SOFTECH INC
Form 10-K
August 31, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

X . **ANNUAL REPORT PURSUANT TO SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Fiscal Year Ended: May 31, 2015

.**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: 0-10665

SofTech, Inc.
(Exact name of registrant as specified in its charter)

Massachusetts	**04-2453033**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

650 Suffolk Street, Suite 415, Lowell, MA 01854
(Address of principal executive offices, including zip code)

(978) 513-2700
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, $.10 par value per share

Rights to Purchase Common Stock

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes . No X .

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes . No X .

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 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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. X .

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 .	Accelerated filer .
Non-accelerated filer . (Do not check if a smaller reporting company)	Smaller reporting company X .

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes . No X .

The aggregate market value of our voting stock held by non-affiliates was approximately $589,651 on November 30, 2014 based on the last reported sale price of our common stock on the Over the Counter Bulletin Board QB market tier on November 25, 2014.

The number of shares outstanding of registrant s common stock at August 24, 2015 was 893,724 shares.

ANNUAL REPORT ON FORM 10-K FOR FISCAL YEAR 2015

Table of Contents

		Page
PART I.		
Item 1.	Business	5
Item 1A.	Risk Factors	8
Item 1B.	Unresolved Staff Comments	14
Item 2.	Properties	14
Item 3.	Legal Proceedings	14
PART II.		
Item 5.	Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	15
Item 6.	Selected Financial Data	16
Item 7.	Management s Discussion and Analysis of Financial Condition and Results of Operations	16
Item 7A.	Quantitative and Qualitative Disclosures about Market Risk	27
Item 8.	Financial Statements and Supplementary Data	27
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	27
Item 9A.	Controls and Procedures	27
Item 9B.	Other Information	27
PART III.		
Item 10.	Directors, Executive Officers and Corporate Governance	28
Item 11.	Executive Compensation	31
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	33
Item 13.	Certain Relationships and Related Transactions, and Director Independence	34
Item 14.	Principal Accountant Fees and Services	35
PART IV.		
Item 15.	Exhibits and Financial Statement Schedules	36
Exhibit Index		37
APPENDIX A		
Reports of Independent Registered Public Accounting Firms		F-1, F-2

Consolidated Financial Statements	F-3
Notes to Consolidated Financial Statements	F-8

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

This report includes forward-looking statements. These forward-looking statements are often identified by words such as may, will, should, could, would, expect, intend, plan, anticipate, believe, estimate, proj similar expressions. These statements are only predictions and involve estimates, assumptions and uncertainties that could cause actual results to differ materially from those expressed. You should not place any undue reliance on these forward-looking statements.

You should be aware that our actual results could differ materially from those contained in forward-looking statements due to a number of factors, including our ability to:

.

raise new capital necessary to fund the development and launch of our new product;

.

generate sufficient cash flows from our operations or other sources to fund our working capital needs and growth initiatives;

.

maintain good relationships with our lender;

.

comply with the requirements of our loan agreement;

.

successfully introduce and attain market acceptance of any new products and/or enhancements of existing products;

.

attract and retain qualified personnel;

.

prevent obsolescence of our technologies;

.

maintain agreements with our critical software vendors;

.

secure renewals of existing software maintenance contracts, as well as contracts with new maintenance customers; and

.

secure new business, both from existing and new customers.

The forward-looking statements speak only as of the date on which they are made, and, except to the extent required by federal securities laws, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. References in this prospectus to the Company, we, our, and us refer to the registrant, SofTech, Inc., and its wh owned subsidiaries.

PART I

ITEM 1. BUSINESS

Our Company

SofTech, Inc., a Massachusetts corporation was formed in Massachusetts on June 10, 1969. The Company has been engaged in the development, marketing, distribution and support of computer software solutions that enable companies to manage the entire lifecycle of their products from conception through design and manufacture, to service and disposal, all of which is known in the industry as Product Lifecycle Management (PLM). These solutions include software technology offerings for Computer Aided Design (CAD), which we described below as our *CADRA* product offering and Product Data Management (PDM) and collaboration technologies, which we described below as our *ProductCenter* offering. In addition, we offer a technology platform that allows for data exchange between various third party technology offerings which we describe as our *Connector* offering. We deliver these enterprise level PLM solutions, with comprehensive out-of-the-box capabilities, to meet the needs of manufacturers of all sizes quickly and cost-effectively. Our operations are organized geographically in the U.S. and Europe. We have sales and customer support offices in the U.S. and Italy. We also operate through resellers in North America, Europe and Asia. For geographical information about our operating revenues and assets, see Note E to the Consolidated Financial Statements included in this Annual Report.

In March 2011, the current management team (CEO and VP of Business Development) completed a transaction (the Recapitalization Transaction) in which a group of eight investors purchased 39% of the Company s common stock, arranged for debt facilities of $3.2 million and negotiated for a $7.6 million debt reduction from Greenleaf Capital, Inc. (Greenleaf), at that time, the Company s sole lender and largest shareholder. Subsequently, the Company repurchased 271,411 shares of its common stock from Greenleaf which represented all of its equity holdings in SofTech.

A core tenet of the management team s strategy following the Recapitalization Transaction has been to actively consider ways to monetize some or all of the Company s assets and to pursue new strategic initiatives, including in new industries, such as potential business combinations, sale transactions, new product development and/or strategic partnerships. The Company has taken a number of steps consistent with the implementation of this strategy, including the sale of the Company s AMT and CADRA product lines, the sale of its PLM related patents, the filing and acquisition of new patents and the development of the new product offerings, namely Connector and HomeView . Following the sale of its CADRA product line (as described below), the Company has been focused on restructuring its business to enable it to successfully operate as a significantly smaller company and will continue to seek new sources of revenue and new strategic initiatives, including in new industries, such as eCommerce.

Products and Services

ProductCenter

Our ProductCenter technology manages the engineering data and electronic files of discrete parts designed in various widely used third party proprietary design technologies. ProductCenter is a proven enterprise-wide, collaborative PLM solution delivering a unique and powerful combination of document management, design integration, configuration control, change management, bill of materials management and integration capability with other enterprise-wide systems. ProductCenter is designed to help companies rapidly optimize the product development process. ProductCenter provides for the secure management of product information and allows engineers and the entire design chain to manage, share, modify and track product data and documents throughout the product development lifecycle. ProductCenter supports engineering change management and bill of materials management for automating business processes. ProductCenter s web-based collaboration capabilities allow employees, customers, suppliers, and other globally dispersed team members to securely exchange product information while maintaining a centralized database of critical product data. ProductCenter also enables integration with other business applications such as enterprise resource planning, supply chain management and customer relationship management for continuous data exchange across the product lifecycle.

Connector Platform

In 2012, the Company entered into a technology partnership with Aras Corporation (Aras) wherein we agreed to develop, market and support a technology that allows for a direct interface between Aras s Innovator solution and multiple, proprietary CAD products. Our Connector platform was first available in the fourth quarter of fiscal year 2012 and is offered under an annual subscription revenue model.

HomeView

HomeView is a secure, intelligent home asset management and maintenance system. HomeView allows homeowners to create a virtual home manual that logs, manages and tracks personal assets and home attributes. Home ownership is made easier by managing user manuals, warranty periods, service records, maintenance reminders and other projects with HomeView. This product offering is still in its development phase. We have been testing it with a limited number of consumers. A commercial launch is expected during fiscal year 2016.

CADRA

CADRA is a drafting and design software package for the professional mechanical engineer.

On October 18, 2013, the Company sold substantially all of the assets of its CADRA product line, including all intellectual property related to that technology but specifically excluding cash, billed accounts receivable and liabilities other than the deferred maintenance liability associated with CADRA customer maintenance contracts for support services (the CADRA Sale), to Mentor Graphics Corporation (Mentor), pursuant to an Asset Purchase Agreement dated August 30, 2013 (the Asset Purchase Agreement). The aggregate consideration for the CADRA Sale is up to $3.95 million, which is comprised of (i) $3.2 million, $2.88 million of which was paid on the closing date and $320,000 (representing a 10% holdback) of which was paid on the one year anniversary of the closing date, and (ii) earn-out payments of up to an aggregate $750,000 over the three-year period subsequent to the closing date, based on 10% of the net revenue generated by the CADRA business, subject to the terms of the Earn-Out Agreement dated August 30, 2013 (the Earn-Out Agreement). Through May 31, 2015, the Company has received approximately $327,000 under the terms of the Earn-Out Agreement.

In conjunction with completing the CADRA Sale, the Company entered into a one-year, exclusive Distributorship Agreement with Mentor that allowed us to market and support the CADRA technology as a reseller throughout Europe (except Germany) at a gross margin ranging between thirty (30%) and thirty-five percent (35%). In addition, for the one year period from the closing of the transaction the Company retained the right to market the CADRA

technology to Sikorsky Aircraft, the largest CADRA user in the United States. Due to the significant continued involvement in the sale and support of the CADRA product line, the sale did not qualify for presentation as discontinued operations. The Distributorship Agreement for Europe (except Germany) was extended on a non-exclusive basis with gross margins of between thirty (30%) and forty (40%) percent (dependent of the type of revenue and annual volumes) through January 31, 2016. The right to market the CADRA product line to Sikorsky Aircraft in North America was a one year arrangement only and expired on October 16, 2014.

Consulting

Our consulting group is composed of deeply experienced, long tenured experts solving very complex problems relating to data migration, customization, data control, access, version control, connectivity between proprietary systems and a myriad of other problems encountered by our customers.

Marketing and Distribution

We market and distribute our products and services primarily through a direct sales force and through our service organization in North America and Europe. In addition, we market and support the technology offerings of our partners through distribution agreements. We have also contracted with resellers in North America, Europe and Asia to reach areas not covered by our direct sales presence and to supplement our existing sales force; however, to date, the revenue generated from this indirect distribution has not been material.

Competition

We compete against much larger entities, all of which have substantially greater financial resources than we do. We operate in an extremely competitive market for all of our software and service offerings. We compete in all our markets on the basis of meeting our customers business needs with a viable solution that offers an affordable price, low cost of ownership and a high level of customer support and service.

Our CAD and PLM technology offerings compete against product offerings from companies such as Parametric Technology Corporation (PTC), Dassault Systemes SolidWorks (SolidWorks), Siemens, Inc. (Siemens) and Autodesk, Inc. (Autodesk) that together dominate the PLM market. In addition to these billion dollar revenue companies, there are numerous other technologies offered by smaller entities that we also compete against.

Our service offerings, which include consulting, training and discrete engineering services, compete with offerings by all of the large PLM companies noted above, small regional engineering services companies and the in-house capabilities of our customers.

Our HomeView technology has not yet commercially launched, however, we expect to do so in fiscal 2016. There are a significant number of technology companies that are competing in the residential property market especially related to home automation products and services as well as the Internet of Things, a way of describing connecting such things as appliances and other assets and items to the internet. There are many software applications available for download that allow a consumer to organize the things they own and even some that alert the homeowner to maintenance needs. Until such time as we launch the product it is difficult to identify those participants in the market for whom we will be a competitor and those for whom we will be a likely partner.

Personnel

As of May 31, 2015, we employed 27 persons, 26 on a full time basis and 1 part time.

Backlog

Backlog as of May 31, 2015 was approximately $645,000 as compared to $311,000 as of May 31, 2014. Deferred revenue, consisting primarily of software maintenance services to be performed over the subsequent twelve month period, totaled approximately $1,732,000 and $1,462,000 at May 31, 2015 and 2014, respectively.

Research and Development

We have approximately 7 product development engineers in our research and development groups located in Massachusetts and Michigan. In fiscal years 2015 and 2014, we incurred research and development expense of approximately $894,000 and $1.2 million, respectively, related to the development of our technology and products. In fiscal years 2015 and 2014, we capitalized approximately $202,000 and $57,000, respectively, of direct costs related to the development of new products.

Intellectual Property

We rely primarily on a combination of trade secrets, patents, copyright and trademark laws, and confidentiality procedures to protect our technology. Due to the technological change that characterizes the PLM industry, we believe that the improvement of existing products, reliance upon trade secrets and unpatented proprietary know-how and the development of new products are generally as important as patent protection in establishing and maintaining a competitive advantage.

Since the Recapitalization Transaction, we filed three new U.S. patents. In addition to our patents, we have secured registration on a number of trademarks which we consider important to the protection of our brands.

Governmental Regulation

We export our products throughout the world, and thus we are subject to Federal Export Regulations. We believe we comply with all such regulations. Although our non-U.S. based revenue was approximately 19.4% of total revenue in 2015, we do not view these regulations as particularly onerous nor are the compliance costs material to our operations.

Seasonality

Our first fiscal quarter, which begins June 1 and ends August 31, has historically produced the lowest revenue. We believe that this is due primarily to the buying habits of our customers as this quarter falls within prime vacation periods.

Available Information

We maintain an Internet site at http://www.softech.com on which we make available, free of charge, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to the foregoing as soon as reasonably practicable after these reports are electronically filed with, or furnished to, the Securities and Exchange Commission (SEC). In addition, stockholders may access these reports and documents on the SEC s web site at www.sec.gov. Our principal offices are located at 650 Suffolk Way, Suite 415, Lowell, Massachusetts 01854, and our telephone number is (978) 513-2700.

ITEM 1A. RISK FACTORS

Our business is subject to numerous risks. We caution you that the following important factors, among others, could cause our actual results to differ materially from those expressed in forward-looking statements made by us or on our behalf in filings with the SEC, press releases, communications with investors and oral statements. Any or all of our forward-looking statements in the Annual Report on Form 10-K and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Any factors mentioned in the discussion below will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may differ materially from those anticipated in forward-looking statements. We undertake no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosure we make in our reports filed with the SEC.

Risks Related to Our Business

Following the sale of the CADRA business in October 2013, we have been and will continue to restructure our business to enable us to successfully operate as a significantly smaller company and to seek new sources of revenue and new strategic initiatives. SofTech operating results subsequent to the sale of the CADRA business may not be profitable, and we may be unsuccessful in developing new business opportunities.

The CADRA business was responsible for about half of the consolidated revenue in fiscal 2013 and the majority of the profitability and cash flow. The importance of the CADRA business to the consolidated results in fiscal 2013 was similar in at least the two immediately preceding fiscal years. The remaining product lines following the CADRA Sale, namely ProductCenter and the Connector technologies, are product lines that have historically been less profitable than the CADRA business, have fewer customers and have a more complex sales cycle. It is likely that the Company will need to reduce spending in order to achieve profitability, and ultimately will need to find new strategic directions and new sources of revenue in order to meaningfully increase the size of its business. The new product ideas that the management team has interest in pursuing as described in the patent filings over the last few years are speculative in that the products are still in development and the management team may not have the depth of experience required to be successful in those new markets.

We will need additional capital to continue to develop and launch our HomeView technology and launch this new product.

We generated positive cash flow as measured by EBITDA, a non-GAAP measure, every fiscal year from 2002 through 2014. The sale of the CADRA product line in fiscal 2014 together with the investment made in 2015 to develop a new product for the residential property market has resulted in current year cash losses that have been funded by our balance sheet, sales of common stock and limited additional borrowings. As beta testing is completed on our new product offering, additional capital will be required for the commercial launch. There can be no assurance that the capital needed will be available or if the terms will be reasonable. If we are unable to raise additional capital we may not be able to fully implement our marketing plans for HomeView potentially limiting its consumer adoption.

The consolidated financial statements have been prepared on a basis that contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. The Company s long-term viability is dependent on its ability to generate sufficient product revenue, net income and cash flows from operations to support its business as well as its ability to obtain additional financing. Management s plans also include reducing operating costs and delaying certain expenditures, if necessary, to maintain the Company s liquidity.

The Company had a cash balance of approximately $310,000 as of May 31, 2015. Management believes that with its available cash and current operating plan that projects cash generation from future operations it will have sufficient cash to meet the Company s working capital and capital expenditure requirements through at least the next twelve months. There can be no assurance, however, that the Company will not require additional financing in the future if funds from future operations or estimated expenses differ materially from those amounts estimated by management. If we were required to obtain additional financing in the future, there can be no assurance that sources of capital would be available on terms favorable to us, if at all.

Our HomeView product when launched during fiscal 2016 may not gain enough market acceptance to warrant continued investment.

We have made a substantial investment in pursuing the HomeView product idea especially during fiscal year 2015. If we are able to raise the additional capital we need to launch the technology, we expect that investment to continue and possibly increase in fiscal 2016. While our analysis supports the need for this kind of technology in the residential property market, there can be no assurance that HomeView will gain the number of users required to warrant the continued investment. Failure to gain market acceptance may lead to the write off of the investment made in HomeView through a charge to income.

Continued revenue declines in our product lines may have a material adverse impact upon our business and overall financial performance.

We have experienced consolidated revenue declines each fiscal year since 2006. The revenue declines for fiscal years 2014 and 2015, however, were primarily due to the CADRA Sale that was completed four months into fiscal year 2014.

Revenue from our ProductCenter technology declined for eight straight fiscal years from fiscal year 2006 through fiscal year 2014. In fiscal year 2015, ProductCenter revenue increased by 14.6% compared to the prior fiscal year and the backlog, pipeline of active deals and Q1 contract awards indicate that the double digit revenue growth will continue for fiscal 2016. The revenue declines described above were due to several factors. In July 2007, PTC informed us that it would not renew its partnership agreement with us when the agreement expired in January 2008. We had been a member of the PTC partnership program for 12 years. The PTC partnership agreement, among other things, provided us with the right to distribute certain information that allowed for our technology to directly interface with PTC s proprietary CAD tools. The non-renewal has essentially prevented us from marketing our ProductCenter solution to new customers that utilize PTC s technology and has negatively impacted our product revenue from this technology offering. In addition to the PTC partnership termination, ProductCenter revenues have been negatively affected by: (i) an increased number of competitive offerings in the marketplace, (ii) elongation of purchase decisions by customers of a technology that already has a long sales cycle, and (iii) uncertain economic conditions. The increase in ProductCenter revenue in fiscal 2015 as compared to 2014 has resulted from existing customers expanding their use of the technology. It is difficult for the Company to determine if the current year revenue increase is sustainable.

Subscription revenue from our Connector technology increased by 108.3% from fiscal 2014 to 2015. We added ten (10) new customers and we hope to continue to build on that momentum. This solution is offered only as a subscription which makes revenue growth a more likely event year-over-year as compared to the perpetual license model employed with our ProductCenter technology. The customers for our Connector technology are Aras Innovator (a third party PLM solution) users that have already made the investment in that technology and are now trying to get more functionality from that investment. It is our understanding that Aras Innovator continues to grow at a much faster rate than the overall PLM market which provides us with an opportunity to continue to grow our Connector revenue.

While the recent revenue trend for ProductCenter is encouraging and the market acceptance for our Connector technology is building, we do not have enough broad based momentum from either technology to yet be able to definitively conclude that our historical revenue declines are behind us.

Significant future declines in our total revenues may have a material adverse impact upon our business and overall financial performance.

We compete against numerous technology companies in the mature PLM industry that are significantly larger and have vastly greater financial resources at their disposal.

Many of our competitors, including PTC, SolidWorks, Siemens and Autodesk, have substantially greater financial, technological, marketing, managerial and research and development resources and experience than we do and represent significant competition for us. Our competitors may succeed in developing competing technologies or products which may gain market acceptance more rapidly than our products. Existing or proposed products of our competitors may render our existing or proposed products noncompetitive or obsolete. If we are unable to compete successfully in the future, the competitive pressures that we face could adversely affect our profitability or financial performance.

Our agreements with certain software vendors may be terminated at will by the vendors.

We utilize third party vendors to provide certain software and utilities which help us to continue to develop and support ProductCenter customers with their integrations from ProductCenter to their respective CAD solutions. These agreements are subject to termination at will by the vendors, and, if terminated, we would need to seek alternative methods of providing continuing support to our existing customers and an alternative solution to meet the needs of prospective customers, which could have a material adverse effect on future performance. For example, in July 2007, we were informed that our agreement with one such vendor, PTC, was not going to be extended beyond its renewal date of January 31, 2008. Thus the agreement with PTC has since expired. A significant number of our current ProductCenter customers utilize PTC s proprietary CAD technology. We continue to support our current customers who are utilizing PTC s CAD solution with a customer specific consulting solution. While this customer specific consulting solution has allowed us to retain the majority of our customers utilizing PTC s CAD tool, it has precluded us from proposing our solution to new customers using that CAD technology. Our inability to offer our solution to new customers utilizing PTC s technology or similar restrictions that could result from any future terminations of similar agreements with other vendors could have an adverse effect on our future revenues.

