stock on the effective date the Exchange Offer. The deferred compensation will be amortized to equity-related compensation expense over the vesting period of the restricted stock.

Separately, during the six months ended June 30, 2001, we issued approximately 2.2 million shares of restricted common stock to employees under our 1998 Stock Incentive Plan. The shares of restricted stock were sold at a price of $0.01 per share and vest at various rates over a two-year period. We recorded deferred compensation of approximately $14.8 million for the intrinsic value of the shares of restricted stock on the date of issuance. The deferred compensation will be amortized to equity-related compensation over the vesting period of the shares of restricted stock.

Impairment of Goodwill. We review goodwill and other long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may exceed their fair value. We consider several factors in determining whether an impairment may have occurred, including our market capitalization compared to our book value per share, the overall business climate and current estimates for operating results of acquired businesses. A review of these factors as of March 31, 2001 indicated that an impairment assessment was required for long-lived assets of acquired businesses. We grouped all long-lived assets for acquired businesses, including goodwill and other intangible assets, and estimated the future discounted cash flows related to these long-lived assets. The discount rate used was based on the risks associated with the acquired businesses. As a result of this analysis, we recorded an impairment charge of $1,912.8 million for the three months ended March 31, 2001 to adjust the carrying amount of goodwill arising from the acquisitions of Network*24* Communications, Inc., which we refer to as Network*24,* and InterVu to its fair value as of March 31, 2001.

Interest (Expense) Income, Net. Interest (expense) income, net, includes interest earned on invested cash balances, which are invested in money market funds, United States Treasury obligations, high-quality corporate obligations and certificates of deposit, and interest paid on our debt obligations. Interest (expense) income, net, decreased to $(1.1) million for the six months ended June 30, 2001 compared to $7.4 million for the same period in 2000. The decrease was due to interest accrued on our convertible subordinated notes and a decrease in invested cash balances.

Equity in Losses of Affiliate. Equity in losses of affiliate of $2.0 million in the six months ended June 30, 2001 reflects our share of the losses in Sockeye. See Note 8 to the interim consolidated financial statements included in this Form 10-Q for further discussion of Sockeye.

Loss on Investments. As described in Note 6 to our interim consolidated financial statements included in this Form 10-Q, loss on investments for the six months ended June 30, 2001, includes $9.0 million for the adjustment to market value of equity investments. Loss on investments also includes a realized loss of $2.7

million on an exchange of an equity holding in a private company due to its merger with an unrelated company and a $1 million impairment of an investment in a private company.

Liquidity and Capital Resources

Prior to our initial public offering in November 1999, we financed our operations primarily through private sales of our capital stock and issuance of senior subordinated notes totaling approximately $124.6 million in net proceeds through December 31, 1999. In November 1999, we sold shares of common stock through our initial public offering. Net proceeds to us from the initial public offering were $217.6 million after deducting an aggregate of $16.4 million in underwriting discounts and commissions to the underwriters. In June 2000, we issued $300.0 million of 5½% convertible subordinated notes for aggregate net proceeds of $290.2 million. The convertible notes are due July 1, 2007 and are convertible any time, at the option of the holders, into shares of our common stock at a conversion price of $115.47 per share (equivalent to 8.6603 shares of common stock per $1,000 principal amount of convertible notes), subject to adjustment in certain events. In January 2001, we filed a universal shelf registration statement with the Securities and Exchange Commission that will enable us to sell up to $500 million of equity or debt securities in one or more public offerings over the next six quarters. In addition, we have signed contracts for approximately $25 million of financing with equipment vendors. As of June 30, 2001, cash, cash equivalents and marketable securities totaled $267.1 million.

Cash used in operating activities was $74.4 million for the six months ended June 30, 2001 compared to $49.2 million for the same period in 2000. Cash used in operating activities in the current period reflects an increase in losses from operations and an increase in accounts receivable offset by an increase in other long-term liabilities and accrued expenses. We expect cash flows from operating activities to be negative through at least the next 12 months.