Our ability to use our federal and state net operating loss carryforwards (NOLs) to reduce taxable income generated in the future could be substantially limited or eliminated.

As of May 31, 2015, we had approximately $21 million of federal NOLs available to offset future taxable income, which expire in varying amounts beginning in 2022, if unused. We may not generate taxable income in time to use these NOLs prior to their expiration, and the Internal Revenue Service may not agree with the amount or timing of prior losses, thereby limiting the value of our NOLs. Furthermore, our ability to use our NOLs is subject to an annual limitation due to ownership changes that may have occurred or that could occur in the future, as determined by Section 382 of the Internal Revenue Code of 1986, as amended, as well as similar state regulations. Depending on the actual amount of any limitation on our ability to use our NOLs, our future taxable income could be subject to federal and/or state income tax, creating federal and/or state income tax liabilities. We previously maintained a tax benefits preservation plan with respect to our NOLs, which expired in February 2015.

Our quarterly results may fluctuate making our future revenue and financial results difficult to predict.

Our quarterly revenue and operating results are difficult to predict and may fluctuate significantly from quarter to quarter. Our quarterly revenue may fluctuate significantly for several reasons including: the timing and success of introductions of any new products or product enhancements or those of our competitors; uncertainty created by changes in the market; variations in the size and timing of individual orders; competition and pricing; seasonality; and customer order deferrals or cancellations as a result of general economic conditions or industry decline. Furthermore, we have often recognized a substantial portion of our product revenues in the last month of a quarter, with these revenues frequently concentrated in the last weeks or days of a quarter. As a result, product revenues in any quarter are substantially dependent on orders booked and shipped in the latter part of that quarter and revenues from any

future quarter are not predictable with any significant degree of accuracy. We typically do not experience order backlog; our significant fiscal year-end 2015 backlog being atypical. For these reasons, we believe that period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as indications of future performance.

Our financial condition could be adversely affected if significant errors or defects are found in our software.

Sophisticated software can sometimes contain errors, defects or other performance problems. If errors or defects are discovered in our current or future products, we may need to expend significant financial, technical and management resources, or divert some of our development resources, in order to resolve or work around those defects, and we may not be able to correct them in a timely manner or provide an adequate response to our customers.

Errors, defects or other performance problems in our products could cause us to delay new product releases or customer deployments. Any such delays could negatively impact our ability to realize revenue from the licensing and shipment of new or enhanced products and give our competitors a greater opportunity to market competing products. Such difficulties could also cause us to lose customers. Technical problems or the loss of customers could also damage our business reputation and cause us to lose new business opportunities.

We are dependent on key personnel whose loss could impair our operations, our product development or our sales efforts.

We are a small company especially for one that is publicly held. Our technologies are complex and have been developed over many years. While we enjoy the benefit of a very experienced, long-tenured employee group, we are dependent on many of those employees for the familiarity, expertise and unique insight they have developed with our products that would be extremely difficult and time consuming to replace. The loss of services of any of our key personnel could make it difficult for us to meet important objectives, such as timely and effective product introductions and financial goals.

We may be sued for infringing on the intellectual property rights of others.

Our ProductCenter technology was launched in the early 1990 s. Over the decades that our technologies have been in the marketplace, a significant number of patents have been filed by competitors. It is difficult if not impossible for us to monitor these patent awards to become familiar with their claims and we do not attempt to do so. Third parties may assert that we are employing their proprietary technology without authorization. There can be no assurance that we do not or will not infringe on the patent or proprietary rights of others. Parties making claims against us may be able to obtain injunctive or other equitable relief that could effectively block our ability to further develop, commercialize and sell products, and such claims could result in the award of substantial damages against us. In the event of a successful claim of infringement against us, we may be required to pay damages and obtain one or more licenses from third parties. We may not be able to obtain these licenses at a reasonable cost, if at all. In that event, we could encounter delays in product introductions while we attempt to develop alternative methods or products or be required to cease offering affected products and our operating results would be harmed.

Our sales and operations are globally dispersed, which exposes us to additional operating and compliance risks.

We sell and deliver software and services, and maintain support operations in multiple countries whose laws and practices differ from one another. For the fiscal years ended May 31, 2015 and 2014, North America accounted for approximately 81% and 67%, Europe for approximately 19% and 23% and Asia for approximately zero and 10% of our revenue. Managing these geographically dispersed operations requires significant attention and resources to ensure compliance with laws. Accordingly, while we maintain a compliance program, we cannot guarantee that an employee, agent or business partner will not act in violation of our policies or U.S. or other applicable laws. Such violations can lead to civil and/or criminal prosecutions, substantial fines and the revocation of our rights to continue certain operations and also cause business and reputation loss.

We are obligated to maintain proper and effective internal control over financial reporting. We may not complete our analysis of our internal control over financial reporting in a timely manner, or these internal controls may not

be determined to be effective, which may adversely affect investor confidence in our company and, as a result, the value of our common stock.

In December 2011, we filed a Form 8-A with the SEC in connection with the effectiveness of our registration statement (333-174818), subjecting us again to the reporting requirements under the Exchange Act. As a public company, we are required, pursuant to Section 404 of the Sarbanes-Oxley Act, to furnish a report by management on, among other things, the effectiveness of our internal control over financial reporting. This assessment includes disclosure of any material weaknesses identified by our management in our internal control over financial reporting. We may not be able to remediate future material weaknesses, or to complete our evaluation, testing and any required remediation in a timely fashion. During the evaluation and testing process, if we identify one or more material weaknesses in our internal control over financial reporting, we will be unable to assert that our internal controls are effective. If we are unable to assert that our internal control over financial reporting is effective, we could lose investor confidence in the accuracy and completeness of our financial reports, which would have a material adverse effect on the price of our common stock.

Because we are a relatively small company, the requirements of being a public company, including compliance with the reporting requirements of the Exchange Act and the requirements of the Sarbanes-Oxley Act, may strain our resources, increase our costs and distract management; and we may be unable to comply with these requirements in a timely or cost-effective manner.

As a public company, we need to comply with certain laws, regulations and requirements, certain corporate governance provisions of the Sarbanes-Oxley Act and related regulations of the SEC. If we list our securities on an exchange, the exchange will impose additional requirements on listed companies, including enhanced corporate governance practices. For example, the NASDAQ listing requirements require that listed companies satisfy certain corporate governance requirements relating to independent directors, audit committees, distribution of annual and interim reports, shareholder meetings, shareholder approvals, solicitation of proxies, conflicts of interest, shareholder voting rights and codes of business conduct. Complying with the SEC statutes, regulations and requirements will occupy a significant amount of time of our board of directors and management and could increase our costs and expenses.

From time to time we may make acquisitions. The failure to successfully integrate future acquisitions could harm our business, financial condition and operating results.

As a part of our business strategy, we have in the past and may make acquisitions in the future. We may also make significant investments in complementary companies, products or technologies. Acquisitions present many risks, and we may not realize the financial and strategic goals that were contemplated at the time of any transaction. We cannot provide assurance that we will be able to successfully integrate any business, products, technologies or personnel that we may acquire in the future, and our failure to do so could harm our business, financial condition and operating results.

Weakness in the United States and international economies may continue to adversely affect our business.

The past few years have been characterized by weak global economic conditions. Because we market, sell and license our products throughout the world, in addition to the ongoing adverse effects on our business of continued weakness in the U.S. economy, we could be significantly affected by continuing weak economic conditions in foreign and domestic markets that could reduce demand for our products.

Risks Related to the Market for our Common Stock

Our stock price has been and is likely to continue to be volatile, and an investment in our common stock could decline in value.

Since the Recapitalization Transaction, the closing stock price has ranged from a low price of $1.00 per share to a high price of $4.95 per share. A contributing factor to the price fluctuation is the low average daily volume, which over the last three fiscal years has averaged fewer than 1,000 shares per day. Given the lack of market makers in the stock and the low demand, a shareholder s attempt to sell a large number of shares relative to the average daily volume in a short period of time will likely have a material negative impact on the share price.

Our common stock may be considered penny stock , further reducing its liquidity.

Our common stock may be considered penny stock , which will further reduce the liquidity of our common stock. Trading in penny stocks is limited because broker-dealers are required to provide their customers with disclosure documents prior to allowing them to participate in transactions involving the common stock. These disclosure

requirements are burdensome to broker-dealers and may discourage them from allowing their customers to participate in transactions involving our common stock, thereby further reducing the liquidity of our common stock.

Penny stocks are equity securities with a market price below $5.00 per share other than a security (i) that is registered on a national exchange or included for quotation on the NASDAQ system, (ii) whose issuer has net tangible assets of more than $2,000,000 if it has been in continuous operation for greater than three years, or net tangible assets of more than $5,000,000 if it has been in continuous operation for less than three years or (iii) whose issuer has average revenue of at least $6,000,000 for the last three fiscal years.

Rules promulgated by the Securities and Exchange Commission under Section 15(g) of the Exchange Act require broker-dealers engaging in transactions in penny stocks, to first provide to their customers a series of disclosures and documents including:

.

a standardized risk disclosure document identifying the risks inherent in investment in penny stocks;

.

all compensation received by the broker-dealer in connection with the transaction;

.

current quotation prices and other relevant market data; and

.

a monthly account statement reflecting the fair market value of the securities.

These rules also require that a broker-dealer obtain financial and other information from a customer, determine that transactions in penny stocks are suitable for such customer and deliver a written statement to such customer setting forth the basis for this determination.

A small number of shareholders own a large number of shares thereby potentially exerting significant influence over us.

As of August 24, 2015, the three members of our board of directors beneficially own approximately 33.5% of our outstanding shares. Two other shareholders together beneficially own approximately 33.8% of outstanding shares. This concentration of ownership could significantly influence all matters requiring shareholder approval and could delay, deter or prevent a change in control of the Company or other business combinations that might otherwise be beneficial to our other shareholders. Accordingly, this concentration of ownership may harm the market price of our common stock. In addition, the interest of our significant shareholders may not always coincide with the interest of the Company s other shareholders. In deciding how to vote on such matters, they may be influenced by interests that conflict with our other shareholders.

Our stock is thinly traded, so you may be unable to sell at or near ask prices or at all.

The shares of our common stock are traded on the OTC Bulletin Board. Shares of our common stock are thinly traded, meaning that the number of persons interested in purchasing our common stock at or near ask prices at any given time may be relatively small or non-existent. This situation is attributable to a number of factors, including the fact that we are a small company that is relatively unknown to stock analysts, stockbrokers, institutional investors and others in the investment community who generate or influence sales volume. Even in the event that we come to the attention of such persons, they would likely be reluctant to follow an unproven company such as ours or purchase or recommend the purchase of our shares until such time as we become more seasoned and viable. As a consequence, our stock price may not reflect an actual or perceived value of the business. Also, there may be periods of several days or more when trading activity in our shares is minimal or non-existent, as compared to a seasoned issuer that has a large and steady volume of trading activity that will generally support continuous sales without an adverse effect on share price. A broader or more active public trading market for our common shares may not develop or if developed, may not be sustained. Due to these conditions, you may not be able to sell your shares at or near ask prices or at all if you need money or otherwise desire to liquidate your shares.

We do not presently intend to pay any cash dividends or repurchase any shares of our common stock.

We do not presently intend to pay any cash dividends on our common stock. Any payment of future dividends will be at the discretion of the board of directors and will depend on, among other things, our earnings, financial condition, capital requirements, level of indebtedness, statutory and contractual restrictions applying to the payment of dividends, and other considerations that our board of directors deems relevant. Cash dividend payments in the future may only be made out of legally available funds and, if we experience substantial losses, such funds may not be available. Accordingly, you may have to sell some or all of your common stock in order to generate cash flow from your investment.

We are a smaller reporting company and the reduced disclosure requirements applicable to us may make our common stock less attractive to investors.

We are currently a smaller reporting company , meaning that we are not an investment company, an asset-backed issuer, or a majority-owned subsidiary of a parent company that is not a smaller reporting company and have a public float of less than $75 million and annual revenues of less than $50 million during the most recently completed fiscal year. Smaller reporting companies are able to provide simplified executive compensation disclosures in their filings; are exempt from the provisions of Section 404(b) of the Sarbanes-Oxley Act requiring that independent registered public accounting firms provide an attestation report on the effectiveness of internal control over financial reporting; and have certain other decreased disclosure obligations in their SEC filings, including, among other things, only being required to provide two years of audited financial statements in annual reports. We have taken advantage of some of these reduced disclosure obligations, and thus the information we provide shareholders may be different from what you might receive from other public companies in which you hold shares.

Risks Related to the CADRA Sale

A portion of the purchase price was deferred and we may not receive those payments.

Up to $750,000 of the total purchase price from the CADRA Sale is based on the revenues generated by the CADRA business during the three-year period following the asset sale. Specifically, the Company will be paid 10% of CADRA revenue generated by Mentor up to the $750,000 maximum. The Company has no obligation subsequent to the transaction date with regard to royalty payments. In March 2014 and 2015, the Company received the first two royalty payments totaling approximately $327,000 under this deferred arrangement related to the period from the transaction date to January 31, 2015. The Company is due two additional royalty payments under the Earn-Out Agreement based on CADRA revenues generated between February 1, 2015 and October 31, 2016 (the Remaining Royalty Period). Mentor has broad discretion to operate its post-closing business, and may choose to do so in a manner which may or may not result in the payment of all of the CADRA royalties pursuant to the Earn-Out Agreement.

CADRA royalty payments were recorded at the transaction date based on fair value of the expected royalty payments as described in the financial statements. As of May 31, 2015, the Company estimated the fair value of these future payments at $376,000 and are subject to adjustment each fiscal quarter based on an independent third party valuation. The maximum royalty that could be received by the Company is $423,000.

There can be no assurance that the Company will receive all of the royalty payments it has recorded on its balance sheet as of May 31, 2015. If the actual CADRA revenue results are lower than the forecasted results the Company may have to adjust the royalty asset through a charge to earnings. CADRA annualized revenue would have to average approximately $2.417 million over the Remaining Royalty Period to maximize the royalty payments. For Mentor s most recently completed full fiscal year, CADRA revenue was approximately $2.835 million.

We will continue to incur the expenses of complying with public company reporting requirements following the closing of the CADRA Sale.

After the CADRA Sale, we will continue to be required to comply with the applicable reporting requirements of the Securities Exchange Act of 1934, as amended, even though compliance with such reporting requirements is economically burdensome and will represent an even greater percentage of our expenses post-closing as we will be a significantly smaller company following the sale of the CADRA business.

Closure of the office located in Germany

Our office located in Germany was focused exclusively on selling and supporting the CADRA product line. During fiscal year 2014, the Company closed this office and ceased operating in that country. We believe we have satisfied and/or accrued for all material obligations related to that closure including satisfying all employment related obligations to our former employees, however, the risk of identification of additional liabilities does exist.

Mentor did not assume any of the excluded liabilities under the Asset Purchase Agreement.

Under the Asset Purchase Agreement, Mentor did not assume all of the liabilities associated with the CADRA business. Certain liabilities remained with the Company post-closing. For example, Mentor only assumed customer support obligations related to certain assigned contracts and obligations for performance under contracts that arise after the closing, and did not assume liability for any obligation or breach by the Company that occurred or arose prior to the closing. While the Company believes that it has adequately accrued for these liabilities or is adequately insured against certain of the risks associated with such excluded liabilities, there can be no assurances that additional expenditures will not be incurred in resolving these liabilities.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

We are headquartered in Lowell, MA and maintain a sales and support office in Milan, Italy all of which are leased facilities. We believe that our current office space is adequate for current and anticipated levels of business activity.

ITEM 3. LEGAL PROCEEDINGS

None

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is quoted on the OTCQB® market maintained by OTC Markets Group, Inc. under the symbol SOFT". The following table sets forth the high and low closing price for our common stock for the periods indicated, which reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

	High	Low
Fiscal Year Ended May 31, 2015		
First Quarter	$ 2.40	$ 1.25
Second Quarter	2.80	1.40
Third Quarter	1.93	1.45
Fourth Quarter	1.55	1.10
Fiscal Year Ended May 31, 2014		
First Quarter	$ 2.25	$ 1.77
Second Quarter	2.55	1.51
Third Quarter	4.95	1.50
Fourth Quarter	2.35	1.80

On August 24, 2015, the last reported sale price of our common stock was $1.34 per share. As of August 24, 2015, there were 893,724 shares of our common stock outstanding held by approximately 102 holders of record, and we had outstanding options to purchase an aggregate of 147,000 shares of common stock, with a weighted average exercise price of $1.77 per share.

Dividend Policy

We have not paid any cash dividends on our common stock since 1997, and we have no present intention to pay any cash dividends again in the future.

Equity Compensation Plan Information

The following table provides information, as of May 31, 2015, regarding our 2011 Equity Incentive Plan, (2011 Plan):

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in second column)
Equity compensation plans approved by security holders[1]	147,000	$ 1.77	3,000
Equity compensation plans not approved by security holders	-	-	-
Total	147,000	$ 1.77	3,000

(1)

As of May 31, 2015, 78,907 options were exercisable. For additional information, see EXECUTIVE COMPENSATION SofTech Equity Incentive Plans .

Recent Sale of Unregistered Securities

Not Applicable

Issuer Purchases of Equity Securities

During the fourth quarter of fiscal year 2015, we did not purchase any shares of our common stock.

ITEM 6. SELECTED FINANCIAL DATA

We are a Smaller Reporting Company , as defined by the SEC, and are not required to provide the information required by this Item.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and results of operations should be read in conjunction with the consolidated financial statements and the notes to those statements included in this Form 10-K. This discussion includes forward-looking statements that involve risks and uncertainties. As a result of many factors, such as those set forth in this Form 10-K under Risk Factors, actual results may differ materially from those anticipated in these forward-looking statements.

Overview

We operate in one reportable segment and are engaged in the development, marketing, distribution and support of computer software solutions that enable companies to manage the entire lifecycle of their products from conception through design and manufacture, to service and disposal, all of which is known in the industry as Product Lifecycle Management (PLM). These solutions include software technology offerings for Computer Aided Design (CAD), Product Data Management (PDM) and Collaboration technologies, all of which fit under the broadly defined PLM industry. Our operations are organized geographically in the U.S. and Europe. We have sales and customer support offices in the U.S. and Italy. We also operate through resellers in North America, Europe and Asia.

During fiscal 2015, the Company developed a new data management product for the residential property market called HomeView . The solution is based on a patent filed by the Company in December 2012. We expect to launch the product during fiscal 2016.

In March 2011, the current management team (CEO and VP of Business Development) completed a transaction (the Recapitalization Transaction) in which a group of eight investors purchased 39% of the Company s common stock, arranged for debt facilities of $3.2 million and negotiated for a $7.6 million debt reduction from Greenleaf Capital, Inc. (Greenleaf), at that time, the Company s sole lender and largest shareholder. Subsequent to the Recapitalization Transaction the Company purchased all of Greenleaf s 271,411 shares in Company common stock and retired them.

A core tenet of the management team s strategy following the Recapitalization Transaction has been to actively consider ways to monetize some or all of SofTech s assets and to pursue new strategic initiatives, such as potential business combinations, sale transactions, development of new product offerings, filing of new patent ideas and strategic partnerships.

Since the Recapitalization Transaction, the Company has taken the following actions consistent with this strategy:

.

Sold the AMT product line in May 2011 in exchange for cash;

.

Sold the existing CAD and PLM patents in June and September 2012 in exchange for cash and a percent of future funds recovered;

.

Filed three patents and acquired the rights to another;

.

Developed and launched the Connector product line described hereunder;

.

Sold the CADRA product line in October 2013 in exchange for cash and a percent of future revenues; and

.

Developed a new data management product for the residential property market called HomeView.

The above actions have allowed the Company to improve its liquidity by reducing its outstanding debt. The product line sales and patent sales generated taxable income that were sheltered from both federal and state income taxes through utilization of the Company s tax assets.

The sale of the CADRA product line, described below, was the most significant of the above described events.

On October 18, 2013, the Company sold substantially all of the assets of its CADRA product line, including all intellectual property related to that technology but specifically excluding cash, billed accounts receivable and liabilities other than the deferred maintenance liability associated with CADRA customer maintenance contracts for support services (the CADRA Sale), to Mentor Graphics Corporation (Mentor), pursuant to an Asset Purchase Agreement dated August 30, 2013 (the Asset Purchase Agreement). The aggregate consideration for the CADRA Sale was up to $3.95 million, comprised of (i) $2.88 million of which was paid on the closing date; (ii) $320,000 which was paid on the one year anniversary (the Holdback Payment) of the closing date; and (iii) up to an aggregate $750,000 over the three-year period subsequent to the closing date, based on 10% of the net revenue generated by the CADRA business during the three-year period immediately following the transaction, (the Earn-Out Payments) subject to the terms of the Earn-Out Agreement dated August 30, 2013 (the Earn-Out Agreement).

The Company continued to offer the CADRA technology as a reseller throughout Europe (except Germany) on an exclusive basis until October 18, 2014 pursuant to a distribution agreement with Mentor (the Distributorship Agreement). This arrangement was extended on a non-exclusive basis through January 31, 2016 and is subject to annual renewals by mutual agreement thereafter. In addition, for the one-year period from the closing of the transaction the Company retained the right to market the CADRA technology to Sikorsky Aircraft, the largest CADRA user in the United States. The right to market the CADRA product line to Sikorsky Aircraft in North America was a one year arrangement only and expired on October 16, 2014. Due to the significant continued involvement in the sale and support of the CADRA product line, the transaction did not qualify for presentation as discontinued operations.

The CADRA business was responsible for about half of the consolidated revenue in fiscal 2013 and the majority of the profitability and cash flow. The importance of the CADRA business to the consolidated results in fiscal 2013 was similar in at least the two immediately preceding fiscal years. The remaining revenue generating product lines following the CADRA Sale, namely ProductCenter and the Connector technologies, are product lines that have historically been less profitable than the CADRA business, have fewer customers and have a more complex sales cycle.

The following summary presents the quarterly operating results for the six full fiscal quarters that have been completed since the CADRA Sale (000 s):

	Q3 2014	Q4 2014	Q1 2015	Q2 2015	Q3 2015	Q4 2015
Revenue	$ 1,342	$ 879	$ 864	$ 1,027	$ 925	$ 1,126
Cost of sales - Internal expenses	303	245	293	315	301	271
	263	123	115	154	129	112

- 3rd party purchases						
Gross margin	776	511	456	558	495	743
R&D	276	256	272	222	183	217
SG&A	835	900	717	645	592	527
Change in fair value of deferred payments	-	(17)	(39)	(21)	(10)	(15)
Operating income (loss)	(335)	(628)	(494)	(288)	(270)	14
Interest expense	10	48	63	63	31	8
Other	(6)	(19)	15	28	55	18
Net loss						

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

We have operations in numerous foreign countries and may continue to expand our sales and support organizations internationally. Such expansion could require us to make significant expenditures. We are increasingly subject to a number of risks associated with international business activities that may increase our costs, lengthen our sales cycle and require significant management attention. These risks include:

- increased expenses associated with marketing services in foreign countries;
- currency exchange rate fluctuations;
- unexpected changes in regulatory requirements resulting in unanticipated costs and delays;
- interpretations of laws or regulations that would subject us to regulatory supervision or, in the alternative, require us to exit a country, which could have a negative impact on the quality of our services or our results of operations;
- uncertainty regarding liability for content or services;
- adjusting to different employee/employer relationships and different regulations governing such relationships;

longer accounts receivable payment cycles and difficulties in collecting accounts receivable; and

potentially adverse tax consequences.

Any failure to meet our debt obligations would damage our business.

We have long-term debt. As of December 31, 2008, our total long-term debt was $199.9 million. If we are unable to remain profitable or if we use more cash than we generate in the future, our level of indebtedness could adversely affect our future operations by increasing our vulnerability to adverse changes in general economic and industry conditions and by limiting or prohibiting our ability to obtain additional financing for future capital expenditures, acquisitions and general corporate and other purposes. In addition, if we are unable to make interest or principal payments when due, we would be in default under the terms of our long-term debt obligations, which would result in all principal and interest becoming due and payable which, in turn, would seriously harm our business.

Changes in regulations or user concerns regarding privacy and protection of user data could adversely affect our business.

Federal, state, foreign and international laws and regulations may govern the collection, use, retention, sharing and security of data that we receive from our customers, visitors to their websites and others. In addition, we have and post on our website our own privacy policy concerning the collection, use and disclosure of user data. Any failure, or perceived failure, by us to comply with our posted privacy policies or with any privacy- related laws, government regulations or directives, or industry self-regulatory principles could result in damage to our reputation or proceedings or actions against us by governmental entities or others, which could potentially have an adverse effect on our business.

Table of Contents

A large number of legislative proposals pending before the United States Congress, various state legislative bodies and foreign governments concern data privacy and retention issues related to our business, particularly the advertising-related services we have begun to offer. It is not possible to predict whether, when, or the extent to which such legislation may be adopted. In addition, the interpretation and application of user data protection laws are currently unsettled. These laws may be interpreted and applied inconsistently from jurisdiction to jurisdiction and inconsistently with our current data protection policies and practices. Complying with these varying international requirements could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business.

Internet-related and other 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 tax, consumer protection and privacy laws, both in the United States and abroad, that may impose additional burdens on companies conducting business online or providing Internet-related services such as ours. The adoption of an of these measures could negatively affect both our business directly as well as the businesses of our customers, which could reduce their demand for our services. Local tax laws that might apply to our servers, which are located in many different jurisdictions, could require us to pay additional taxes in those jurisdictions, which could adversely affect our continued profitability. We have recorded certain tax reserves to address potential exposures involving our sales and use and franchise tax positions. These potential tax liabilities result from the varying application of statutes, rules, regulations and interpretations by different jurisdictions. Our reserves, however, may not be adequate to reflect our total actual liability. Congress has been contemplating net neutrality legislation. The adoption of laws regulating the operation of the Internet could affect our business. As a government contractor, we are also subject to numerous laws and regulations. If we fail to comply with applicable requirements, then we could face penalties, contract terminations and damage to our reputation. We also may be required to devote substantial resources to the development and improvement of procedures to ensure compliance with applicable regulations.

If our ability to deliver media files in popular proprietary content formats were to become restricted or cost-prohibitive, demand for our content delivery services could decline, we could lose customers and our financial results could suffer.

Our business depends on our ability to deliver media content in all major formats. If our legal right or technical ability to store and deliver content in one or more popular proprietary content formats, such as Adobe® Flash® or Windows® Media®, was limited, our ability to serve our customers in these formats would be impaired and the demand for our content delivery services would decline by customers using these formats. Owners of propriety content formats may be able to block, restrict or impose fees or other costs on our use of such formats, which could lead to additional expenses for us and for our customers, or which could prevent our delivery of this type of content altogether. Such interference could result in a loss of existing customers, increased costs and impairment of our ability to attract new customers, which would harm our revenue, operating results and growth.

Provisions of our charter documents, our stockholder rights plan and Delaware law 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, amended and restated 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. In addition, our Board of Directors has adopted a stockholder rights plan the provisions of which could make it more difficult for a potential acquirer of Akamai to consummate an acquisition transaction without the approval of our Board of Directors.

Table of Contents

If we are required to seek additional funding, such funding may not be available on acceptable terms or at all.

If we seek to acquire significant businesses or technologies or require more cash to fund our future plans, we may need to obtain funding from outside sources. The current economic environment makes it difficult for companies to obtain financing, particularly raising debt financing or implementing credit facilities. Therefore, we may not be able to raise additional capital, which could limit future actions we may want to take. Even if we were to find outside funding sources, we might be required to issue securities with greater rights than the securities we have outstanding today or issue debt that places restrictions on our future activities. 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.

A class action lawsuit has been filed against us and an adverse resolution of such action could have a material adverse effect on our financial condition and results of operations in the period in which the lawsuit is resolved.

We are named as a defendant in a purported class action lawsuit filed in 2001 alleging that the underwriters of our initial public offering received undisclosed compensation in connection with our initial public offering of common stock in violation of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. See Note 11 to the financial statements included elsewhere in this annual report on Form 10-K for more information. Any conclusion of these matters in a manner adverse to us could have a material adverse affect on our financial position and results of operations.

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

In the ordinary course of business, we are or 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.

Item 1B. ***Unresolved Staff Comments***
None.

Item 2. ***Properties***
Our headquarters are located in approximately 175,000 square feet of leased office space in Cambridge, Massachusetts; the leases for such space are scheduled to expire in December 2019. Of this space, we have subleased approximately 12,000 square feet to another company. Our primary west coast office is located in approximately 67,000 square feet of leased office space in San Mateo, California; the lease for such space is scheduled to expire in October 2015. We maintain offices in several other locations in the United States, including in or near each of Los Angeles and San Diego, California; Denver, Colorado; Atlanta, Georgia; Chicago, Illinois; New York, New York; Dallas, Texas; Reston, Virginia and Seattle, Washington. We also maintain offices in Europe and Asia in or near the following cities: Bangalore, India; Beijing, China; Munich, Germany; Paris, France; London, England; Tokyo, Japan; Singapore; Madrid, Spain; Sydney, Australia; Milan, Italy; Stockholm, Sweden; and Seoul, South Korea. All of our facilities are leased. The square footage amounts above are as of December 31, 2008. We believe our facilities are sufficient to meet our needs for the foreseeable future and, if needed, additional space will be available at a reasonable cost.

Table of Contents

Item 3. ***Legal Proceedings***

We are subject to legal proceedings, claims and litigation arising in the ordinary course of business. We do not expect the ultimate costs to resolve these matters to have a material adverse effect on our consolidated financial position, results of operations or cash flows. In addition to ordinary-course litigation, we are a party to the litigation described below.

Between July 2, 2001 and November 7, 2001, purported class action lawsuits seeking monetary damages were filed in the United States District Court for the Southern District of New York against us as well as against the underwriters of our October 28, 1999 initial public offering of common stock. 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 complaints are similar and allege violations of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, primarily based on the allegation that the underwriters received undisclosed compensation in connection with our initial public offering. On April 19, 2002, a single consolidated amended complaint was filed, reiterating in one pleading the allegations contained in the previously filed separate actions. The consolidated amended complaint defines the alleged class period as October 28, 1999 through December 6, 2000. A Special Litigation Committee of our Board of Directors authorized management to negotiate a settlement of the pending claims substantially consistent with a Memorandum of Understanding that was negotiated among class plaintiffs, all issuer defendants and their insurers. The parties negotiated a settlement that was subject to approval by the Court. On February 15, 2005, the Court issued an Opinion and Order preliminarily approving the settlement, provided that the defendants and plaintiffs agree to a modification narrowing the scope of the bar order set forth in the original settlement agreement. The parties agreed to a modification narrowing the scope of the bar order, and on August 31, 2005, the Court issued an order preliminarily approving the settlement. On December 5, 2006, the United States Court of Appeals for the Second Circuit overturned the District Court s certification of the class of plaintiffs who are pursuing the claims that would be settled in the settlement against the underwriter defendants. Thereafter, the District Court ordered a stay of all proceedings in all of the lawsuits pending the outcome of plaintiffs petition to the Second Circuit for rehearing en banc and resolution of the class certification issue. On April 6, 2007, the Second Circuit denied plaintiffs rehearing petition, but clarified that the plaintiffs may seek to certify a more limited class in the District Court. On June 25, 2007, the District Court signed an order terminating the settlement. We believe that we have meritorious defenses to the claims made in the complaint, and we intend to contest the lawsuit vigorously. An adverse resolution of this action could have a material adverse effect on our financial condition and results of operations in the period in which the lawsuit is resolved. We are not presently able to estimate potential losses, if any, related to this lawsuit.

In addition, on or about October 3, 2007, Vanessa Simmonds, a purported Akamai shareholder, filed a complaint in the United States District Court for the Western District of Washington, against the underwriters involved in our 1999 initial public offering of common stock, alleging violations of Section 16(b) of the Exchange Act. The complaint alleges that the combined number of shares of our common stock beneficially owned by the lead underwriters and certain unnamed officers, directors, and principal shareholders exceeded ten percent of our outstanding common stock from the date of our initial public offering on October 29, 1999, through at least October 28, 2000. The complaint further alleges that those entities and individuals were thus subject to the reporting requirements of Section 16(a) and the short-swing trading prohibition of Section 16(b) and failed to comply with those provisions. The complaint seeks to recover from the lead underwriters any short-swing profits obtained by them in violation of Section 16(b). Akamai was named as a nominal defendant in the action, but has no liability for the asserted claims. None of our directors or officers serving in such capacities at the time of our initial public offering are currently named as defendants in this action, but there can be no guarantee that the complaint will not be amended or a new complaint or suit filed to name such directors or officers as defendants in this action or another action alleging a violation of the same provisions of the Securities Exchange Act of 1934, as amended. We do not expect the results of this action to have a material adverse effect on our business, results of operations or financial condition.

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

None.

20

Table of Contents

PART II

Item 5. ***Market For Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Our common stock, par value $0.01 per share, trades under the symbol AKAM on The NASDAQ Global Select Market. The following table sets forth, for the periods indicated, the high and low sale price per share of the common stock on The NASDAQ Global Select Market:

	High	Low
Fiscal 2007:		
First Quarter	$ 59.69	$ 46.60
Second Quarter	$ 56.25	$ 41.02
Third Quarter	$ 50.98	$ 27.75
Fourth Quarter	$ 41.45	$ 28.26
Fiscal 2008:		
First Quarter	$ 36.00	$ 25.06
Second Quarter	$ 40.90	$ 29.02
Third Quarter	$ 35.72	$ 14.60
Fourth Quarter	$ 17.95	$ 9.25

As of February 25, 2009, there were 698 holders of record of our common stock.

We have never paid or declared any cash dividends on shares of our common stock or other securities and do not anticipate paying any cash dividends in the foreseeable future. We currently intend to retain all future earnings, if any, for use in the operation of our business. We did not repurchase any equity securities in 2008.

Table of Contents

Item 6. ***Selected Consolidated Financial Data***

The following selected consolidated financial data should be read in conjunction with our consolidated financial statements and related notes, Management s Discussion and Analysis of Financial Condition and Results of Operations and other financial data included elsewhere in this annual report on Form 10-K. The consolidated statement of operations and balance sheet data for all periods presented is derived from the audited consolidated financial statements included elsewhere in this annual report on Form 10-K or in annual reports on Form 10-K for prior years on file with the Commission.

Statements of operations data for the years ended December 31, 2005 and 2004 included a loss on early extinguishment of debt of $1.4 million and $6.8 million, respectively, as a result of our repurchase of $56.6 million and $169.4 million in aggregate principal amount of our 5 $^{1}/2$% convertible subordinated notes, respectively, in those years.

In 2005, we acquired Speedera Networks, Inc., or Speedera, which was accounted for under the purchase method of accounting, for a purchase price of $142.2 million, comprised primarily of our common stock. We allocated $137.4 million of the cost of this acquisition to goodwill and other intangible assets. Net income from operations for the years ended December 31, 2005, 2006, 2007 and 2008 included $5.1 million, $8.3 million, $7.4 million and $6.1 million, respectively, for the amortization of other intangible assets related to this acquisition.

In 2005, we released nearly all of our United States and foreign deferred tax asset valuation allowance. Based upon our cumulative operating results and an assessment of our expected future results, we determined at that time that it was more likely than not that our deferred tax assets would be realized. During 2005, the total valuation allowance release recorded as an income tax benefit in the statement of operations was $285.8 million.

In December 2003 and January 2004, we issued $200.0 million in aggregate principal amount of our 1% senior convertible notes due December 15, 2033, which we refer to as our 1% senior convertible notes, for proceeds of $194.1 million net of offering expenses. Additionally, in 2005, we completed an equity offering of 12.0 million shares of our common stock at a price of $16.855 per share for proceeds of $202.1 million, net of offering expenses.

On January 1, 2006, we adopted, on a modified prospective basis, the provisions of Statement of Financial Accounting Standards, or SFAS, No. 123R, Share-Based Payment, or SFAS No. 123R, which requires us to record compensation expense for employee stock awards at fair value at the time of grant. As a result, our stock-based compensation expense increased significantly in 2006 as compared to prior years, causing our net income to decrease significantly as well. For the year ended December 31, 2006, our pre-tax stock-based compensation expense was $49.6 million.

In 2006, we acquired Nine Systems for a purchase price of $157.5 million, comprised primarily of our common stock. This acquisition was accounted for under the purchase method of accounting. We allocated $168.4 million of the cost of this acquisition to goodwill and other intangible assets. Net income from operations for the years ended December 31, 2006, 2007 and 2008 included $0.1 million, $3.3 million and $4.1 million, respectively, for the amortization of other intangible assets related to this acquisition.

In March 2007, we acquired Netli for a purchase price of $154.4 million, comprised primarily of our common stock. This acquisition was accounted for under the purchase method of accounting. We allocated $148.4 million of the cost of this acquisition to goodwill and other intangible assets. Net income from operations for the years ended December 31, 2007 and 2008 included $0.7 million and $3.1 million, respectively, for the amortization of other intangible assets related to this acquisition.

22

Table of Contents

In April 2007, we acquired Red Swoosh for a purchase price of $18.7 million, comprised primarily of our common stock. This acquisition was accounted for under the purchase method of accounting. We allocated $16.9 million of the cost of this acquisition to goodwill and other intangible assets. Net income from operations for the year ended December 31, 2008 included $0.1 million for the amortization of other intangible assets related to this acquisition.

In November 2008, we acquired acerno for a purchase price of $90.7 million in cash, of which $5.8 million was subsequently paid in the first quarter of 2009. This acquisition was accounted for under the purchase method of accounting. We allocated $99.7 million of the cost of this acquisition to goodwill and other intangible assets. Net income from operations for the year ended December 31, 2008 included $0.5 million for the amortization of other intangible assets related to this acquisition.

	For the Years Ended December 31,				
	2008	2007	2006	2005	2004
	(In thousands, except per share data)				
Consolidated Statements of Operations Data:					
Revenues	$ 790,924	$ 636,406	$ 428,672	$ 283,115	$ 210,015
Total costs and operating expenses	578,660	491,478	345,566	209,740	161,048
Operating income	212,264	144,928	83,106	73,375	48,967
Net income	145,138	100,967	57,401	327,998	34,364
Net income per weighted average share:					
Basic	$ 0.87	$ 0.62	$ 0.37	$ 2.41	$ 0.28
Diluted	$ 0.79	$ 0.56	$ 0.34	$ 2.11	$ 0.25
Weighted average shares used in per share calculation:					
Basic	167,673	162,959	155,366	136,167	124,407
Diluted	186,685	185,094	176,767	156,944	146,595

	As of December 31,				
	2008	2007	2006	2005	2004
	(In thousands)				
Consolidated Balance Sheet Data:					
Cash, cash equivalents and unrestricted marketable securities	$ 768,014	$ 629,895	$ 430,247	$ 309,574	$ 103,763
Restricted marketable securities	3,613	3,613	4,207	4,555	4,654
Working capital	401,453	606,667	285,409	293,122	61,903
Total assets	1,880,951	1,656,047	1,247,932	891,499	182,743
Other long-term liabilities	11,870	9,265	3,657	3,565	3,035
1% convertible senior notes	199,855	199,855	200,000	200,000	200,000
5 1/2% convertible subordinated notes					56,614
Total stockholders equity (deficit)	$ 1,568,770	$ 1,358,552	$ 954,693	$ 624,214	$ (125,931)

Table of Contents

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Overview

We provide services for accelerating and improving the delivery of content and applications over the Internet. We primarily derive income from the sale of services to customers executing contracts with terms of one year or longer, which we refer to as recurring revenue contracts or long-term contracts. These contracts generally commit the customer to a minimum monthly level of usage with additional charges applicable for actual usage above the monthly minimum. In recent years, however, we have entered into increasing numbers of customer contracts that have minimum usage commitments that are based on quarterly, twelve-month or longer periods. Our goal of having a consistent and predictable base level of income is important to our financial success. Accordingly, to be successful, we must maintain our base of recurring revenue contracts by eliminating or reducing lost monthly or annual recurring revenue due to customer cancellations or terminations and build on that base by adding new customers and increasing the number of services, features and functions 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.