Cash provided by investing activities was $40.2 million for the six months ended June 30, 2001. Cash used in investing activities was $168.0 million for the six months ended June 30, 2000. Cash provided by investing activities in the current period reflects net sales and maturities of investments of $82.7 million and purchases of property and equipment of $42.5 million, consisting primarily of servers for the deployment and expansion of our network and information systems used to operate our business. Cash used in investing activities in the same period in the prior year reflects net investment purchases of $129.8 million, capital expenditures of $55.6 million and cash acquired of $17.5 million, net of cash paid, for the acquisition of businesses. We expect capital expenditures to be between $70 million and $80 million for the year ended December 31, 2001.

Cash provided by financing activities was $4.3 million for the six months ended June 30, 2001 and $302.2 million for the same period in 2000. Cash provided by financing activities in the current period primarily reflects proceeds from the issuance of common stock under our stock plans. Cash provided by financing activities for the same period in the prior year primarily reflects the sale in June 2000 of our 5½% convertible notes due 2007.

We believe, based on our present business plan, that our current cash, cash equivalents and marketable securities will be sufficient to meet our cash needs for working capital and capital expenditures on both a short-term and long-term basis. If the assumptions underlying our business plan regarding future revenue and expenses change or if unexpected opportunities or needs arise, we may raise additional cash by selling equity or debt securities. If additional funds are raised through the issuance of debt securities, these securities could have rights, preferences and privileges senior to those accruing to holders of common stock, and the terms of such debt could impose restrictions on our operations. The sale of additional equity or convertible debt securities could result in additional dilution to our stockholders. See "Factors Affecting Future Operating Results."

Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141 ("SFAS 141"), "Business Combinations." SFAS 141 requires the purchase method of accounting for business combinations initiated after June 30, 2001 and eliminates the pooling-of-interests method. We do not believe that the adoption of SFAS 141 will have a significant impact on our financial statements.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets", which is effective January 1, 2002. SFAS 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the standard includes provisions for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the identification of reporting units for purposes of assessing potential future impairments of goodwill. SFAS 142 also requires us to complete a transitional goodwill impairment test six months from the date of adoption. We are currently assessing but have not yet determined the impact of SFAS 142 on our financial position and results of operations.

Factors Affecting Future Operating Results

The following important factors, among other things, could cause our actual operating results to differ materially from those indicated or suggested by forward-looking statements made in this quarterly report on Form 10-Q or presented elsewhere by management from time to time.

Our business is difficult to evaluate and our business strategy may not successfully address risks we face because we have a limited operating history.

We were founded in August 1998 and began offering our services commercially in April 1999. We have limited historical financial data upon which to base planned operating expenses and upon which investors may evaluate us and our prospects. In addition, while our operating expenses are largely based on anticipated but unpredictable revenue trends, a high percentage of these expenses is and will continue to be fixed in the short-term. Because of our limited operating history, our business strategy may not successfully address all of the risks we face.

We are primarily dependent on our Internet content, applications and streaming media delivery services and our future revenue depends on continued demand for our services.

Currently, our future growth depends on the commercial success of our Internet distributed application and content delivery services and other services and products we may develop and/or offer. While we have been selling our services commercially since April 1999, sales may not continue in the future for a variety of reasons. First, the market for our existing services is relatively new and issues concerning the commercial use of the Internet, including security, reliability, speed, cost, ease of access, quality of service, regulatory initiatives and necessary increases in bandwidth availability, remain unresolved and are likely to affect its development. Furthermore, our new services and products under development may not achieve widespread market acceptance. Failure of our current and planned services to operate as expected could also hinder or prevent their adoption. If a broad-based, sustained market for our services does not emerge and our target customers do not adopt, purchase and successfully deploy our current and planned services, our revenue will not grow significantly and our business, results of operations and financial condition will be seriously harmed.

Failure to increase our revenue would prevent us from achieving and maintaining profitability.

We have never been profitable. We have incurred significant losses since inception and expect to continue to incur losses in the future. We cannot be certain that our revenue will continue to grow or that we will produce sufficient revenue to achieve profitability. Our failure to significantly increase our revenue would seriously harm our business and operating results. We have large fixed expenses, and we expect to continue to incur significant sales and marketing, product development, administrative and other expenses, including fees to obtain access to bandwidth for the transport of data over our network. As a result, we will need to generate significantly higher revenue to achieve and maintain profitability. If our revenue grows more slowly than we anticipate or if our operating expenses increase more than we expect or cannot be reduced in the event of lower revenue, we may need to obtain funding from outside sources. If we are unable to obtain needed outside funding, our business would be materially and adversely affected. In addition, even if we were to find outside funding sources, we might be required to issue to such outside sources securities with greater rights than those currently possessed by holders of our currently outstanding securities. We might also be required to take other actions that could lessen the value of our common stock, including borrowing money on terms that are not favorable to us.