This Management s Discussion and Analysis of Financial Condition and Results of Operations, or MD&A, should be read in conjunction with our consolidated financial statements and notes thereto which appear elsewhere in this annual report on Form 10-K. See Risk Factors elsewhere in this annual report on Form 10-K for a discussion of certain risks associated with our business. The following discussion contains forward-looking statements. The forward-looking statements do not include the potential impact of any mergers, acquisitions, or divestitures of business combinations that may be announced after the date hereof.

Our increase in net income in 2008 as compared to 2007 and 2006 reflects the success of our efforts to increase our monthly and annual recurring revenues while limiting the expenses needed to support such growth. The following sets forth, as a percentage of revenues, consolidated statements of operations data for the years indicated:

	2008	2007	2006
Revenues	100%	100%	100%
Cost of revenues	28	26	22
Research and development	5	7	8
Sales and marketing	21	23	28
General and administrative	17	19	21
Amortization of other intangible assets	2	2	2
Restructuring charge (benefit)			
Total costs and operating expenses	73	77	81
Income from operations	27	23	19
Interest income	3	4	4
Interest expense			(1)
Other income (expense), net			
Gain (loss) on investments, net			
Loss on early extinguishment of debt			
Income before provision for income taxes	30	27	22
Provision for income taxes	11	11	9

Net income	19%	16%	13%

24

Table of Contents

We were profitable for fiscal years 2008, 2007 and 2006; however, we cannot guarantee continued profitability or profitability at the levels we have recently experienced for any period in the future. We have observed the following trends and events that are likely to have an impact on our financial condition and results of operations in the foreseeable future:

During each quarter of 2008, the dollar volume of new recurring revenue contracts that we booked exceeded the dollar volume of the contracts we lost through cancellations, terminations and non-payment. A continuation of this trend would lead to increased revenues.

During each quarter of 2008, unit prices offered to some new and existing customers declined, including contracts signed with certain customers at higher committed service levels that reflected volume discounts. Additionally, increased competition from new entrants into the market that are willing to use low unit prices as a method of differentiation contributed to these price declines. If we continue to experience decreases in unit prices for new and existing customers, our operating profit percentage could decrease.

During each quarter of 2008, we reduced our network bandwidth costs per unit by entering into new supplier contracts with lower pricing and amending existing contracts to take advantage of price reductions offered by our existing suppliers. Additionally, we continue to invest in internal-use software development to improve the performance and efficiency of our network. Due to increased traffic delivered over our network, however, our total bandwidth costs increased during these quarters. We believe that our overall bandwidth costs will continue to increase as a result of expected higher traffic levels, but we anticipate 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 in excess of our expectations in 2009.

During each quarter of 2008, no customer accounted for 10% or more of our total revenues. We expect that customer concentration levels will continue to decline compared to those in prior years if our customer base continues to grow.

During the year ended December 31, 2008, revenues derived from customers outside the United States accounted for 25% of our total revenues. We expect revenues from such customers as a percentage of our total revenues to be between 25% and 30% in 2009.

As of January 1, 2006, we adopted SFAS No. 123R, which requires us to record compensation expense for employee stock awards at fair value at the time of grant. For the years ended December 31, 2008, 2007 and 2006, our stock-based compensation expense was $57.9 million, $66.6 million and $49.6 million, respectively. We expect that stock-based compensation expense will continue at the current level, because we have a significant number of unvested employee awards outstanding that we expect will be offset by grants of stock-based compensation awards in the future at lower fair values than those previously granted. As of December 31, 2008, our total unrecognized compensation costs for stock-based awards were $75.9 million, which we expect to recognize as expense over a weighted average period of 1.2 years. This expense is expected to be recognized through 2012.

Depreciation and amortization expense related to our network equipment and internal-use software development costs increased by $18.1 million during 2008 as compared to 2007. Due to expected future purchases of network equipment during 2009, we believe that depreciation expense related to our network equipment will continue to increase in 2009. We expect to continue to enhance and add functionality to our service offerings and capitalize stock-based compensation expense attributable to employees working on such projects, which would increase the amount of capitalized internal-use software costs. As a result, we believe that the amortization of internal-use software development costs, which we include in cost of revenues, will increase in 2009 as compared to 2008.

Table of Contents

- As of December 31, 2008, we have recorded a pre-tax cumulative unrealized loss in stockholders equity of $38.1 million related to the temporary impairment of our marketable security investments and $12.9 million of realized loss in our statement of operations related to the other-than-temporary impairment of our investments in auction rate securities, or ARS. We also recorded a realized gain of $12.5 million related to an agreement we entered into with one of our investment advisors. Under the terms of the agreement, the investment advisor agreed to repurchase, in June 2010, the ARS it previously sold to us. The gain represented by the put option incorporated into this agreement was included in gain (loss) on investments, net in our statement of operations. Based upon our cash, cash equivalents and marketable securities balance of $771.6 million and expected operating cash flows, we do not anticipate that the lack of liquidity associated with our ARS will adversely affect our ability to conduct business during 2009. We believe we have the ability to hold these ARS until a recovery of the auction process, a buyer is found outside the auction process, the securities are called or refinanced by the issuer, or until maturity.

- During the year ended December 31, 2008, our effective income tax rate was 38.1%. While we expect our annual effective income tax rate to remain relatively consistent during 2009, we do not expect to make significant cash tax payments due to the continued utilization of our deferred tax assets.

In November 2008, we announced a workforce reduction affecting 110 employees across all functional areas. We recorded $2.0 million as a restructuring charge for the amount of one-time benefits provided to affected employees. Included in these costs is a net reduction in non-cash stock-based compensation of $0.8 million, reflecting a modification to certain stock-based awards previously granted to affected employees. Additionally, in December 2008, in connection with excess and vacated facilities under long-term non-cancelable leases, we recorded $0.5 million as a restructuring charge for the estimated future lease payments, less estimated sublease income, for these vacated facilities. We expect that $1.7 million of these liabilities will be paid in 2009.

Based on our analysis of, among other things, the aforementioned trends and events, as of the date of this annual report on Form 10-K, we expect to continue to generate net income on a quarterly and annual basis during 2009; however, our future results are likely to be affected by many factors identified in the section captioned Risk Factors and elsewhere in this annual report on Form 10-K, including our ability to:

- increase our revenue by adding customers through long-term contracts and limiting customer cancellations and terminations;

- offset unit price declines for our services with higher volumes of traffic delivered on our network as well as increased sales of our value-added solutions;

- prevent disruptions to our services and network due to accidents or intentional attacks; and

- maintain our network bandwidth 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.

Application of Critical Accounting Policies and Estimates

Overview

Our MD&A is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. These principles require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, cash flow and related disclosure of contingent assets and liabilities. Our estimates include those related to revenue recognition, accounts receivable and related reserves, valuation and impairment of investments and marketable securities, capitalized internal-use software costs, goodwill and other intangible assets, tax reserves, impairment

and useful lives of long-lived assets, loss contingencies and stock-based compensation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances at the time such estimates are made. Actual results may differ from these estimates. For a complete description of our significant accounting policies, see Note 2 to our consolidated financial statements included elsewhere in this annual report on Form 10-K.

Definitions

We define our critical accounting policies as those accounting principles generally accepted in the United States of America that require us to make subjective estimates and judgments about matters that are uncertain and are likely to have a material impact on our financial condition and results of operations as well as the specific manner in which we apply those principles. Our estimates are based upon assumptions and judgments about matters that are highly uncertain at the time the accounting estimate is made and applied and require us to assess a range of potential outcomes.

Review of Critical Accounting Policies and Estimates

Revenue Recognition:

We recognize service revenue in accordance with the Commission s Staff Accounting Bulletin No. 104, Revenue Recognition, and the Financial Accounting Standards Board, or FASB, Emerging Issues Task Force, or EITF, Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. Revenue is recognized only when the price is fixed or determinable, persuasive evidence of an arrangement exists, the service is performed and collectability of the resulting receivable is reasonably assured.

We primarily derive revenues from the sale of services to customers executing contracts with terms of one year or longer. These contracts generally commit the customer to a minimum monthly, quarterly or annual level of usage and specify the rate at which the customer must pay for actual usage above the monthly, quarterly or annual minimum. For these services, we recognize the monthly minimum as revenue each month provided that an enforceable contract has been signed by both parties, the service has been delivered to the customer, the fee for the service is fixed or determinable and collection is reasonably assured. Should a customer s usage of our service exceed the monthly minimum, we recognize revenue for such excess usage in the period of the usage. For annual or other non-monthly period revenue commitments, we recognize revenue monthly based upon the customer s actual usage each month of the commitment period and only recognize any remaining committed amount for the applicable period in the last month thereof.

We typically charge customers an installation fee when the services are first activated. The installation fees are recorded as deferred revenue and recognized as revenue ratably over the estimated life of the customer arrangement. We also derive income from services sold as discrete, non-recurring events or based solely on usage. For these services, we recognize revenue when the event or usage has occurred.

When more than one element is contained in a single arrangement, we allocate revenue between the elements based on each element s relative fair value, provided that each element meets the criteria as a separate unit of accounting. An item is considered a separate unit of accounting if it has value to the customer on a standalone basis and there is objective and verifiable evidence of the fair value of the separate elements. Fair value is generally determined based upon the price charged when the element is sold separately. If the fair value of each element cannot be objectively determined, the total value of the arrangement is recognized ratably over the entire service period commencing when all services have begun to be provided. For most multi-element service arrangements we have entered into to date, the fair value of each element has not been objectively determinable. Therefore, all revenue under these arrangements has been

recognized ratably over the related service period commencing when we have begun to provide all services ordered.

At the inception of a customer contract for service, we make an estimate as to that customer s ability to pay for the services provided. We base our estimate on a combination of factors, including the successful completion of a credit check or financial review, our collection experience with the customer and other forms of payment assurance. Upon the completion of these steps, we recognize revenue monthly in accordance with our revenue recognition policy. If we subsequently determine that collection from the customer is not reasonably assured, we record an allowance for doubtful accounts and bad debt expense for all of that customer s unpaid invoices and cease recognizing revenue for continued services provided until cash is received. Changes in our estimates and judgments about whether collection is reasonably assured would change the timing of revenue or amount of bad debt expense that we recognize.

We also sell our services through a reseller channel. Assuming all other revenue recognition criteria are met, we recognize revenue from reseller arrangements based on the reseller s contracted non-refundable minimum purchase commitments over the term of the contract, plus amounts sold by the reseller to its customers in excess of the minimum commitments. These excess commitments are recognized as revenue in the period in which the service is provided.

From time to time, we enter into contracts to sell our services or license our technology to unrelated companies at or about the same time we enter into contracts to purchase products or services from the same companies. If we conclude that these contracts were negotiated concurrently, we record as revenue only the net cash received from the vendor, unless the product or service received has a separate and identifiable benefit and the fair value to us of the vendor s product or service can be objectively established.

We may from time to time resell licenses or services of third parties. We record revenue for these transactions on a gross basis when we have risk of loss related to the amounts purchased from the third party and we add value to the license or service, such as by providing maintenance or support for such license or service. If these conditions are present, we recognize revenue when all other revenue recognition criteria are satisfied.

Deferred revenue represents amounts billed to customers for which revenue has not been recognized. Deferred revenue primarily consists of the unearned portion of monthly billed service fees; prepayments made by customers for future periods; deferred installation and activation set-up fees; and amounts billed under customer arrangements with extended payment terms.

Accounts Receivable and Related Reserves:

Trade accounts receivable are recorded at the invoiced amounts and do not bear interest. In addition to trade accounts receivable, our accounts receivable balance includes unbilled accounts that represent revenue recorded for customers that is typically billed within one month. We record reserves against our accounts receivable balance. These reserves consist of allowances for doubtful accounts and revenue from certain customers on a cash basis. Increases and decreases in the allowance for doubtful accounts are included as a component of general and administrative expenses. Increases in the reserve for cash basis customers are recorded as reduction of revenue. The reserve for cash basis customers increases as services are provided to customers for which collection is no longer assured. 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 our 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 we no longer believe that the customer has the ability to pay for prior services provided. We perform on-going credit evaluations of our 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 creation of a cash basis reserve until we receive consistent payments.

Table of Contents

Valuation and Impairment of Investments and Marketable Securities:

Effective January 1, 2008, we implemented SFAS No. 157, Fair Value Measurement, or SFAS No. 157, for our financial assets and liabilities that are re-measured and reported at fair value at each reporting period, and non-financial assets and liabilities that are re-measured and reported at fair value at least annually. SFAS No. 157 defines fair value 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. We have certain financial assets and liabilities recorded at fair value (principally cash equivalents and short- and long-term marketable securities) that have been classified as Level 1, 2 or 3 within the fair value hierarchy as described in SFAS No. 157. Fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access. Fair values determined by Level 2 inputs utilize data points that are observable such as quoted prices, interest rates and yield curves. Fair values determined by Level 3 inputs utilize unobservable data points for the asset or liability.

Investments and marketable securities are considered to be impaired when a decline in fair value below cost basis is determined to be other-than-temporary. We periodically evaluate whether a decline in fair value below cost basis is other-than-temporary by considering available evidence regarding these investments including, among other factors, the duration of the period that, and extent to which, the fair value is less than cost basis; the financial health of and business outlook for the issuer, including industry and sector performance and operational and financing cash flow factors; overall market conditions and trends; and our intent and ability to retain our investment in the security for a period of time sufficient to allow for an anticipated recovery in market value. Once a decline in fair value is determined to be other-than-temporary, a write-down is recorded and a new cost basis in the security is established. Assessing the above factors involves inherent uncertainty. Write-downs, if recorded, could be materially different from the actual market performance of investments and marketable securities in our portfolio, if, among other things, relevant information related to our investments and marketable securities was not publicly available or other factors not considered by us would have been relevant to the determination of impairment.

Included in our short- and long-term marketable securities at December 31, 2008 and 2007 are ARS that are primarily AAA-rated bonds, most of which are collateralized by federally guaranteed student loans. ARS are long-term variable rate bonds tied to short-term interest rates that may reset through a Dutch auction process that is designed to occur every seven to 35 days. Historically, the carrying value (par value) of ARS approximated fair market value due to the resetting of variable interest rates. Beginning in mid-February 2008 and continuing throughout the period ended December 31, 2008, however, the auctions for ARS then held by us were unsuccessful. As a result, the interest rates on ARS reset to the maximum rate per the applicable investment offering statements. We will not be able to liquidate affected ARS until a future auction on these investments is successful, a buyer is found outside the auction process, the securities are called or refinanced by the issuer, or the securities mature. Due to the long-term nature of the underlying student loan bonds and the failure of the auction process to provide a current market, we classified these investments as long-term on our consolidated balance sheet as of December 31, 2008.

In light of these liquidity issues, we performed a discounted cash flow analysis to determine the estimated fair value of these ARS investments. The discounted cash flow analysis we performed considered the timing of expected future successful auctions, the impact of extended periods of maximum interest rates, collateralization of underlying security investments and the creditworthiness of the issuer. The discounted cash flow analysis performed as of December 31, 2008 assumes a weighted average discount rate of 6.275% and expected term of five years. The discount rate was determined using a proxy based upon the current market rates for similar debt offerings within the AAA-rated ARS market. The expected term was based on management s estimate of future liquidity. As a result, as of December 31, 2008, we have estimated an aggregate loss of $50.1 million, of which $37.2 million was related to the impairment of ARS

deemed to be temporary and included in accumulated other comprehensive income (loss) within stockholders equity and of which $12.9 million was related to the

29

Table of Contents

impairment of ARS deemed other-than-temporary and included in gain (loss) on investments, net in the consolidated statement of operations.

Despite the failed auctions, we continue to receive cash flows in the form of specified interest payments from the issuers of ARS. In addition, except for ARS with respect to which we have entered into an agreement allowing us to sell such ARS in June 2010, we have the intent and ability to hold our ARS until a recovery of the impairment because we believe we have sufficient cash and other marketable securities on-hand and from projected cash flows from operations such that we do not anticipate a need to sell our ARS prior to a recovery to par value. See Liquidity and Capital Resources below.

Impairment and Useful Lives of Long-Lived Assets:

We review our long-lived assets, such as fixed assets and intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Events that would trigger an impairment review include a change in the use of the asset or forecasted negative cash flows related to the asset. When such events occur, we compare the carrying amount of the asset to the undiscounted expected future cash flows related to the asset. If this comparison indicates that impairment is present, the amount of the impairment is calculated as the difference between the carrying amount and the fair value of the asset. If a readily determinable market price does not exist, fair value is estimated using discounted expected cash flows attributable to the asset. The estimates required to apply this accounting policy include forecasted usage of the long-lived assets, the useful lives of these assets and expected future cash flows. Changes in these estimates could materially impact results from operations.

Goodwill and Other Intangible Assets:

We test goodwill for impairments on an annual basis or more frequently if events or changes in circumstances indicate that the asset might be impaired. We concluded that we had one reporting unit and assigned the entire balance of goodwill to this reporting unit as of December 31, 2008 and 2007. The fair value of the reporting unit was determined using our market capitalization as of December 31, 2008 and 2007. We performed an impairment test of goodwill as of each of December 31, 2008 and December 31, 2007. These tests did not result in an impairment of goodwill. Other intangible assets consist of completed technologies, customer relationships, trademarks and non-compete agreements arising from acquisitions of businesses and acquired license rights. Purchased intangible assets, other than goodwill, are amortized over their estimated useful lives based upon the economic value derived from the related intangible assets. Goodwill is carried at its historical cost.

Loss Contingencies:

We define a loss contingency as a condition involving uncertainty as to a possible loss related to a previous event that will not be resolved until one or more future events occur or fail to occur. Our primary loss contingencies relate to pending or threatened litigation. We record a liability for a loss contingency when we believe that it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. When we believe the likelihood of a loss is less than probable and more than remote, we do not record a liability. Material loss contingencies are disclosed in the notes to our consolidated financial statements.

Tax Reserves:

Our provision for income taxes is comprised of a current and a deferred portion. The current income tax provision is calculated as the estimated taxes payable or refundable on tax returns for the current year. The deferred income tax provision is calculated for the estimated future tax effects attributable to temporary differences and carryforwards using expected tax rates in effect

in the years during which the differences are expected to reverse or the carryforwards are expected to be realized.

Table of Contents

We currently have significant deferred tax assets, comprised of net operating loss, or NOL, carryforwards, tax credit carryforwards and deductible temporary differences. Our management periodically weighs the positive and negative evidence to determine if it is more likely than not that some or all of the deferred tax assets will not be realized.

We have recorded certain tax reserves to address potential exposures involving our income tax and sales and use tax positions. These potential tax liabilities result from the varying application of statutes, rules, regulations and interpretations by different taxing jurisdictions. Our estimate of the value of our tax reserves contains assumptions based on past experiences and judgments about the interpretation of statutes, rules and regulations by taxing jurisdictions. It is possible that the costs of the ultimate tax liability or benefit from these matters may be materially more or less than the amount that we estimated.

In June 2006, the FASB issued FASB Interpretation, or FIN, No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a two-step process to determine the amount of tax benefit to be recognized. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon external examination. If the tax position is deemed more-likely-than-not to be sustained, the tax position is then assessed to determine the amount of benefit to recognize in the financial statements. The amount of the benefit that may be recognized is the largest amount that has a greater than 50 percent likelihood of being realized upon ultimate settlement. We adopted the provisions of FIN 48 on January 1, 2007. As of the date of adoption, we had unrecognized tax benefits of $2.1 million, including accrued interest and penalties, and did not record any cumulative effect adjustment to retained earnings as a result of adopting FIN 48. As of December 31, 2008, we had unrecognized tax benefits of $6.1 million, including accrued interest and penalties.

Accounting for Stock-Based Compensation:

We account for stock-based compensation in accordance with SFAS No. 123R. Under the fair value recognition provisions of SFAS No. 123R, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the vesting period. We have selected the Black-Scholes option pricing model to determine fair value of stock option awards. Determining the fair value of stock-based awards at the grant date requires judgment, including estimating the expected life of the stock awards and the volatility of the underlying common stock. Our assumptions may differ from those used in prior periods because of adjustments to the calculation of such assumptions based upon the guidance of SFAS No. 123R and Staff Accounting Bulletin No. 107, Share-Based Payment. Changes to the assumptions may have a significant impact on the fair value of stock options, which could have a material impact on our financial statements. In addition, judgment is also required in estimating the amount of stock-based awards that are expected to be forfeited. Should our actual forfeiture rates differ significantly from our estimates, our stock-based compensation expense and results of operations could be materially impacted.

For stock options, restricted stock, restricted stock units and deferred stock units, we recognize compensation cost on a straight-line basis over the awards vesting periods for those awards that contain only a service vesting feature. For awards with a performance condition vesting feature, we recognize compensation cost on a graded-vesting basis over the awards expected vesting periods.

Capitalized Internal-Use Software Costs:

We capitalize the salaries and payroll-related costs of employees and consultants who devote time to the development of internal-use software projects. If a project constitutes an enhancement to previously developed software, we assess whether the enhancement is significant and creates additional functionality to the software, thus qualifying the work incurred

for capitalization. Once the project is complete, we estimate the useful life of the internal-use software, and we periodically assess whether the software is impaired. Changes in our estimates related to internal-use software would increase or decrease operating expenses or amortization recorded during the period.

Table of Contents

Results of Operations

Revenues. Total revenues increased 24%, or $154.5 million, to $790.9 million for the year ended December 31, 2008 as compared to $636.4 million for the year ended December 31, 2007. Total revenues increased 48%, or $207.7 million, to $636.4 million for the year ended December 31, 2007 as compared to $428.7 million for the year ended December 31, 2006. The increases in revenue during the years presented were primarily attributable to an increase in the number of customers under recurring revenue contracts, as well as increases in traffic and additional services sold to new and existing customers. Increased sales to existing customers contributed to increases in the average revenue per customer during each year, partially offset by reduced unit prices offered to new and renewing customers. We believe that the continued growth in use of the Internet by businesses and consumers was the principal factor driving increased purchases of our services. We expect this trend to continue in 2009 but at lower rates of growth due to general economic conditions and a leveling off of the rate of increased growth in use of the Internet. Also contributing to the increase in revenues for the years ended December 31, 2008 and 2007 were revenues generated through our acquisitions of acerno, which added $6.9 million of revenue during the fourth quarter of 2008, Netli, Nine Systems and Red Swoosh. As of December 31, 2008, we had 2,858 customers under recurring revenue contracts as compared to 2,645 at December 31, 2007 and 2,347 at December 31, 2006.

For 2008 and 2007, 25% and 23%, respectively, of our total revenues was derived from our operations located outside of the United States, of which 18% and 17% of total revenues, respectively, was derived from operations in Europe. For 2006, 22% of our total revenues was derived from our operations located outside of the United States, of which 18% of total revenues was derived from operations in Europe. Other than the United States, no single country accounted for 10% or more of our total revenues during these periods. We expect international sales to increase slightly as a percentage of our total sales in 2009 as compared to prior years. Resellers accounted for 16% of revenues in 2008, 18% in 2007 and 20% in 2006. For 2008, 2007 and 2006, no single customer accounted for 10% or more of total revenues.

Cost of Revenues. Cost of revenues includes fees paid to network providers for bandwidth and co-location of our network equipment. Cost of revenues also includes payroll and related costs and stock-based compensation expense for network operations personnel, cost of software licenses, depreciation of network equipment used to deliver our services and amortization of internal-use software.

Cost of revenues was comprised of the following (in millions):

	For the Years Ended December 31,		
	2008	2007	2006
Bandwidth, co-location and storage fees	$ 136.8	$ 103.2	$ 59.2
Payroll and related costs of network operations personnel	10.8	8.8	5.8
Stock-based compensation	2.4	3.3	2.0
Depreciation and impairment of network equipment	55.2	41.1	19.4
Amortization of internal-use software	17.4	11.0	7.7
Total cost of revenues	$ 222.6	$ 167.4	$ 94.1

Cost of revenues increased 33%, or $55.2 million, to $222.6 million for the year ended December 31, 2008 as compared to $167.4 million for the year ended December 31, 2007. Cost of revenues increased 78%, or $73.3 million, to $167.4 million for the year ended December 31, 2007 as compared to $94.1 million for the year ended December 31, 2006. These increases were primarily due to an increase in the amounts paid to network providers due to higher traffic levels, partially offset by reduced bandwidth costs per unit, and increases in depreciation expense of network equipment and amortization of internal-use software as we continued to

invest in our infrastructure. Additionally, in 2008, 2007 and 2006, cost of revenues included stock-based compensation expense; such expense decreased by $0.9 million in 2008 as compared to 2007 and increased by $1.4 million in 2007 as compared to 2006. Cost of revenues during 2008, 2007 and 2006 also included credits received of approximately $3.3 million, $3.4 million and $1.5 million, respectively, from settlements and renegotiations entered into in connection with billing disputes related to bandwidth contracts. Credits of this nature may occur in the future; however, the timing and amount of future credits, if any, will vary.

Table of Contents

We have long-term purchase commitments for bandwidth usage and co-location with various networks and Internet service providers. For the years ending December 31, 2009 and 2010, the minimum commitments related to bandwidth usage and co-location services are approximately $42.4 million and $8.0 million, respectively.

We believe cost of revenues will increase in 2009. We expect to deliver more traffic on our network, which would result in higher expenses associated with the increased traffic; however, such costs are likely to be partially offset by lower bandwidth costs per unit. Additionally, for 2009, we anticipate increases in depreciation expense related to our network equipment and amortization of internal-use software development costs, along with increased payroll and related costs, as we continue to make investments in our network with the expectation that our customer base will continue to expand.

Research and Development. Research and development expenses consist primarily of payroll and related costs and stock-based compensation expense for research and development personnel who design, develop, test, deploy and enhance our services and our network. Research and development costs are expensed as incurred, except for certain internal-use software development costs eligible for capitalization. During the years ended December 31, 2008, 2007 and 2006, we capitalized software development costs of $23.9 million, $17.8 million and $11.7 million, respectively, net of impairments. These development costs consisted of external consulting, payroll and payroll-related costs for personnel involved in the development of internal-use software used to deliver our services and operate our network. Additionally, for the years ended December 31, 2008, 2007 and 2006, we capitalized as internal-use software $7.4 million, $6.4 million and $4.3 million, respectively, of non-cash stock-based compensation. These capitalized internal-use software costs are amortized to cost of revenues over their estimated useful lives of two years.

Research and development expenses decreased 11%, or $4.9 million, to $39.2 million for the year ended December 31, 2008 as compared to $44.1 million for the year ended December 31, 2007. Research and development expenses increased 33%, or $11.0 million, to $44.1 million for the year ended December 31, 2007, as compared to $33.1 million for the year ended December 31, 2006. The research and development expense decrease in 2008 as compared to 2007 was due to decreases in stock-based compensation expense and travel costs as well as an increase in amount of costs capitalized as internal-use software, partially offset by an increase in payroll and related costs resulting from higher headcount. The research and development expense increase in 2007 as compared to the prior year was due to increases in payroll and related costs resulting from higher headcount, as well as additional stock-based compensation expense.

The following table quantifies the net changes in the various components of our research and development expenses for the periods presented (in millions):

	Increase (Decrease) in Research and Development Expenses	
	2008 to 2007	**2007 to 2006**
Payroll and related costs	$ 6.2	$ 12.5
Stock-based compensation	(4.6)	4.2
Capitalized salaries and other	(6.5)	(5.7)
Total net (decrease) increase	$ (4.9)	$ 11.0

We believe that research and development expenses will increase in 2009 because we expect to continue to hire additional development personnel in order to make improvements in our core technology, develop new services and make refinements to our other service offerings.

Sales and Marketing. Sales and marketing expenses consist primarily of payroll and related costs, stock-based compensation expense and commissions for personnel engaged in marketing, sales and support functions, as well as advertising and promotional expenses.

Table of Contents

Sales and marketing expenses increased 11%, or $16.8 million, to $164.4 million for the year ended December 31, 2008 as compared to $147.6 million for the year ended December 31, 2007. Sales and marketing expenses increased 23%, or $27.9 million, to $147.6 million for the year ended December 31, 2007 as compared to $119.7 million for the year ended December 31, 2006. The increase in sales and marketing expenses during these periods was primarily due to higher payroll and related costs, particularly commissions for sales and marketing personnel, attributable to revenue growth and as a result of higher marketing-related costs, particularly for the year ended December 31, 2008, as compared to the year ended December 31, 2007.

The following table quantifies the net increase in the various components of our sales and marketing expenses for the periods presented (in millions):

	Increase (Decrease) in Sales and Marketing Expenses	
	2008 to 2007	**2007 to 2006**
Payroll and related costs	$ 8.8	$ 12.6
Stock-based compensation		7.8
Marketing and related costs	4.5	2.9
Other expense	3.5	4.6
Total net increase	$ 16.8	$ 27.9

We expect that sales and marketing expenses will increase in 2009 due to an expected increase in commissions on higher forecasted sales of our services, offset by a reduction in payroll and related costs due to a decrease in our sales and marketing personnel and other marketing costs such as advertising.

General and Administrative. General and administrative expenses consist primarily of the following components:

- payroll, stock-based compensation expense and other related costs, including expenses for executive, finance, business applications, network management, human resources and other administrative personnel;
- depreciation of property and equipment we use internally;
- fees for professional services;
- rent and other facility-related expenditures for leased properties;
- the provision for doubtful accounts;
- insurance costs; and

non-income related taxes.

General and administrative expenses increased 12%, or $14.9 million, to $136.0 million for the year ended December 31, 2008 as compared to $121.1 million for the year ended December 31, 2007. General and administrative expenses increased 34% or $30.9 million, to $121.1 million for the year ended December 31, 2007 as compared to $90.2 million for the year ended December 31, 2006. The increase in general and administrative expenses during both periods was primarily due to an increase in payroll and related costs as a result of headcount growth. Additionally, facilities-related costs increased due to office expansions, and we incurred increased expenditures for professional services, particularly legal and consulting fees. This increase was offset by a decrease in stock-based compensation expense during 2008 in comparison to 2007.

Table of Contents

The following table quantifies the net increase in various components of our general and administrative expenses for the periods presented (in millions):

	Increase (Decrease) in General and Administrative Expenses	
	2008 to 2007	2007 to 2006
Payroll and related costs	$ 4.7	$ 7.8
Stock-based compensation	(3.2)	3.5
Non-income taxes	2.0	(0.5)
Facilities-related costs	3.6	5.2
Depreciation and amortization	3.2	3.4
Provision for doubtful accounts	(0.1)	1.2
Legal fees	0.4	6.9
Consulting and advisory services	1.1	0.8
Other expenses	3.2	2.6
Total net increase	$ 14.9	$ 30.9

We expect general and administrative expenses to increase in 2009 due to increased payroll and related costs attributable to increased hiring and an increase in rent and facilities costs, offset by an expected reduction in litigation-related expenses.

Amortization of Other Intangible Assets. Amortization of other intangible assets consists of the amortization of intangible assets acquired in business combinations and amortization of acquired license rights. Amortization of other intangible assets increased 22%, or $2.5 million, to $13.9 million for the year ended December 31, 2008 as compared to $11.4 million for the year ended December 31, 2007. Amortization of other intangible assets for the year ended December 31, 2007 increased by $2.9 million, or 35%, over amortization of other intangible assets in the year ended December 31, 2006 of $8.5 million. The increase in amortization of other intangible assets in 2008 as compared to 2007 was due to the amortization of intangible assets from the acquisitions of acerno in November 2008 and a full year of amortization of intangible assets from the Red Swoosh acquisition in April 2007. The increase in amortization of intangible assets in 2007 as compared to 2006 was due to the amortization of intangible assets from the acquisition of Netli in March 2007 and a full year of amortization of intangible assets from the Nine Systems acquisition in December 2006. Based on our currently-owned intangible assets, we expect amortization of other intangible assets to be approximately $16.7 million, $16.4 million, $16.4 million, $15.4 million and $12.6 million for the years ending December 31, 2009, 2010, 2011, 2012 and 2013, respectively.

Interest Income. Interest income includes interest earned on invested cash balances and marketable securities. Interest income decreased 4%, or $1.0 million, to $24.8 million for the year ended December 31, 2008 as compared to $25.8 million for the year ended December 31, 2007. Interest income increased 46%, or $8.1 million, to $25.8 million for the year ended December 31, 2007 as compared to $17.7 million for the year ended December 31, 2006. The decrease in 2008 as compared to 2007 was primarily due to a decrease in the interest rates, offsetting higher cash and marketable securities balances driven by an increase in our cash from operations. The increase in 2007 as compared to 2006 was primarily due to an increase in our total invested marketable securities as a result of an increase in our cash from operations.

Interest Expense. Interest expense includes interest paid on our debt obligations as well as amortization of deferred financing costs. Interest expense decreased 8%, or $0.3 million, to $2.8 million for the year ended December 31, 2008 compared to $3.1 million for the year ended December 31, 2007. Interest expense decreased 3%, or $85,000, to $3.1 million for the year ended December 31, 2007 compared to $3.2 million for the year

35

Table of Contents

ended December 31, 2006. Interest expense during these periods was primarily attributable to interest payable on the outstanding amount of our 1% convertible senior notes. Based upon our outstanding indebtedness at December 31, 2008, we believe that interest expense on our debt obligations, including deferred financing amortization, will not exceed $3.1 million in 2009.

Other Income (Expense), net. Other income (expense), net primarily represents net foreign exchange gains and losses incurred during the periods presented as well as gains on legal settlements. Other income, net decreased 13%, or $66,000, to other income, net of $0.5 million for the year ended December 31, 2008 as compared to other income, net of $0.5 million for the year ended December 31, 2007. Other income, net was $0.6 million for the year ended December 31, 2006. Other income, net for the year ended December 31, 2008 consisted of $0.5 million of foreign exchange gains and $4,000 of net gains on legal settlements. Other income, net of $0.5 million for the year ended December 31, 2007 consisted of approximately $35,000 of foreign exchange gains and $0.5 million of net gains on legal settlements. For the year ended December 31, 2006, other income, net of $0.6 million consisted of approximately $90,000 of foreign exchange losses, offset by $0.5 million of net gains on legal settlements. Other income (expense), net may fluctuate in the future based upon movements in foreign exchange rates, the outcome of legal proceedings and other events.

Gain (Loss) on Investments, net. During the year ended December 31, 2008, we recorded a net loss on investments of $0.2 million, which reflects a loss of $12.9 million due to other-than-temporary impairments on marketable securities; a gain of $12.5 million realized on a put option received from one of our investment advisors in November 2008; and a gain of $0.2 million on the sale of marketable securities. During the years ended December 31, 2007 and 2006, we recorded a net gain on investments of $24,000 and $0.3 million, respectively, from the sale of marketable securities. We do not expect significant gains or losses on investments in 2009.

Loss on Early Extinguishment of Debt. During 2007, we recorded a loss on early extinguishment of debt in the amount of $3,000, as a result of conversions to common stock of $0.1 million in principal amount of our 1% convertible notes in August 2007 and $40,000 in principal amount of such notes in January 2007. We did not record any loss on the early extinguishment of debt in the 2006 or 2008.

Provision for Income Taxes. For the year ended December 31, 2008, our effective tax rate of 38.1% was higher than the 35% statutory federal income tax rate applicable to corporations due primarily to state income taxes and the effect of non-deductible stock-based compensation, partially offset by the benefit recorded for research and development tax credits. For the years ended December 31, 2007 and December 31, 2006, our effective tax rates of 40.0% and 41.5% respectively, were higher than the 35% statutory federal income tax rate due primarily to state income taxes and the effect of non-deductible stock-based compensation, partially offset by the benefit recorded for research and development tax credits.

Provision for income taxes increased by 33%, or $22.2 million, to $89.4 million for the year ended December 31, 2008 as compared to $67.2 million during the year ended December 31, 2007. Provision for income taxes increased by 64%, or $26.2 million, to $67.2 million for the year ended December 31, 2007 as compared to $41.1 million during the year ended December 31, 2006. These increases were primarily due to increases in our operating income.

While we expect our consolidated annualized effective tax rate in 2009 to remain relatively consistent with 2008, this expectation does not take into consideration the effect of discrete items recorded as a result of our compliance with SFAS No. 123R or any potential tax planning strategies. Our effective tax rate could be materially different depending on the nature and timing of the disposition of incentive and other employee stock options. Further, our effective tax rate may fluctuate within a fiscal year and from quarter to quarter, due to items arising from discrete events, including settlements of tax audits and assessments, the resolution or identification of tax position uncertainties and acquisitions of other companies.

Because of the availability of NOLs, a significant portion of our future provision for income taxes is expected to be a non-cash expense; consequently, the amount of cash paid with respect to income taxes is expected to be a relatively small portion of the total annualized tax expense during periods in which the NOLs are utilized. In determining our net deferred tax assets and valuation allowances, annualized effective tax rates, and cash paid for income taxes, management is required to make judgments and estimates about domestic and foreign profitability, the timing and extent of the utilization of NOL carryforwards, applicable tax rates, transfer pricing methodologies and tax planning strategies. Judgments and estimates related to our projections and assumptions are inherently uncertain; therefore, actual results could differ materially from our projections.

We have recorded certain tax reserves to address potential exposures involving our income tax and sales and use tax positions. These potential tax liabilities result from the varying application of statutes, rules, regulations and interpretations by different taxing jurisdictions. Our estimate of the value of these tax reserves reflects assumptions based on past experiences and judgments about the interpretation of statutes, rules and regulations by taxing jurisdictions. It is possible that the ultimate tax liability or benefit from of these matters may be materially greater or less than the amount that we have estimated.

Liquidity and Capital Resources

To date, we have financed our operations primarily through the following transactions:

- private sales of capital stock and subordinated notes, which notes were repaid in 1999;
- an initial public offering of our common stock in October 1999, which generated net proceeds of $217.6 million;
- the sale in June 2000 of an aggregate of $300 million in principal amount of our 5 1/2% convertible subordinated notes, which generated net proceeds of $290.2 million and were repaid or redeemed in full between December 2003 and September 2005;
- the sale in December 2003 and January 2004 of an aggregate of $200 million in principal amount of our 1% convertible senior notes, which generated net proceeds of $194.1 million;
- the public offering of 12.0 million shares of our common stock in November 2005, which generated net proceeds of $202.1 million;
- proceeds from the exercise of stock awards; and
- cash generated by operations.

As of December 31, 2008, our cash, cash equivalents and marketable securities, which consisted of corporate debt securities, U.S. treasury and government agency securities, commercial paper, corporate debt securities and student loan-backed ARS, totaled $771.6 million. We place our cash investments in instruments that meet high credit quality standards, as specified in our

investment policy. Our investment policy also limits the amount of our credit exposure to any one issue or issuer and seeks to manage these assets to achieve our goals of preserving principal, maintaining adequate liquidity at all times, and maximizing returns subject to our investment policy.

We held approximately $287.1 million and $280.0 million in par value of ARS at December 31, 2008 and 2007, respectively. The ARS are primarily AAA-rated bonds, most of which are guaranteed by the U.S. government as part of the Federal Family Education Loan Program through the U.S. Department of Education. None of the auction rate securities in our portfolio are mortgage-backed or collateralized debt obligations. In mid-February 2008, all of our ARS experienced failed auctions, which failures continued throughout the rest of 2008. As a result, we have been unable to liquidate most of our holdings of ARS. Based on our ability to access our cash and other short-term investments, our expected operating cash flows, and our other sources of cash, we do not anticipate the current lack of liquidity on these investments to have a material impact on our financial

Table of Contents

condition or results of operations in 2009. In November 2008, we entered into an agreement with one of our investment advisors that provides for the repurchase in June 2010 of $76.5 million of the ARS we hold if we have been unable to achieve liquidity with respect to such securities before that time.