Any failure of our network infrastructure could lead to significant costs and disruptions which could reduce our revenue and harm our business, financial results and reputation.

Our business is dependent on providing our customers with fast, efficient and reliable Internet distribution application and content delivery services. To meet these customer requirements, we must protect our network infrastructure against damage from:

- sabotage and vandalism;
- human error;
- physical or electronic intrusion and security breaches;
- fire, earthquake, flood and other natural disasters;
- power loss; and
- similar events.

For our EdgeSuite, FreeFlow and FreeFlow Streaming services, we currently provide a content delivery service guarantee that our networks will deliver Internet content 24 hours a day, seven days a week, 365 days a year. If we do not provide this service, the customer does not pay for its services on that day. Any widespread loss or interruption of services would reduce our revenue and could harm our business, financial results and reputation.

Our services and our network may be subject to intentional disruption.

Although we believe we have sufficient controls in place to prevent intentional disruptions of our services, such as disruptions caused by software viruses specifically designed to impede the performance of our services, we may be an ongoing target of such disruptions. Similarly, experienced computer programmers, or "hackers," may attempt to penetrate our network security or the security of our Web site in order to misappropriate proprietary information or cause interruptions of our operations. Our activities could be substantially disrupted and our reputation and future sales harmed if these efforts are successful.

Because our services are complex and are deployed in complex environments, they may have errors or defects that could seriously harm our business.

Our services are highly complex and are designed to be deployed in and across numerous large and complex networks. As of June 30, 2001, our network consisted of over 11,000 servers across more than 800 different networks. We and our customers have from time to time discovered errors and defects in our software. In the future, there may be additional errors and defects in our software that may adversely affect our services. If we are unable to efficiently fix errors or other problems that may be identified, we could experience:

- loss of or delay in revenues and loss of market share;
- diversion of development and engineering resources;
- loss of credibility or damage to business reputation;
- increased service costs; and
- legal actions by our customers.

Any failure of our telecommunications and network providers to provide required transmission capacity to us could result in interruptions in our services.

Our operations are dependent in part upon transmission capacity provided by third-party telecommunications network providers. Any failure of these network providers to provide the capacity we require may result in a reduction in, or interruption of, service to our customers. This failure may be a result of the telecommunications providers or Internet service providers experiencing interruptions or other failures, failing to comply with or terminating their existing agreements with us, otherwise denying or interrupting service, refusing to enter into relationships with us or only agreeing to enter into relationships with us on terms that are not commercially acceptable to us. If we do not have access to third-party transmission capacity, we could lose customers. If we are unable to obtain transmission capacity on terms commercially acceptable to us, our business and financial results could suffer. In addition, our telecommunications and network providers typically provide rack space for our servers. Damage or destruction of, or other denial of access to, a facility where our servers are housed could result in a reduction in, or interruption of, service to our customers.

The markets in which we operate are highly competitive and we may be unable to compete successfully against new entrants and established companies with greater resources.

We compete in markets that are new, intensely competitive, highly fragmented and rapidly changing. We have experienced and expect to continue to experience increased competition. Many of our current competitors, as well as a number of our potential competitors, have longer operating histories, greater name recognition, broader customer relationships and industry alliances and substantially greater financial, technical and marketing resources than we do. Our competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements. Some of our current or potential competitors may bundle their services with other services, software or hardware in a manner that may discourage Web site owners from purchasing any service we offer or Internet service providers from installing our servers.

As competition in the Internet content, streaming media and applications delivery markets continues to intensify, new solutions will come to market. We are aware of other companies that are focusing or may in the future focus significant resources on developing and marketing products and services or entering into strategic alliances that will compete with us. These companies include networking hardware and software manufacturers, content distribution providers, traditional hardware manufacturers, telecommunications providers, software database companies, and large diversified software and technology companies. Increased competition could result in:

- price and revenue reductions and lower profit margins;
- increased cost of service from telecommunications providers;
- loss of customers; and
- loss of market share.