Net cash provided by operating activities increased $106.5 million to $343.5 million for the year ended December 31, 2008 compared to $237.0 million for the year ended December 31, 2007. Cash provided by operating activities increased $104.2 million to $237.0 million for the year ended December 31, 2007 compared to $132.7 million for the year ended December 31, 2006. We expect that cash provided by operating activities will continue to increase as a result of an expected increase in cash collections related to higher revenues, partially offset by an expected increase in operating expenses that require cash outlays such as salaries and higher commissions. Current economic conditions could negatively impact our cash provided by operating activities if we are unable to manage our days sales outstanding or our business otherwise deteriorates.

Net cash used in investing activities was $364.4 million for the year ended December 31, 2008, compared to $226.7 million for the year ended December 31, 2007. Net cash used in investing activities was $205.6 million for the year ended December 31, 2006. Cash used in investing activities for 2008 reflects the purchase of acerno in November 2008 for $83.7 million, net purchases of short- and long-term marketable securities of $533.1 million and purchases of property and equipment of $115.4 million, including the capitalization of internal-use software development costs. Amounts attributable to these purchases and investments were offset, in part, by the proceeds from the sales and maturities of short- and long-term marketable securities of $367.7 million. Net cash used in investing activities for 2007 reflects net purchases of short- and long-term marketable securities of $550.6 million and purchases of property and equipment of $100.5 million, including the capitalization of internal-use software development costs. Amounts attributable to these purchases and investments were offset, in part, by the proceeds from the sales and maturities of short- and long-term marketable securities of $415.8 million and $7.9 million of net cash acquired through our acquisitions of Netli in March 2007 and Red Swoosh in April 2007. Additionally, net cash used in investing activities during 2007 included a decrease of $0.7 million in restricted investments previously held for security deposits. Net cash used in investing activities for 2006 reflects net purchases of short- and long-term investments of $395.9 million and purchases of property and equipment of $69.3 million, including the capitalization of internal-use software development costs. In addition, approximately $5.1 million of cash, including transaction costs, was used to acquire Nine Systems in December 2006. These purchases and investments were offset by the proceeds from the sales and maturities of short- and long-term securities of $264.3 million and a decrease of $0.4 million in restricted investments previously held for security deposits. For 2009, we expect total capital expenditures, a component of cash used in investing activities, to be approximately 15% of total revenue for the year. We expect to fund such capital expenditures through cash generated from operations.

Cash provided by financing activities was $33.1 million for the year ended December 31, 2008, compared to $52.5 million for the year ended December 31, 2007. Cash provided by financing activities was $60.4 million for the year ended December 31, 2006. Cash provided by financing activities for the year ended December 31, 2008 included proceeds of $22.0 million from the issuance of common stock upon the exercise of stock options and the sale of shares under our employee stock purchase plan. Cash provided by financing activities for the year ended December 31, 2008 also included $11.2 million related to excess tax benefits resulting from the exercise of stock options. Cash provided by financing activities was $52.5 million for the year ended December 31, 2007, compared to $60.4 million for the year ended December 31, 2006. Cash provided by financing activities for the year ended December 31, 2007 included proceeds of $31.6 million from the issuance of common stock upon the exercise of stock options and the sale of shares under our employee stock purchase plan. Cash provided by financing activities for the year ended December 31, 2007 also included $20.9 million related to excess tax benefits resulting from the exercise of stock options. Cash provided by financing activities for the year ended December 31, 2006 included proceeds of $27.9 million from the issuance of common

stock upon the exercise of stock options and the sale of shares under our employee stock purchase plan. Cash provided by financing activities for the year ended December 31, 2006 also included $32.5 million related to excess tax benefits resulting from the exercise of stock options.

Table of Contents

Changes in cash, cash equivalents and marketable securities are dependent upon changes in, among other things, working capital items such as deferred revenue, accounts payable, accounts receivable and various accrued expenses, as well as changes in our capital and financial structure, including debt repurchases and issuances, stock option exercises, sales of equity investments and similar events.

The following table represents the net inflows and outflows of cash, cash equivalents and marketable securities for the periods presented (in millions):

	For the Years Ended December 31,		
	2008	2007	2006
Cash, cash equivalents and marketable securities balance as of December 31, 2007, 2006 and 2005, respectively	$ 633.5	$ 434.5	$ 314.1
Changes in cash, cash equivalents and marketable securities:			
Receipts from customers	786.6	627.8	412.3
Payments to vendors	(366.4)	(319.0)	(197.5)
Payments for employee payroll	(184.2)	(179.6)	(134.6)
Realized loss on investments and other investment-related assets	(0.2)		
Debt interest and premium payments	(2.0)	(2.0)	(2.0)
Stock option exercises and employee stock purchase plan issuances	22.0	31.6	27.9
Cash (used) acquired in business acquisitions	(83.7)	8.8	(4.5)
Unrealized loss on marketable securities, net of unrealized gains	(38.1)		
Interest income	24.8	25.8	17.7
Taxes paid	(11.9)	(3.1)	(3.5)
Other	(8.8)	8.7	4.6
Net increase	138.1	199.0	120.4
Cash, cash equivalents and marketable securities balance as of December 31, 2008, 2007 and 2006, respectively	$ 771.6	$ 633.5	$ 434.5

As part of an agreement entered into with one of our investment advisors under which it agreed to repurchase $76.5 million of our ARS in June 2010, we were also offered the ability to enter into a line of credit that would be collateralized by the underlying ARS investments. In January 2009, the line of credit for $76.5 million was approved by the investment advisor. We have not yet used the line of credit.

We believe, based on our present business plan, that our cash, cash equivalents and marketable securities and forecasted cash flows from operations will be sufficient to meet our cash needs for working capital and capital expenditures for at least the next 24 months. If the assumptions underlying our business plan regarding future revenue and expenses change or if unexpected opportunities or needs arise, we may seek to raise additional cash by selling equity or debt securities. We may not, however, be able to sell equity or debt securities on terms we consider reasonable or at all. If additional funds are raised through the issuance of equity or 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 would also result in additional dilution to our existing stockholders. See Risk Factors elsewhere in this annual report on Form 10-K for a discussion of additional factors that could affect our liquidity.

39

Table of Contents

Contractual Obligations, Contingent Liabilities and Commercial Commitments

The following table presents our contractual obligations and commercial commitments, as of December 31, 2008, for the next five years and thereafter (in millions):

		Payments Due by Period			
Contractual Obligations	**Total**	**Less than 12 Months**	**12 to 36 Months**	**36 to 60 Months**	**More than 60 Months**
1% convertible senior notes assuming no early redemption or repurchases	$ 199.9	$	$	$	$ 199.9
Interest on convertible notes outstanding assuming no early redemption or repurchases	50.0	2.0	4.0	4.0	40.0
Real estate operating leases	167.8	18.1	38.8	31.0	79.9
Bandwidth and co-location agreements	50.4	42.4	8.0		
Open vendor purchase orders	15.0	15.0			
Total contractual obligations	$ 483.1	$ 77.5	$ 50.8	$ 35.0	$ 319.8

In accordance with FIN No. 48, as of December 31, 2008, we had unrecognized tax benefits of $6.1 million, which included approximately $1.3 million of accrued interest and penalties. We do not expect to recognize any of these tax benefits in 2009. We are not, however, able to provide a reasonably reliable estimate of the timing of future payments relating to these obligations.

Letters of Credit

As of December 31, 2008, we had outstanding $8.6 million in irrevocable letters of credit issued by us in favor of third-party beneficiaries, primarily related to facility leases. Approximately $3.6 million of these letters of credit are collateralized by restricted marketable securities, of which $3.4 million are classified as short-term marketable securities and $0.2 million are classified as long-term marketable securities on our consolidated balance sheet at December 31, 2008. The restrictions on these marketable securities lapse as we fulfill our obligations or as such obligations expire under the terms of the letters of credit. These restrictions are expected to lapse at various times through May 2011. The remaining $5.0 million of irrevocable letters of credit are unsecured and are expected to remain in effect until December 2019.

Off-Balance Sheet Arrangements

We have entered into various indemnification arrangements with third parties, including vendors, customers, landlords, our officers and directors, shareholders of acquired companies, joint venture partners and third party licensees of our technology. Generally, these indemnification agreements require us to reimburse losses suffered by third parties due to various events, such as lawsuits arising from patent or copyright infringement or our negligence. These indemnification obligations are considered off-balance sheet arrangements in accordance with FASB Interpretation 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. To date, we have not encountered material costs as a result of such obligations and have not accrued any significant liabilities related to such indemnification obligations in our financial statements. See Note 11 to our consolidated financial statements included elsewhere in this annual report on Form 10-K for further discussion of these indemnification agreements.

The conversion features of our 1% convertible senior notes due December 15, 2033 are equity-linked derivatives. As such, we recognize these instruments as off-balance sheet arrangements. The conversion features associated with these notes would be accounted for as derivative instruments, except that they are indexed to our common stock and classified in stockholders equity. Therefore, these instruments meet the scope exception of paragraph 11(a) of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and are

Table of Contents

accordingly not accounted for as derivatives for purposes of SFAS No. 133. See Note 12 to our consolidated financial statements included elsewhere in this annual report on Form 10-K for more information.

Litigation

We are party to litigation that we consider routine and incidental to our business. Management does not currently expect the results of any of these litigation matters to have a material adverse effect on our business, results of operations or financial condition. See Legal Proceedings elsewhere in this annual report on Form 10-K for further discussion on litigation.

Recent Accounting Pronouncements

We adopted SFAS No. 157 on January 1, 2008. SFAS No. 157 defines fair value, establishes a methodology for measuring fair value and expands the required disclosure for fair value measurements. During 2008, the FASB issued the following amendments to SFAS No. 157:

FASB Staff Position No. 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13, or FSP FAS No. 157-1, which amends SFAS No. 157 to remove certain leasing transactions from its scope. The adoption of FSP FAS No. 157-1 did not have a material impact on our financial position or results of operations in 2008.

FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157, which delays the effective date of SFAS No. 157 from 2008 to 2009 for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). We are currently evaluating the potential impact of SFAS No. 157 for non-financial assets and non-financial liabilities on our financial position and results of operations.

FASB Staff Position No. 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active, or FSP FAS No. 157-3, which clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP FAS No. 157-3 became effective in October 2008. The adoption of FSP FAS No. 157-3 did not have a material impact on our financial position or results of operations in 2008.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations, or SFAS No. 141R. SFAS No. 141R establishes principles and requirements for how the acquirer in a business combination (i) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree, (ii) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase and (iii) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141R became effective for us on January 1, 2009. The impact of the standard on our financial position and results of operations will be dependent upon the number of and magnitude of the acquisitions that are consummated once the standard is effective.

In December 2007, the FASB released SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements an amendment of ARB No. 51. This statement will change the accounting

and reporting for minority interests, which will be re-characterized as non-controlling interests and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. This statement is effective for us on January 1, 2009. As of December 31, 2008, we did not have any minority interests.

In April 2008, the FASB issued an FASB Staff Position on SFAS No. 142-3, Determination of the Useful Life of Intangible Assets, or FSP FAS No. 142-3. FSP FAS No. 142-3 amends the factors that should be

41

Table of Contents

considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets, or SFAS No. 142. FSP FAS No. 142-3 is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141R and other generally accepted accounting principles in the United States of America. FSP FAS No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. We do not expect FSP FAS No. 142-3 will have a material impact on our financial position or results of operations.

In June 2008, the FASB issued FASB Staff Position, or FSP, EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. This FSP provides that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. Upon adoption, we are required to retrospectively adjust our earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data) to conform with the provisions in this FSP. This FSP became effective for us on January 1, 2009. We have not yet determined the impact, if any, of this FSP on our consolidated financial statements.

Table of Contents

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

Our exposure to market risk for changes in interest rates relates primarily to our debt and investment portfolio. In our investment portfolio, we do not use derivative financial instruments. 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 and municipal obligations and certificates of deposit. Our investment policy also limits the amount of our credit exposure to any one issue or issuer and seeks to manage these assets to achieve our goals of preserving principal, maintaining adequate liquidity at all times and maximizing returns subject to our investment policy.

At December 31, 2008, we held $287.1 million in par value of ARS that have experienced failed auctions, which has prevented us from liquidating those investments. As a result, we have classified these investments as long-term marketable securities on our consolidated balance sheet as of December 31, 2008. Due to these liquidity issues, we performed a discounted cash flow analysis to determine the estimated fair value of these ARS investments. The discounted cash flow analysis we performed considered the timing of expected future successful auctions, the impact of extended periods of maximum interest rates, collateralization of underlying security investments and the creditworthiness of the issuer. The discounted cash flow analysis performed as of December 31, 2008 assumes a weighted average discount rate of 6.275% and expected term of five years. The discount rate was determined using a proxy based upon the current market rates for similar debt offerings within the AAA-rated ARS market. The expected term was based on management s estimate of future liquidity. As a result, as of December 31, 2008, we have estimated an aggregate loss of $50.1 million, of which $37.2 million was related to the impairment of ARS deemed to be temporary and included in accumulated other comprehensive income (loss) within stockholders equity and of which $12.9 million was related to the impairment of ARS deemed other-than-temporary and included in gain (loss) on investments, net in the consolidated statement of operations. Based on our ability to access our cash and short-term investments and our expected cash flows, we do not anticipate the current lack of liquidity on these ARS will have a material impact on our financial condition or results of operations during 2009 or our ability to operate our business in 2009.

Our valuation of the ARS is sensitive to market conditions and management s judgment and could change significantly based on the assumptions used. If we had used a term of three years or seven years and discount rate of 6.275%, the gross unrealized loss on the $210.6 million in par value of ARS classified as available-for-sale would have been $23.7 million or $49.1 million, respectively. If we had used a term of five years and discount rate of 5.275% or 7.275%, the gross unrealized loss on the $210.6 million in par value of ARS classified as available-for-sale would have been $28.8 million or $45.1 million, respectively.

During November 2008, we entered into an agreement with one of our investment advisors providing for it to repurchase the ARS held through such advisor at par value beginning on June 30, 2010. The ARS covered by this agreement had a par value of $76.5 million at December 31, 2008. We expect to continue to hold these long-term debt instruments until the earlier of the settlement date or the date on which the market for active trading of ARS at par value is re-established. At any time during the period up until the June 2010, our investment advisor can call the ARS at par value. We elected to apply the fair value option under SFAS No. 159 to the put option incorporated in this repurchase agreement. The $12.5 million fair value of such put option is grouped with other long-term marketable securities on our consolidated balance sheet with the resultant gain offsetting $12.9 million of the related ARS impairment included in other income, net. The fair value of the put option is determined by comparing the fair value of the related ARS, as described above, to their par values and also considers the credit risk associated with our investment advisor. This put option will be adjusted on each balance sheet date based on its then fair value.

The valuation of our $76.5 million in par value of ARS subject to the put option is also sensitive to market conditions and management s judgment and could change significantly based on assumptions used, resulting in a change in the realized loss on investments recorded in our consolidated statement of operations. Any change in the realized loss on the ARS would,

however, be offset by a corresponding change in the realized gain on the valuation of the put option related to these ARS recorded in our consolidated statement of operations. Any net gain (loss) from future changes in market conditions is not expected to be material because the changes in valuations of the ARS and related put option will generally offset each other.

Table of Contents

Our 1% convertible senior notes are subject to changes in market value. Under certain conditions, the holders of our 1% convertible senior notes may require us to redeem the notes on or after December 15, 2010. As of December 31, 2008, the aggregate outstanding principal amount and the fair value of the 1% convertible senior notes were $199.9 million and $221.0 million, respectively.

We have operations in Europe, Asia, Australia and India. As a result, we are exposed to fluctuations in foreign exchange rates. Additionally, we may continue to expand our operations globally and sell to customers in foreign locations, which may increase our exposure to foreign exchange fluctuations. We do not have any foreign currency hedge contracts.

Table of Contents

Item 8. ***Financial Statements and Supplementary Data***

AKAMAI TECHNOLOGIES, INC.

Index to Consolidated Financial Statements and Schedule

	Page
Report of Independent Registered Public Accounting Firm	46
Consolidated Balance Sheets as of December 31, 2008 and 2007	47
Consolidated Statements of Operations for the years ended December 31, 2008, 2007 and 2006	48
Consolidated Statements of Cash Flows for the years ended December 31, 2008, 2007 and 2006	49
Consolidated Statements of Stockholders Equity for the years ended December 31, 2008, 2007 and 2006	50
Notes to Consolidated Financial Statements	52

Schedule:

Schedule II Valuation and Qualifying Accounts	S-1

Note: All other financial statement schedules are omitted because they are not applicable or the required information is included in the consolidated financial statements or notes thereto.

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Akamai Technologies, Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Akamai Technologies, Inc. and its subsidiaries at December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management s Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company s internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 18 to the consolidated financial statements, the Company changed the manner in which it accounts for uncertain tax positions in 2007.

As discussed in Note 2 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 159 in 2008 and elected to measure certain financial assets at fair value, with unrealized gains and losses being reported in earnings at each subsequent reporting period.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Boston, Massachusetts

March 2, 2009

46

Table of Contents

AKAMAI TECHNOLOGIES, INC.

CONSOLIDATED BALANCE SHEETS

	December 31,	
	2008	2007
	(in thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 156,074	$ 145,078
Marketable securities (including restricted securities of $3,460 and $511 at December 31, 2008 and 2007, respectively)	174,557	401,091
Accounts receivable, net of reserves of $11,270 and $10,391 at December 31, 2008 and 2007, respectively	139,612	118,944
Prepaid expenses and other current assets	27,124	23,782
Deferred income tax assets	4,542	6,147
Total current assets	501,909	695,042
Property and equipment, net	174,483	134,546
Marketable securities (including restricted securities of $153 and $3,102 at December 31, 2008 and 2007, respectively)	440,996	87,339
Goodwill	441,258	361,637
Other intangible assets, net	92,995	87,500
Deferred income tax assets	223,718	285,463
Other assets	5,592	4,520
Total assets	$ 1,880,951	$ 1,656,047
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 21,165	$ 18,540
Accrued expenses and other current liabilities	66,132	56,233
Deferred revenue	11,506	12,995
Accrued restructuring	1,653	607
Total current liabilities	100,456	88,375
Deferred revenue	1,251	1,453
Other liabilities	10,619	7,812
1% convertible senior notes	199,855	199,855
Total liabilities	312,181	297,495
Commitments, contingencies and guarantees (Note 11)		
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; 169,371,675 and 166,212,638 shares issued and outstanding at December 31, 2008 and 2007, respectively	1,694	1,662
Additional paid-in capital	4,539,154	4,446,703
Accumulated other comprehensive income (loss)	(24,350)	3,053

Accumulated deficit	(2,947,728)	(3,092,866)
Total stockholders equity	1,568,770	1,358,552
Total liabilities and stockholders equity	$ 1,880,951	$ 1,656,047

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

47

Table of Contents

AKAMAI TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended December 31,		
	2008	2007	2006
	(in thousands, except per share amounts)		
Revenues	$ 790,924	$ 636,406	$ 428,672
Cost and operating expenses:			
Cost of revenues	222,610	167,444	94,100
Research and development	39,243	44,141	33,102
Sales and marketing	164,365	147,556	119,689
General and administrative	136,028	121,101	90,191
Amortization of other intangible assets	13,905	11,414	8,484
Restructuring charge (benefit)	2,509	(178)	
Total cost and operating expenses	578,660	491,478	345,566
Income from operations	212,264	144,928	83,106
Interest income	24,792	25,815	17,703
Interest expense	(2,825)	(3,086)	(3,171)
Other income (expense), net	461	527	570
Gain (loss) on investments, net	(157)	24	261
Loss on early extinguishment of debt		(3)	
Income before provision for income taxes	234,535	168,205	98,469
Provision for income taxes	89,397	67,238	41,068
Net income	$ 145,138	$ 100,967	$ 57,401
Net income per weighted average share:			
Basic	$ 0.87	$ 0.62	$ 0.37
Diluted	$ 0.79	$ 0.56	$ 0.34
Shares used in per share calculations:			
Basic	167,673	162,959	155,366
Diluted	186,685	185,094	176,767

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

Table of Contents

AKAMAI TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
	2008	2007	2006
	(in thousands)		
Cash flows from operating activities:			
Net income	$ 145,138	$ 100,967	$ 57,401
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	98,080	71,895	40,585
Amortization of deferred financing costs	840	840	841
Stock-based compensation	57,899	66,555	49,556
Provision for deferred income taxes, net	81,698	65,272	38,510
Provision for doubtful accounts	2,575	2,901	830
Excess tax benefit from stock-based compensation	(11,176)	(20,862)	(32,511)
Non-cash portion of loss on early extinguishment of debt		3	
Non-cash portion of restructuring charge (benefit)	(842)	(178)	
Losses (gains) on investments and disposal of property and equipment, net	242	23	(228)
Changes in operating assets and liabilities, net of effects of acquisitions:			
Accounts receivable	(21,474)	(31,937)	(28,020)
Prepaid expenses and other current assets	(5,471)	(12,009)	(8,062)
Accounts payable, accrued expenses and other current liabilities	(4,181)	(12,965)	15,382
Deferred revenue	(1,492)	5,297	343
Accrued restructuring	1,216	(2,722)	(1,970)
Other non-current assets and liabilities	442	3,874	66
Net cash provided by operating activities	343,494	236,954	132,723
Cash flows from investing activities:			
Cash paid for acquisitions, net of cash acquired	(83,719)	7,875	(5,127)
Purchases of property and equipment	(90,369)	(81,405)	(56,752)
Capitalization of internal-use software costs	(25,017)	(19,057)	(12,576)
Purchases of short- and long-term marketable securities	(533,069)	(550,614)	(395,871)
Proceeds from sales and maturities of short- and long-term marketable securities	367,652	415,771	264,308
Proceeds from sale of property and equipment	82		
Decrease in restricted investments held for security deposits		723	400
Net cash used in investing activities	(364,440)	(226,707)	(205,618)
Cash flows from financing activities:			
Proceeds from the issuance of common stock under stock option and employee stock purchase plans	21,966	31,621	27,918
Excess tax benefits from stock-based compensation	11,176	20,862	32,511
Payments on capital leases		(23)	
Net cash provided by financing activities	33,142	52,460	60,429
Effect of exchange rate changes on cash and cash equivalents	(1,200)	1,776	1,269
Net increase (decrease) in cash and cash equivalents	10,996	64,483	(11,197)
Cash and cash equivalents at beginning of year	145,078	80,595	91,792

Cash and cash equivalents at end of year	$ 156,074	$ 145,078	$ 80,595
Supplemental disclosure of cash flow information:			
Cash paid for interest	$ 1,999	$ 2,005	$ 2,005
Cash paid for income taxes	11,870	3,147	3,455
Non-cash financing and investing activities:			
Capitalization of stock-based compensation, net of impairments	$ 7,436	$ 6,353	$ 4,262
Common stock and vested stock options issued in connection with acquisitions of businesses		171,957	152,560
Common stock issued upon conversion of 1% convertible senior notes		145	
Common stock returned upon settlement of escrow claims related to prior business acquisitions	(3,126)	(177)	

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

49

Table of Contents

AKAMAI TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

For the Years Ended December 31, 2008, 2007 and 2006

(in thousands, except share data)

	Common Stock							
	Shares	**Amount**	**Additional Paid-in Capital**	**Deferred Compensation**	**Accu-mulated Other Compre-hensive Income (Loss)**	**Accu-mulated Deficit**	**Total Stock-holders Equity**	**Compre-hensive Income**
at December 31, 2005	152,922,092	1,529	3,880,985	(7,537)	471	(3,251,234)	624,214	
ensive income:								
ne						57,401	57,401	$ 57,401
urrency translation adjustment					756		756	756
n unrealized gain (loss) on -for-sale marketable securities					69		69	69
ensive income								$ 58,226
of common stock upon the exercise of ons and vesting of deferred stock	4,182,931	42	21,383				21,425	
of common stock under employee chase plan	295,113	3	6,490				6,493	
sed compensation			53,338				53,338	
of common stock for acquisition of a	2,664,650	27	133,463				133,490	
ions issued in acquisition of a			19,070				19,070	
	234,136	2	(2)					
ication of deferred compensation to l paid-in capital upon adoption of . 123R			(7,537)	7,537				
fits from the exercise of stock options ng of restricted common stock			37,944				37,944	
sed compensation from awards issued nployees for services rendered			493				493	
at December 31, 2006	160,298,922	1,603	4,145,627		1,296	(3,193,833)	954,693	
ensive income:								
ne						100,967	100,967	$ 100,967
urrency translation adjustment					1,343		1,343	1,343
n unrealized gain (loss) on -for-sale marketable securities					414		414	414
ensive income								$ 102,724
of common stock upon the exercise of ons and vesting of deferred stock	2,803,496	28	21,930				21,958	
of common stock under employee chase plan	279,356	3	9,667				9,670	
sed compensation			72,770				72,770	
	(3,525)		(177)				(177)	

stock returned upon settlement of aims related to prior business ons						
of common stock for acquisitions of s	2,825,010	28	157,808			157,836
ions issued in acquisitions of s			14,121			14,121
of common stock upon conversion of ertible senior notes	9,379		145			145
fits from the exercise of stock options ng of restricted common stock			24,672			24,672
sed compensation from awards issued nployees for services rendered			140			140
at December 31, 2007	166,212,638	1,662	4,446,703	3,053	(3,092,866)	1,358,552

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

50

Table of Contents

AKAMAI TECHNOLOGIES, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (Continued)

For the Years Ended December 31, 2008, 2007 and 2006

(in thousands, except share data)

	Common Stock							
	Shares	Amount	Additional Paid-in Capital	Deferred Compensation	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders Equity	Comprehensive Income
Balance at December 31, 2007	166,212,638	1,662	4,446,703		3,053	(3,092,866)	1,358,552	
Comprehensive income:								
Net income						145,138	145,138	$ 145,138
Foreign currency translation adjustment					(4,038)		(4,038)	(4,038)
Change in unrealized gain (loss) on available-for-sale marketable securities					(23,365)		(23,365)	(23,365)
Comprehensive income								$ 117,735
Issuance of common stock upon the exercise of stock options and vesting of deferred stock units	2,920,692	29	14,734				14,763	
Issuance of common stock under employee stock purchase plan	348,584	4	7,199				7,203	
Stock-based compensation			64,513				64,513	
Common stock returned upon settlement of escrow claims related to prior business acquisitions	(110,239)	(1)	(3,125)				(3,126)	
Tax benefits from the exercise of stock options and vesting of restricted			9,133				9,133	

common stock							
Stock-based compensation from awards issued to non-employees for services rendered			(3)				(3)
Balance at December 31, 2008	169,371,675	$ 1,694	$ 4,539,154	$	$ (24,350)	$ (2,947,728)	$ 1,568,770

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

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Business and Basis of Presentation:

Akamai Technologies, Inc. (Akamai or the Company) provides services for accelerating and improving the delivery of content and applications over the Internet. Akamai s globally distributed platform comprises thousands of servers in hundreds of networks in approximately 70 countries. The Company was incorporated in Delaware in 1998 and is headquartered in Cambridge, Massachusetts. Akamai currently operates in one industry segment: providing services for accelerating and improving the delivery of content and applications over the Internet.

The accompanying consolidated 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.

2. Summary of Significant Accounting Policies:

Use of Estimates

The Company prepares its consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. These principles require management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the amounts disclosed in the related notes to the consolidated financial statements. Actual results and outcomes may differ materially from management s estimates, judgments and assumptions. Significant estimates, judgments and assumptions used in these financial statements include, but are not limited to, those related to revenues, accounts receivable and related reserves, valuation and impairment of investments and marketable securities, loss contingencies, useful lives and realizability of long-lived assets and goodwill, capitalized internal-use software costs, income and other tax reserves, and accounting for stock-based compensation. Estimates are periodically reviewed in light of changes in circumstances, facts and experience. The effects of material revisions in estimates are reflected in the consolidated financial statements prospectively from the date of the change in estimate.

Revenue Recognition

The Company recognizes service revenues in accordance with the Securities and Exchange Commission s (the Commission) Staff Accounting Bulletin No. 104, Revenue Recognition, and the Financial Accounting Standards Board s (FASB) Emerging Issues Task Force Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. Revenue is recognized only when the price is fixed or determinable, persuasive evidence of an arrangement exists, the service is performed and collectability of the resulting receivable is reasonably assured.

Akamai primarily derives revenues from the sale of services to customers executing contracts having terms of one year or longer. These contracts generally commit the customer to a minimum monthly, quarterly or annual level of usage and specify the rate at which the customer must pay for actual usage above the monthly, quarterly or annual minimum. For these services, Akamai recognizes the monthly minimum as revenue each month provided that an enforceable contract has been signed by both parties, the service has been delivered to the customer, the fee for the service is fixed or determinable and collection is reasonably assured. Should a customer s usage of Akamai services exceed the monthly, quarterly or annual minimum, Akamai recognizes revenue for such excess in the period of the usage. For annual or other non-monthly

period revenue commitments, the Company recognizes revenue monthly based upon the customer s actual usage each month of the commitment period and only recognizes any remaining committed amount for the applicable period in the last month thereof.

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company typically charges its customers an installation fee when the services are first activated. The installation fees are recorded as deferred revenue and recognized as revenue ratably over the estimated life of the customer arrangement. The Company also derives revenue from services sold as discrete, non-recurring events or based solely on usage. For these services, the Company recognizes revenue when the event or usage has occurred.

When more than one element is contained in a single arrangement, the Company allocates revenue between the elements based on each element s relative fair value, provided that each element meets the criteria as a separate unit of accounting. An item is considered a separate unit of accounting if it has value to the customer on a standalone basis and there is objective and verifiable evidence of the fair value of the separate element. Fair value is generally determined based upon the price charged when the element is sold separately. If the fair value of each element cannot be objectively determined, the total value of the arrangement is recognized ratably over the entire service period commencing when all services have begun to be provided at the outset of the period. For most multi-element service arrangements to date, the fair value of each element has not been objectively determinable. Therefore, all revenue under these arrangements has been recognized ratably over the applicable service period commencing when the Company had begun providing all services ordered.

At the inception of a customer contract for service, the Company makes an assessment as to that customer s ability to pay for the services provided. The Company bases its assessment on a combination of factors, including the successful completion of a credit check or financial review, its collection experience with the customer and other forms of payment assurance. Upon the completion of these steps, the Company recognizes revenue monthly in accordance with its revenue recognition policy. If the Company subsequently determines that collection from the customer is not reasonably assured, the Company records an allowance for doubtful accounts and bad debt expense for all of that customer s unpaid invoices and ceases recognizing revenue for continued services provided until cash is received from the customer. Changes in the Company s estimates and judgments about whether collection is reasonably assured would change the timing of revenue or amount of bad debt expense that the Company recognizes.

The Company also sells its services through a reseller channel. Assuming all other revenue recognition criteria are met, the Company recognizes revenue from reseller arrangements based on the reseller s contracted non-refundable minimum purchase commitments over the term of the contract, plus amounts sold by the reseller to its customers in excess of the minimum commitments. Amounts attributable to this excess usage are recognized as revenue in the period in which the service is provided.

From time to time, the Company enters into contracts to sell its services or license its technology to unrelated enterprises at or about the same time that it enters into contracts to purchase products or services from the same enterprise. If the Company concludes that these contracts were negotiated concurrently, the Company records as revenue only the net cash received from the vendor, unless the product or service received has a separate identifiable benefit and the fair value of the vendor s product or service can be established objectively.

The Company may from time to time resell licenses or services of third parties. The Company records revenue for these transactions on a gross basis when the Company has risk of loss related to the amounts purchased from the third party and the Company adds value to the license or service, such as by providing maintenance or support for such license or service. If these conditions are present, the Company recognizes revenue when all other revenue recognition criteria are satisfied.

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Deferred revenue represents amounts billed to customers for which revenue has not been recognized. Deferred revenue primarily consists of the unearned portion of monthly billed service fees; prepayments made by customers for future periods; deferred installation and activation set-up fees; and amounts billed under customer arrangements with extended payment terms.

Cost of Revenues

Cost of revenues consists primarily of fees paid to network providers for bandwidth and for housing servers in third-party network data centers, also known as co-location costs. Cost of revenues also includes network operation employee costs, network storage costs, cost of software licenses, depreciation of network equipment used to deliver the Company s services, amortization of network-related internal-use software and costs for the production of live events. The Company enters into contracts for bandwidth with third-party network providers with terms typically ranging from several months to two years. These contracts generally commit Akamai to pay minimum monthly fees plus additional fees for bandwidth usage above the committed level. In some circumstances, Internet service providers (ISPs) make available to Akamai rack space for the Company s servers and access to their bandwidth at discounted or no cost. In exchange, the ISP and its customers benefit by receiving content through a local Akamai server resulting in better content delivery. The Company does not consider these relationships to represent the culmination of an earnings process. Accordingly, the Company does not recognize as revenue the value to the ISPs associated with the use of Akamai s servers, nor does the Company recognize as expense the value of the rack space and bandwidth received at discounted or no cost.

Accounting for Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with Statement of Financial Accounting Standard (SFAS) No. 123R, Share-Based Payment (SFAS No. 123R). SFAS No. 123R requires recognizing compensation costs for all share-based payment awards made to employees and directors based upon the awards grant-date fair value. The standard covers employee stock options, restricted stock, restricted stock units, deferred stock units and employee stock purchases related to the Company s employee stock purchase plan. The Company adopted SFAS No. 123R as of January 1, 2006 using the modified prospective transition method.

Under the modified prospective transition method, SFAS No. 123R applies to new equity awards and to equity awards modified, repurchased or canceled after the adoption date of January 1, 2006. Additionally, compensation costs for the portion of awards granted prior to the adoption date for which the requisite service was not rendered as of the adoption date are recognized as the requisite service is rendered. Compensation costs for that portion of awards are based on the grant-date fair value of those awards as calculated in the prior period pro forma disclosures under SFAS No. 123, Accounting for Stock-Based Compensation (SFAS No. 123). Changes to the grant-date fair value of equity awards granted before the effective date are precluded. The compensation cost for those earlier awards is attributed to periods beginning on or after the adoption date using the attribution method that was used under SFAS No. 123, which was the straight-line method. The Company estimates an expected forfeiture rate, which is factored into the determination of the Company s quarterly expense. Deferred compensation related to those earlier awards was eliminated against additional paid-in capital in fiscal 2006. SFAS No. 123R also changes the reporting of tax-related amounts within the statement of cash flows. The excess amount of windfall tax benefits resulting from stock-based compensation is

reported as financing inflows.

For stock options, the Company has selected the Black-Scholes option-pricing model to determine the fair value of stock option awards. For stock options, restricted stock, restricted stock units and deferred stock units,

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the Company recognizes compensation cost on a straight-line basis over the awards vesting periods for those awards that contain only a service vesting feature. For awards with a performance condition vesting feature, the Company recognizes compensation cost on a graded-vesting basis over the awards expected vesting periods, commencing when achievement of the performance condition is deemed probable.

Research and Development Costs and Capitalized Internal-Use Software

Research and development costs consist primarily of payroll and related personnel costs for the design, development, deployment, testing, operation and enhancement of the Company s services and network. Costs incurred in the development of the Company s services are expensed as incurred, except certain software development costs eligible for capitalization. Costs incurred during the application development stage of internal-use software projects, such as those used in the Company s network operations, are capitalized in accordance with SOP 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. Capitalized costs include external consulting fees and payroll and payroll-related costs for employees in the Company s development and information technology groups who are directly associated with, and who devote time to, the Company s internal-use software projects during the application development stage. Capitalization begins when the planning stage is complete and the Company commits resources to the software project. Capitalization ceases when the software has been tested and is ready for its intended use. Amortization of the asset commences when the software is complete and placed in service. The Company amortizes completed internal-use software to cost of revenues over an estimated life of two years. Costs incurred during the planning, training and post-implementation stages of the software development life-cycle are expensed as incurred. Costs related to upgrades and enhancements of existing internal-use software that increase the functionality of the software are also capitalized.

Concentrations of Credit Risk and Fair Value of Financial Measurements

Effective January 1, 2008, the Company implemented SFAS No. 157, Fair Value Measurements (SFAS No. 157), for its financial assets and liabilities that are re-measured and reported at fair value at each reporting period and non-financial assets and liabilities that are re-measured and reported at fair value at least annually (see Note 6). In accordance with the provisions of FASB Staff Position (FSP) No. FAS 157-2, Effective Date of FASB Statement No. 157, the Company elected to defer until January 1, 2009 the implementation of SFAS No. 157 as it relates to its non-financial assets and non-financial liabilities that are recognized and disclosed at fair value in the financial statements on a nonrecurring basis.

SFAS No. 157 defines fair value 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 Company has certain financial assets and liabilities recorded at fair value (principally cash equivalents and short- and long-term marketable securities) that have been classified as Level 1, 2 or 3 within the fair value hierarchy as described in SFAS No. 157. Fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Fair values determined by Level 2 inputs utilize data points that are observable, such as quoted prices, interest rates and yield curves. Fair values determined by Level 3 inputs utilize unobservable data points for the asset or liability.

The amounts reflected in the consolidated balance sheets for accounts receivable, other current assets, accounts payable, accrued liabilities and other current liabilities approximate their fair values due to their short-term maturities. The fair value and the carrying amount of the Company s 1% convertible senior notes were

55

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

$221.0 million and $199.9 million, respectively, as of December 31, 2008. The fair value is based upon the trading price of the debt. The Company maintains the majority of its cash, cash equivalents and marketable securities balances principally with domestic financial institutions that the Company believes to be of high credit standing. The Company believes that, as of December 31, 2008, its concentration of credit risk related to cash equivalents and marketable securities was not significant, except as described below with respect to its investments in auction rate securities. 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. For the years ended December 31, 2008, 2007 and 2006, no customer accounted for more than 10% of total revenues. As of December 31, 2008 and 2007, no customer had an account receivable balance greater than 10% of total accounts receivable. The Company believes that, as of December 31, 2008, its concentration of credit risk related to accounts receivable was not significant.

Taxes

The Company s provision for income taxes is comprised of a current and a deferred portion. The current income tax provision is calculated as the estimated taxes payable or refundable on tax returns for the current year. The deferred income tax provision is calculated for the estimated future tax effects attributable to temporary differences and carryforwards using expected tax rates in effect in the years during which the differences are expected to reverse or the carryforwards are expected to be realized.

The Company currently has significant deferred tax assets consisting of net operating loss (NOL) carryforwards, tax credit carryforwards and deductible temporary differences. Management periodically weighs the positive and negative evidence to determine if it is more likely than not that some or all of the deferred tax assets will not be realized.

The Company has recorded certain tax reserves to address potential exposures involving its income tax and sales and use tax positions. These potential tax liabilities result from the varying application of statutes, rules, regulations and interpretations by different taxing jurisdictions. The Company s estimate of the value of its tax reserves contains assumptions based on past experiences and judgments about the interpretation of statutes, rules and regulations by taxing jurisdictions. It is possible that the costs of the ultimate tax liability or benefit from these matters may be materially more or less than the amount that the Company estimated.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a two-step process to determine the amount of tax benefit to be recognized. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon external examination. If the tax position is deemed more-likely-than-not to be sustained, the tax position is then assessed to determine the amount of benefit to recognize in the financial statements. The amount of the benefit that may be recognized is the largest amount that has a greater than 50 percent likelihood of being realized upon ultimate settlement. The Company adopted the provisions of FIN 48 on January 1, 2007. As of the date of adoption, the Company had unrecognized tax benefits of $2.1 million, including accrued interest and penalties, and did not

record any cumulative effect adjustment to retained earnings as a result of adopting FIN 48. As of December 31, 2008, the Company had unrecognized tax benefits of $6.1 million, including accrued interest and penalties (see Note 18).