Any one of these could materially and adversely affect our business, financial condition and results of operations.

As part of our business strategy, we have entered into and may enter into or seek to enter into business combinations and acquisitions that may be difficult to integrate, disrupt our business, dilute stockholder value or divert management attention.

We acquired Network*24* in February 2000, InterVu in April 2000 and CallTheShots Inc., which we refer to as CTS, in July 2000. As a part of our business strategy, we may enter into additional business combinations and acquisitions. Acquisitions are typically accompanied by a number of risks, including the difficulty of integrating the operations and personnel of the acquired companies, the potential disruption of our ongoing business, the potential distraction of management, expenses related to the acquisition and potential unknown liabilities associated with acquired businesses.

If we are not successful in completing acquisitions that we may pursue in the future, we may be required to reevaluate our growth strategy and we may have incurred substantial expenses and devoted significant management time and resources in seeking to complete proposed acquisitions that will not generate benefits for us. In addition, with future acquisitions, we could use substantial portions of our available cash as all or a portion of the purchase price. We could also issue additional securities as consideration for these acquisitions, which could cause our stockholders to suffer significant dilution. Our acquisitions of Network*24*, InterVu and CTS and any future acquisitions may not ultimately help us achieve our strategic goals and may pose other risks to us.

If we are not successful in entering into technology licensing, development or other strategic technology arrangements in the future, our results of operations could be adversely affected.

We derived a portion of our revenue in the six months ended June 30, 2001 from fees under license and development agreements. We expect to derive a portion of our revenue in the future from license agreements that we have entered into as well as additional licensing arrangements, development agreements and other strategic technology arrangements that we may enter into. We may not be successful in completing any additional arrangements within the time periods we anticipate or at all, which could have an adverse effect on our results of operations.

Some of our current customers are emerging Internet-based businesses that may not pay us for our services on a timely basis and that may not succeed over the long term.

Some of our revenue recognized in the six months ended June 30, 2001 was derived from customers that are emerging Internet-based businesses, and a portion of our future revenue will be derived from this customer base. The unproven business models of some of these customers make their continued financial viability uncertain. Given the short operating history and emerging nature of many of these businesses, there is a risk that some of these customers will encounter financial difficulties and fail to pay for our services or delay payment substantially. The failure of our emerging business customers to pay our fees on a timely basis or to continue to purchase our services in accordance with their contractual commitments could adversely affect our revenue collection periods, our revenue and other financial results.

One customer, Sockeye, accounted for more than 10% of our revenue during each quarter of this fiscal year.

During each of the quarters ended March 31, 2001 and June 30, 2001, sales to Sockeye accounted for greater than 10% of our revenue. We expect that sales to Sockeye as a percentage of total sales will decrease but that during the remainder of calendar 2001 sales to Sockeye will continue to represent a meaningful portion of our revenue. We hold a 40% equity stake in Sockeye. A significant decline in sales to Sockeye or any inability on our part to recognize as revenue our sales to Sockeye could reduce our revenue and cause our business and financial results to suffer.

If we are unable to scale our network as demand increases, the quality of our services may diminish and we may lose customers.

Our network may not be scalable to expected customer levels while maintaining superior performance. We cannot be certain that our network can connect and manage a substantially larger number of customers at high transmission speeds. In addition, as customers' usage of bandwidth increases, we will need to make additional investments in our infrastructure to maintain adequate data transmission speeds. We cannot ensure that we will be able to make these investments successfully or at an acceptable or commercially reasonable cost. Our failure to achieve or maintain high capacity data transmission could significantly reduce demand for our services, reducing our revenue and causing our business and financial results to suffer.

If we do not respond rapidly to technological changes, then we may lose customers.

The market for Internet content delivery services is likely to continue to be characterized by rapid technological change, frequent new product and service introductions and changes in customer requirements.

We may be unable to respond quickly or effectively to these developments. If competitors introduce products, services or technologies that are better than ours or that gain greater market acceptance, or if new industry standards emerge, our services may become obsolete, which would materially and adversely affect our business, results of operations and financial condition.

If our license agreement with MIT terminates, then our business could be adversely affected.

We have licensed from the Massachusetts Institute of Technology, or MIT, technology covered by various patent applications and copyrights relating to Internet content delivery technology. Some of our technology is based in part on the technology covered by these patent applications and copyrights. Although the license is effective for the life of the patent and patent applications, MIT may terminate the license agreement if we cease our business due to insolvency or if we materially breach the terms of the license agreement. A termination of our license agreement with MIT could have a material adverse effect on our business.

Our business will be adversely affected if we are unable to protect our intellectual property rights from third-party challenges.

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. These legal protections afford only limited protection. In addition, Digital Island has filed a patent infringement suit against us. Competitors may gain access to our intellectual property which may result in the loss of our customers. We have filed suit in federal court in Massachusetts against Digital Island for infringing one of our licensed patents and patents issued to InterVu. However, we may not prevail in either of these proceedings. In general, monitoring unauthorized use of our services is difficult and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States.

Although we have licensed and proprietary technology covered by United States patents, we cannot be certain that any such patents will not be challenged, invalidated or circumvented. Moreover, although we have filed international patent applications, none of our technology is patented abroad. We cannot be certain that any pending or future patent applications will be granted, that any future patent will not be challenged, invalidated or circumvented, or that rights granted under any patent that may be issued will provide competitive advantages to us.

The rates we charge for our services may decline over time, which would reduce our revenue and could cause our business and financial results to suffer.

We expect that our cost to obtain bandwidth capacity for the transport of data over our network will decline over time as a result of, among other things, the large amount of capital currently being invested to build infrastructure providing additional bandwidth and volume discounts available to us as our network usage increases. We expect the prices we charge for our services may also decline over time as a result of, among other things, existing and new competition in the markets we address. As a result, our historical revenue rates may not be indicative of future revenue based on comparable traffic volumes. If we fail to accurately predict the decline in costs of bandwidth or, in any event, if we are unable to sell our services at acceptable prices relative to our bandwidth costs, or if we fail to offer additional services from which we can derive additional revenue, our revenue will decrease and our business and financial results will suffer.

Our business will suffer if we fail to manage our growth properly.

We have expanded our operations rapidly since our inception. We continue to increase the scope of our operations and our headcount has grown substantially. Our total number of employees increased from 385 at December 31, 1999 to 1,125 at June 30, 2001, although we had a reduction in force of approximately 12% in April 2001. This growth has placed, and our anticipated growth in future operations will continue to place, a significant strain on our management systems and resources. Our ability to successfully offer our services and implement our business plan in a rapidly evolving market requires an effective planning and management process. We expect that we will need to continue to improve our financial and managerial controls, reporting systems and procedures, and will need to continue to train and manage our workforce worldwide. In order to grow and achieve future success, we must also improve our ability to effectively manage multiple relationships with our customers, suppliers and other third parties. In addition, from time to time, we may be required to downsize our operations in order to effectively manage our business. Failure to take any of the steps necessary to manage our growth properly would have a material adverse effect on our business, results of operations and financial condition.

We depend on our key personnel to manage our business effectively. If we are unable to retain our key employees and hire qualified sales and technical personnel, our ability to compete could be harmed.

Our future success depends upon the continued services of our executive officers and other key technology, sales, marketing and support personnel, who have critical industry experience and relationships that they rely on in implementing our business plan. None of our officers or key employees is bound by an employment agreement for any specific term. We have "key person" life insurance policies covering only the lives of F. Thomson Leighton and Daniel M. Lewin. The loss of the services of any of our key employees could delay the development and introduction of and negatively impact our ability to sell our services.

We face intense competition for qualified personnel, including research and development personnel and other persons with necessary technical skills, particularly in the Boston, Massachusetts and San Mateo, California areas. Our employees require extensive training in our Internet content delivery services. If we are unable to hire and promptly train service and support personnel, we may not be able to increase sales of our services, which would seriously harm our business.

We face risks associated with international operations that could harm our business.

We have expanded our international operations to Munich, Germany; London, England and Paris, France. In addition, in April 2001, Akamai and SOFTBANK Broadmedia Corporation formed a joint venture to create Akamai Technologies Japan KK, of which we own 40% of the common stock. A key aspect of our business strategy is to continue to expand our sales and support organizations internationally. Therefore, we expect to commit significant resources to expand our international sales and marketing activities. We are increasingly subject to a number of risks associated with international business activities which may increase our costs, lengthen our sales cycle and require significant management attention. These risks include:

- market acceptance of our products and services by countries outside the United States;
- increased expenses associated with marketing services in foreign countries;
- general economic conditions in international markets;
- currency exchange rate fluctuations;
- unexpected changes in regulatory requirements resulting in unanticipated costs and delays;
- tariffs, export controls and other trade barriers;
- longer accounts receivable payment cycles and difficulties in collecting accounts receivable; and
- potentially adverse tax consequences, including restrictions on the repatriation of earnings.

Insiders have substantial control over us which could limit the ability of other stockholders to influence the outcome of key transactions, including changes of control.

As of June 30, 2001, the executive officers, directors and entities affiliated with them, in the aggregate, beneficially owned approximately 27% of our outstanding common stock. These stockholders, if acting together, are able to influence significantly all matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other business combination transactions.

Provisions of our charter documents may have anti-takeover effects that could prevent a change in control even if the change in control would be beneficial to our stockholders.

Provisions of our amended and restated certificate of incorporation, by-laws, and Delaware law could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders.

The unpredictability of our quarterly results may adversely affect the trading price of our common stock.

Our revenue and operating results will vary significantly from quarter to quarter due to a number of factors, many of which are outside of our control and any of which may cause our stock price to fluctuate. The primary factors that may affect us include the following:

- demand for Internet distributed applications and content delivery services;
- the timing and size of sales of our services;
- the timing of recognizing revenue and deferred revenue;
- new product and service introductions and enhancements by our competitors and us;
- changes in our pricing policies or the pricing policies of our competitors;
- our ability to develop, introduce and deliver new products, services and enhancements that meet customer requirements in a timely manner;
- the length of the sales cycle for our services;
- increases in the prices of, and availability of, the products, services, components or raw materials we purchase, including bandwidth;
- our ability to attain and maintain quality levels for our services;
- expenses related to testing of our services;
- costs related to acquisitions of technology or businesses; and
- general economic conditions as well as those specific to the Internet and related industries.

Due to the above factors, we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. It is likely that in some future quarters, our operating results may be below the expectations of public market analysts and investors. In this event, the price of our common stock will probably fall.

Accounting principles relating to revenue recognition and other topics relevant to our business, and our application of those principles, may change.

In December 1999 the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," which we adopted in 2000. This guidance may continue to evolve. In addition, applying revenue recognition principles to a business like ours is complex. This complexity is in part a function of the continual interpretation of accounting principles by accounting standard setters. In addition, changes in our relationships with particular customers may require us to change how we account for revenue from those customers. Such changes could have a material adverse effect on the timing of revenue recognition and could adversely affect our financial results.

We could incur substantial costs defending our intellectual property from infringement or a claim of infringement.

Other companies or individuals, including our competitors, may obtain patents or other proprietary rights that would prevent, limit or interfere with our ability to make, use or sell our services. As a result, we may be found to infringe on the proprietary rights of others. In the event of a successful claim of infringement against us and our failure or inability to license the infringed technology, our business and operating results would be significantly harmed. Companies in the Internet market are increasingly bringing suits alleging infringement of their proprietary rights, particularly patent rights. Digital Island has filed a patent infringement suit against us. We intend to aggressively defend this lawsuit and to prosecute vigorously the patent infringement suit that we had previously filed against Digital Island. We may not prevail in either of these actions. These claims and any other litigation or claims, whether or not valid, could result in substantial costs and diversion of resources. Intellectual property litigation or claims could force us to do one or more of the following:

- cease selling, incorporating or using products or services that incorporate the challenged intellectual property;
- obtain a license from the holder of the infringed intellectual property right, which license may not be available on reasonable terms or at all; and
- redesign products or services.

If we are forced to take any of these actions, our business may be seriously harmed. Although we carry insurance, our insurance may not cover potential claims of this type or may not be adequate to indemnify us for all liability that may be imposed.

Internet-related laws could adversely affect our business.

Laws and regulations that apply to communications and commerce over the Internet are becoming more prevalent. In particular, the growth and development of the market for online commerce has prompted calls for more stringent consumer protection and privacy laws, both in the United States and abroad, that may impose additional burdens on companies conducting business online. This could negatively affect the businesses of our customers and reduce their demand for our services. Internet-related laws, however, remain largely unsettled, even in areas where there has been some legislative action. The adoption or modification of laws or regulations relating to the Internet, or interpretations of existing law, could adversely affect our business.

Our stock price has been and may continue to be volatile, which could result in litigation against us.

The market price of our common stock has been extremely volatile and has fluctuated significantly in the past. The following factors could cause the market price of common stock to continue to fluctuate significantly:

- the addition or departure of our key personnel;
- variations in our quarterly operating results;
- announcements by us or our competitors of significant contracts, new or enhanced products or service offerings, acquisitions, distribution partnerships, joint ventures or capital commitments;
- changes in financial estimates by securities analysts;
- our sales of common stock or other securities in the future;
- changes in market valuations of networking, Internet and telecommunications companies;
- fluctuations in stock market prices and volumes; and
- changes in general economic conditions, including interest rate levels.

In the past, class action litigation has often been brought against companies following periods of volatility in the market price of those companies' common stock. We may become involved in this type of litigation in the future. Litigation is often expensive and diverts management's attention and resources which could materially adversely affect our business and results of operations.

We face risks relating to possible California power outages.

The State of California is currently experiencing a chronic shortage of power and, as a result, power outages may occur. Although we have limited emergency backup power capabilities at our facilities, repeated or lengthy power outages at our facilities or at network facilities in which our servers are deployed may adversely affect our business.

We may become involved in litigation that may adversely affect us.

In the ordinary course of business, Akamai may become involved in litigation, administrative proceedings and governmental proceedings. Such matters can be time-consuming, divert management's attention and resources and cause us to incur significant expenses. Furthermore, there can be no assurance that the results of any of these actions will not have a material adverse effect on our business, results of operations or financial condition.

Several class action lawsuits have been filed against us which may result in litigation that is costly to defend and the outcome of which is uncertain and may harm our business.

We and several of our officers and current and former directors are named as defendants in several purported class action complaints which have been filed allegedly on behalf of certain persons who purchased our common stock during different time periods, all beginning on October 28, 1999 and ending on various dates, the latest of which is June 29, 2001. These complaints allege violations of the Securities Act of 1933 and the Securities Exchange Act of 1934. Primarily they allege that there was undisclosed compensation received by our underwriters in connection with our initial public offering.

We can provide no assurance as to the outcome of these complaints. Any conclusion of these matters in a manner adverse to us would have a material adverse affect on our financial position and results of operation. In addition, the costs to us of defending any litigation or other proceeding, even if resolved in our favor, could be substantial. Such litigation could also substantially divert the attention of our management and our resources in general. Uncertainties resulting from the initiation and continuation of any litigation or other proceedings could harm our ability to compete in the marketplace.

Item 3. ***Quantitative and Qualitative Disclosures About Market Risk***

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. We place our investments with high quality issuers and, by policy, limit the amount of risk by investing primarily in money market funds, United States Treasury obligations, high-quality corporate obligations and certificates of deposit. We expect to hold our marketable debt securities until maturity and do not expect to realize significant losses on the sale of marketable debt securities prior to maturity. We hold investments in the common or preferred stock of several public and private companies. The carrying amount of these investments at June 30, 2001 was $8.6 million, which approximates fair value. Due to the limited operating history of these companies, many of which are in the start-up stage, we may not be able to recover our investment.

We have $300 million of convertible subordinated notes due 2007. These notes are convertible into shares of our common stock at the option of the holders and accrue interest at a fixed annual rate of 5½%. Although the fair value of these notes is affected by changes in interest rates and the market value of our common stock, Akamai carries these notes at cost. Therefore, we do not believe that our convertible subordinated notes subject us to interest rate risk.

We have operations in Europe and we have established a joint venture in Japan. As a result, we are exposed to fluctuations in foreign exchange rates. However, we do not expect that changes in foreign exchange rates will have a significant impact on our results of operations, financial position or cash flows. We may continue to expand our operations globally and sell to customers in foreign locations, which may increase our exposure to foreign exchange fluctuations.

PART II. OTHER INFORMATION

Item 1. ***Legal Proceedings***

Between July 2, 2001 and July 13, 2001, several purported class action lawsuits were filed in the United States District Court for the Southern District of New York against us and several of our officers and directors as well as against the underwriters who handled our October 28, 1999 initial public offering of common stock. Although neither Akamai nor the individual defendants have been served with any of the complaints, the complaints were filed allegedly on behalf of persons who purchased our common stock during different time periods, all beginning on October 28, 1999 and ending on various dates, the latest of which is June 29, 2001. The complaints are similar, and allege violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 primarily based on the assertion that there was undisclosed compensation received by our underwriters in connection with the our initial public offering.

Although neither Akamai nor the individual defendants have filed answers in any of these matters, Akamai believes that it and the individual defendants have meritorious defenses to the claims made in the complaints and intends to contest the lawsuits vigorously. However, there can be no assurance that we will be successful, and an adverse resolution of the lawsuits could have a material adverse affect on our financial position and results of operation in the period in which the lawsuits are resolved. We are not presently able to reasonably estimate potential losses, if any, related to the lawsuits.

See Item 1 of Part II of our quarterly report on Form 10-Q for the quarterly period ended March 31, 2001 for a discussion of legal proceedings as to which there were no material developments in the quarter ended June 30, 2001.

Item 4. ***Submission of Matters to Vote of Security Holders***

On May 22, 2001, we held our 2001 Annual Meeting of Stockholders. At the meeting the following matters were approved by the vote specified below:

1. F. Thomson Leighton and Edward W. Scott were elected to serve as directors of Akamai, to serve until the annual meeting of stockholders in 2004 or until their successors are duly elected and qualified. Mr. Leighton received 72,840,911 shares of common stock voting in favor of his election, and 2,216,033 shares of common stock were withheld. Mr. Scott received 74,791,060 shares of common stock voting in favor of his election, and 265,884 shares of common stock were withheld. In addition, the terms of the following directors continued after the annual meeting of our stockholders: Arthur H. Bilger, George Conrades, Todd A. Dagres, Daniel M. Lewin and Terrance McGuire. See Item 5. below.

2. An amendment to our Second Amended and Restated 1998 Stock Incentive Plan, which we refer to as the Option Plan, increasing the number of shares of common stock authorized for issuance under the Option Plan from 37,755,600 shares to 41,255,600 shares was approved. The votes were cast as follows: 37,573,138 shares of common stock were voted for the amendment to the Option Plan, 14,770,582 shares of common stock were voted against the amendment to the Option Plan and 325,579 shares of common stock abstained from the vote. There were 22,388,094 shares of common stock subject to non-votes.

3. An amendment to our 1999 Employee Stock Purchase Plan, which we refer to as the ESPP, increasing the number of shares of common stock authorized for issuance under the ESPP from 600,000 shares to 3,100,000 shares was approved. The votes were cast as follows: 51,815,491 shares of common stock were voted for the amendment to the ESPP, 544,783 shares of common stock were voted against the amendment to the ESPP and 309,025 shares of common stock abstained from the vote. There were 22,388,094 shares of common stock subject to non-votes.

4. The ratification of PricewaterhouseCoopers LLP as our independent public accountants for the year ended December 31, 2001 was approved. The votes were cast as follows: 73,288,120 shares of common stock were voted for the ratification, 1,586,370 shares of common stock were voted against the ratification and 182,454 shares of common stock abstained from the vote.

Item 5. ***Other Information***

In June 2001, Terrance McGuire resigned from the Board of Directors of Akamai.

Item 6. ***Exhibits and Reports on Form 8-K***

(a) Exhibits

99.1 Letter Agreement between Akamai Technologies, Inc. and Earl Galleher

(b) Reports on Form 8-K

None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AKAMAI TECHNOLOGIES, INC.

Date: July 23, 2001

By: /s/ TIMOTHY WELLER

Timothy Weller
Vice President and Chief Financial Officer
(Principal Financial Officer)