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In November 2005, the FASB issued FASB Staff Position SFAS 123R-3, Transition Election to Accounting for the Tax Effect of Share-Based Payment Awards. The Company elected to adopt the modified prospective transition method for calculating the tax effects of stock-based compensation pursuant to SFAS No. 123R. Under the modified prospective transition method, no adjustment is made to the deferred tax balances associated with stock-based payments that continue to be classified as equity awards. Additionally, the Company elected to use the long-form method, as provided in paragraph 81 of SFAS No. 123R to determine the pool of windfall tax benefits upon adoption of SFAS 123R. The long-form method required the Company to analyze the book and tax compensation for each award separately as if it had been issued following the recognition provisions of SFAS No. 123, subject to adjustments for NOL carryforwards.

Foreign Currency Translation

Akamai has determined that the functional currency of its foreign subsidiaries is each respective subsidiary s local currency. The assets and liabilities of these 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 transactions are recorded in other income (expense), net. For the years ended December 31, 2008, 2007 and 2006, the Company recorded foreign currency gains of approximately $457,000, $35,000 and $90,000, respectively, in the consolidated statements of operations.

Cash, Cash Equivalents and Marketable Securities

Cash and cash equivalents consist of cash held in bank deposit accounts and short-term, highly liquid investments with remaining maturities of three months or less at the date of purchase. Total cash, cash equivalents and marketable securities were $771.6 million and $633.5 million at December 31, 2008 and 2007, respectively.

Short-term marketable securities consist of corporate, government and other securities with remaining maturities of more than three months at the date of purchase and less than one year from the date of the balance sheet. Long-term marketable securities consist of corporate, government and other securities with maturities of more than one year from the date of the balance sheet. Short-term and long-term marketable securities include investments that are restricted as to use. As of December 31, 2008 and 2007, the Company had $3.6 million of restricted marketable securities, generally representing security for irrevocable letters of credit related to facility leases.

The Company classifies most debt securities and equity securities with readily determinable market values as available for sale in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. These investments are classified as marketable securities on the consolidated balance sheet and are carried at fair market value, with unrealized gains and losses considered to be temporary in nature reported as accumulated other comprehensive income (loss), a separate component of stockholders equity. The Company reviews all investments for reductions in fair value that are other-than-temporary. When such reductions occur, the cost of the investment is adjusted to fair value through recording a loss on investments in the consolidated statement of operations. Gains and losses on investments are calculated on the basis of specific identification.

Investments and marketable securities are considered to be impaired when a decline in fair value below cost basis is determined to be other-than-temporary. The Company periodically evaluates whether a decline in fair

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

value below cost basis is other-than-temporary by considering available evidence regarding these investments including, among other factors: the duration of the period that, and extent to which, the fair value is less than cost basis; the financial health of and business outlook for the issuer, including industry and sector performance and operational and financing cash flow factors; overall market conditions and trends; and Akamai s intent and ability to retain its investment in the security for a period of time sufficient to allow for an anticipated recovery in market value. Once a decline in fair value is determined to be other-than-temporary, a write-down is recorded and a new cost basis in the security is established. Assessing the above factors involves inherent uncertainty. Write-downs, if recorded, could be materially different from the actual market performance of investments and marketable securities in the Company s portfolio, if, among other things, relevant information related to its investments and marketable securities was not publicly available or other factors not considered by the Company would have been relevant to the determination of impairment.

Included in the Company s short- and long-term marketable securities at December 31, 2008 and 2007 are auction rate securities (ARS) that are primarily AAA-rated bonds, most of which are collateralized by federally guaranteed student loans. ARS are long-term variable rate bonds tied to short-term interest rates that may reset through a Dutch auction process that is designed to occur every seven to 35 days. Historically, the carrying value (par value) of ARS approximated fair market value due to the resetting of variable interest rates. Beginning in mid-February 2008 and continuing throughout the period ended December 31, 2008, however, the auctions for ARS then held by the Company were unsuccessful. As a result, the interest rates on ARS reset to the maximum rate per the applicable investment offering statements. The Company will not be able to liquidate affected ARS until a future auction on these investments is successful, a buyer is found outside the auction process, the securities are called or refinanced by the issuer, or the securities mature. Due to the long-term nature of the underlying student loan bonds and the failure of the auction process to provide a current market, the Company classified these investments as long-term on its consolidated balance sheet as of December 31, 2008.

In November 2008, the Company entered into an agreement with one of its investment advisors to repurchase the ARS it holds through such investment advisor at par value beginning on June 30, 2010. Until that time, the Company expects to continue to hold these long-term debt instruments until the earlier of the settlement date or the market for active trading in ARS at par value has been re-established. At any time during the period up until the June 2010, the Company s investment advisor can call these ARS at par value. The agreement entered into between the parties creates a separate financial instrument that the Company has elected to measure and report at fair value per the guidance of SFAS No. 159. The underlying ARS are carried at fair value and classified as trading securities as of December 31, 2008. Previously, these securities were classified as available-for-sale. Prior to entering into such agreement, the Company s intent was to hold the ARS until the earlier of the date on which the market recovered or payment date of the underlying security. The unrealized loss on these investments, previously was included in accumulated other comprehensive income, net of tax. Management s decision to enter into this agreement resulted in classifying the unrealized loss on these investments as other-than-temporary. As a result, the Company recognized a loss on investments for the amount of the unrealized loss not previously recognized in earnings (see Note 6).

On January 1, 2008, the Company adopted SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS No. 159). SFAS No. 159 permits companies to choose to measure certain financial assets and liabilities at fair value (the fair value option). If the fair value option is elected, any upfront costs and fees related to the item must be recognized in earnings and cannot be deferred. The fair

value election is irrevocable and may generally be made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings. The Company chose not to elect the fair value option for

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

its financial assets and liabilities existing on January 1, 2008, and did not elect the fair value option for any financial assets and liabilities transacted during the year ended December 31, 2008, except for the put option related to the Company s ARS.

Accounts Receivable and Related Reserves

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.

For presentation on the balance sheet, the Company reduces customer accounts receivable balances and deferred revenue by the amount of any deferred revenue recorded for each customer that has a balance receivable. The reductions as of December 31, 2008 and 2007 totaled $22.2 million and $18.8 million, respectively.

Property and Equipment

Property and equipment are recorded at cost, net of accumulated depreciation and amortization. Property and equipment generally includes purchases of items with a per unit value greater than $1,000 and a useful life greater than one year. Depreciation and amortization are computed on a straight-line basis over the estimated useful lives of the assets.

Leasehold improvements are amortized over the shorter of related lease terms or their estimated useful lives. Property and equipment acquired under capital leases are depreciated over the shorter of the related lease terms or the estimated useful lives of the assets. The Company periodically reviews the estimated useful lives of property and equipment. Changes to the estimated useful lives are recorded prospectively from the date of the change. Upon retirement or sale, the cost of the assets disposed of and the related accumulated depreciation are removed from the accounts and any resulting gain or loss is included in income from operations. Repairs and maintenance costs are expensed as incurred.

Goodwill and Other Intangible Assets

The Company tests goodwill for impairment on an annual basis or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Company performed an impairment test of goodwill

59

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

as of December 31, 2008 and 2007. These tests did not result in an impairment to goodwill. Other intangible assets consist of completed technologies, customer relationships, trademarks, non-compete agreements arising from acquisitions of businesses and acquired license rights. Purchased intangible assets, other than goodwill, are amortized over their estimated useful lives based upon the economic value derived from the related intangible asset (see Note 3). Goodwill is carried at its historical cost.

Valuation of Other Long-Lived Assets

Long-lived assets are reviewed for impairment under the guidance of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS No. 144). Under SFAS No. 144, long-lived assets are reviewed for impairment whenever events or changes in circumstances, such as service discontinuance, technological obsolescence, a significant decrease in the Company s market capitalization, facility closure or work-force reductions indicate that the carrying amount of the long-lived asset may not be recoverable. When such events occur, the Company compares the carrying amount of the asset to the undiscounted expected future cash flows related to the asset. If this comparison indicates that an impairment is present, the amount of the impairment is calculated as the difference between the carrying amount and the fair value of the asset. The Company did not have any indications of impairment for the years ended December 31, 2008, 2007 and 2006.

Restructuring Charges

A restructuring liability related to employee terminations is recorded by the Company when a one-time benefit arrangement is communicated to an employee who is involuntarily terminated as part of a reorganization and the amount of the termination benefit is known, provided that the employee is not required to render future services in order to receive the termination benefit.

In accordance with SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, the Company records restructuring liabilities, discounted at the appropriate rate, for facility leases only when the space is both vacated and all actions needed to make the space readily available for sublease have been completed. The Company records restructuring liabilities for estimated costs to terminate a facility lease before the end of its contractual term or for estimated costs that will continue to be incurred under the lease for its remaining term where there is no economic benefit to the Company, net of an estimate of sublease income.

Litigation

The Company is currently involved in certain legal proceedings. The Company estimates the range of liability related to pending litigation where the amount and range of loss can be estimated. The Company records its best estimate of a loss when the loss is considered probable. Where a liability is probable and there is a range of estimated loss with no best estimate in the range, the Company records the minimum estimated liability related to the claim. As additional information becomes available, the Company reassesses the potential liability related to the Company s pending litigation and revises its estimate.

Advertising Expense

The Company recognizes advertising expense as incurred. The Company recognized total advertising expense of $1.1 million for the year ended December 31, 2008 and $0.5 million for

each of the years ended December 31, 2007 and 2006.

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Recent Accounting Pronouncements

The Company adopted SFAS No. 157 on January 1, 2008. SFAS No. 157 defines fair value, establishes a methodology for measuring fair value and expands the required disclosure for fair value measurements (see Note 6). During 2008, the FASB issued the following amendments to SFAS No. 157:

FASB Staff Position No. 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13 (FSP FAS No. 157-1), which amends SFAS No. 157 to remove certain leasing transactions from its scope. The adoption of FSP FAS No. 157-1 did not have a material impact on the Company s financial position or results of operations in 2008.

FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157 , which delays the effective date of SFAS No. 157 from 2008 to 2009 for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company is currently evaluating the potential impact of SFAS No. 157 for non-financial assets and non-financial liabilities on the Company s financial position and results of operations.

FASB Staff Position No. 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP FAS No. 157-3), which clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP FAS No. 157-3 became effective October 2008. The adoption of FSP FAS No. 157-3 did not have a material impact on the Company s financial position or results of operations in 2008.

In December 2007, the FASB issued SFAS No. 141(R) (revised 2007), Business Combinations (SFAS No. 141R). SFAS No. 141R establishes principles and requirements for how the acquirer in a business combination (i) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree, (ii) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and (iii) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141R became effective for the Company on January 1, 2009. The impact of the standard on the Company s financial position and results of operations will be dependent upon the number of and magnitude of the acquisitions that are consummated once the standard is effective.

In December 2007, the FASB released SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements an amendment of ARB No. 51. This statement will change the accounting and reporting for minority interests, which will be re-characterized as non-controlling interests and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. This statement became effective for the Company on January 1, 2009. As of December 31, 2008, the Company did not

have any minority interests.

In April 2008, the FASB issued FASB Staff Position (FSP) on SFAS No. 142-3, Determination of the Useful Life of Intangible Assets (FSP FAS No. 142-3). FSP FAS No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets (SFAS No. 142). FSP FAS No. 142-3 is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

No. 141R and other generally accepted accounting principles in the United States of America. FSP FAS No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company does not expect FSP FAS No. 142-3 will have a material impact on the Company s financial position or results of operations.

In June 2008, the FASB issued FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. This FSP provides that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. Upon adoption, a company is required to retrospectively adjust its earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data) to conform with the provisions in this FSP. This FSP became effective for the Company on January 1, 2009. The Company has not yet determined the impact, if any, of this FSP on its consolidated financial statements.

3. Business Acquisitions:

In December 2006, March 2007, April 2007 and November 2008, the Company acquired Nine Systems Corporation (Nine Systems), Netli, Inc. (Netli), Red Swoosh, Inc. (Red Swoosh), and aCerno, Inc. (acerno), 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 and in the aggregate, were not material to the Company s consolidated financial results.

aCerno

On November 3, 2008, the Company acquired all of the outstanding common and preferred stock of the parent entity of acerno, including vested stock options, in exchange for approximately $90.7 million in cash. The purchase of acerno was intended to augment Akamai s Advertising Decision Solutions (ADS) that enable customers to more effectively advertise online by helping them improve ad results by accessing the audiences they want. The aggregate purchase price of $90.7 million consisted of $89.5 million in cash and $1.2 million of transaction costs, which primarily consisted of fees for legal and financial advisory services.

The acquisition of acerno was accounted for using the purchase method of accounting. The results of operations of the acquired business have been included in the consolidated financial statements of the Company since November 3, 2008, the date of acquisition. The total purchase consideration was allocated to the assets acquired and liabilities assumed based on their estimated fair values as of the date of acquisition, as determined by management and, with respect to identifiable intangible assets, by management with the assistance of an appraisal provided by a third-party valuation firm. The purchase price allocation is preliminary pending the Company s review of additional pre-acquisition assumed liabilities, which is expected to be completed during the first quarter of 2009. The excess of the purchase price over the amounts allocated to assets acquired and liabilities assumed was recorded as goodwill. The value of the goodwill from this acquisition can be attributed to a number of business factors including, but not limited to, potential sales opportunities to provide Akamai services to acerno customers; a trained technical workforce in place in the United States; an existing sales pipeline and a trained sales force. In accordance with current accounting standards, goodwill associated with the

acerno acquisition will not be amortized and will be tested for impairment at least annually as required by SFAS No. 142 (see Note 9).

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table presents the preliminary allocation of the purchase price for acerno:

	(In thousands)
Total consideration:	
Cash paid as of December 31, 2008	$ 83,719
Cash to be paid during the first quarter ending March 31, 2009	5,801
Transaction costs	1,229
Total purchase consideration	$ 90,749
Allocation of the purchase consideration:	
Current assets	$ 5,249
Property and equipment	1,828
Identifiable intangible assets	19,400
Goodwill	80,285
Deferred tax liabilities	(7,516)
Other liabilities assumed	(8,497)
	$ 90,749

The following were the identified intangible assets acquired and the respective estimated periods over which such assets will be amortized:

	Amount (In thousands)	Weighted Average useful life (In years)
Completed technologies	$ 9,200	2.5
Customer relationships	4,300	4.1
Non-compete agreements	5,600	2.5
Trade names	300	1.5
Total	$ 19,400	

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 acerno 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 acerno.

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 15%, tax rate of 35% and estimated average economic life of seven years.

The relief-from-royalty method was used to value the completed technologies acquired from acerno. The relief-from-royalty method estimates the cost savings that accrue to the owner of an intangible asset that would

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 10%, discount rate of 15%, tax rate of 35% and estimated average economic life of five years.

The lost-profits method was used to value the non-compete agreements Akamai entered into with certain members of acerno 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 15%, tax rate of 35% and estimated average economic life of five 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 benefit in 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 15%, tax rate of 35% and estimated average economic life of three years.

The total weighted average amortization period for the intangible assets acquired from acerno is 2.8 years. The intangible assets are being amortized based upon the pattern in which the economic benefits of the intangible assets are being utilized, which in general reflects the cash flows generated from such assets. None of the goodwill or identifiable intangible assets resulting from the acerno acquisition is deductible for income tax purposes.

Red Swoosh

On April 12, 2007, the Company acquired all of the outstanding common and preferred stock of Red Swoosh, including vested stock options, in exchange for approximately 350,000 shares of Akamai common stock. The purchase of Red Swoosh was intended to augment Akamai s distributed Internet presence by combining client-side file management and distribution software with the Company s existing network of edge servers. The aggregate purchase price was $18.7 million, which consisted of $18.4 million in shares of Akamai common stock, $4,000 in fair value of Akamai stock options issued, and transaction costs of $0.2 million, which primarily consisted of fees for legal services. In accordance with the FASB s Emerging Issues Task Force Issue No. 99-12, Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination (EITF No. 99-12), the value of the common stock issued in the transaction was calculated using the average closing price of the Company s common stock for the five-day period beginning two days before and ending two days after the date on which all material aspects of the transaction were agreed to by all parties and the acquisition was announced.

The acquisition of Red Swoosh was accounted for using the purchase method of accounting. The results of operations of the acquired business have been included in the consolidated financial statements of the Company since April 12, 2007, the date of acquisition. The total purchase consideration was allocated to the assets acquired and liabilities assumed based on

their estimated fair values as of the date of acquisition, as determined by management. The
excess of the purchase price over the amounts allocated to assets acquired and liabilities

64

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

assumed was recorded as goodwill. The value of the goodwill from this acquisition can be attributed to a number of business factors including, but not limited to, cost synergies expected to be realized and a trained technical workforce. In accordance with current accounting standards, goodwill associated with the Red Swoosh acquisition will not be amortized and will be tested for impairment at least annually as required by SFAS No. 142 (see Note 9).

The following table presents the allocation of the purchase price for Red Swoosh:

		(In thousands)
Total consideration:		
Value of common stock issued	$	18,449
Fair value of stock options issued		4
Transaction costs		237
Total purchase consideration	$	18,690
Allocation of the purchase consideration:		
Current assets, including cash and cash equivalents of $2,677	$	3,236
Long-term assets		14
Identifiable intangible assets		3,731
Deferred tax assets		1,355
Goodwill		13,188
Deferred tax liabilities		(1,458)
Other liabilities assumed		(1,376)
	$	18,690

In determining the purchase price allocation, the Company considered, among other factors, its intention to use the acquired assets and the estimated future demand for the acquired technology. The fair value of identifiable intangible assets was based upon both the cost avoidance and opportunity cost savings approaches. 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 20%, with a tax rate of 40%. 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 and cost savings related to the technology and assets acquired.

The Company has valued the acquired completed technologies at $3.7 million with a weighted average useful life of 4.4 years. The intangible assets are being amortized based upon the pattern in which the economic benefits of the intangible assets are being utilized, which in general reflects the cash flow savings from such assets. None of the goodwill or identifiable intangible assets resulting from the Red Swoosh acquisition is deductible for income tax purposes.

Netli

On March 13, 2007, the Company acquired all of the outstanding common and preferred stock, including vested and unvested stock options, of Netli in exchange for approximately 2.8 million shares of Akamai common stock and options to purchase approximately 400,000 shares of Akamai common stock. Akamai acquired Netli with a goal of expanding the Company s application acceleration technology, as well as broadening its customer base.

65

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The aggregate purchase price was $154.4 million, consisting of $139.4 million in shares of Akamai common stock, $14.1 million in fair value of Akamai stock options issued, and transaction costs of $0.8 million, which primarily consisted of fees for financial advisory and legal services. In accordance with EITF No. 99-12, the value of the common stock issued in the transaction was calculated using the average closing price of the Company s common stock for the five-day period beginning two days before and ending two days after the date on which all material aspects of the transaction were agreed to by all parties and the acquisition was announced.

The fair value of the Company s stock options issued to Netli employees was estimated using the Black-Scholes option pricing model with the following weighted-average assumptions:

Expected life (years)	2.1
Risk-free interest rate	4.5%
Expected volatility	60.1%
Dividend yield	

The acquisition of Netli was accounted for using the purchase method of accounting. The results of operations of the acquired business have been included in the consolidated financial statements of the Company since March 13, 2007, the date of acquisition. The total purchase consideration was allocated to the assets acquired and liabilities assumed based on their estimated fair values as of the date of acquisition, as determined by management and, with respect to identifiable 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 was recorded as goodwill. The value of the goodwill from this acquisition can be attributed to a number of business factors including, but not limited to, potential sales opportunities to provide Akamai services to Netli customers; a trained technical workforce in place in the United States; an existing sales pipeline and a trained sales force; and cost synergies expected to be realized. In accordance with current accounting standards, goodwill associated with Netli will not be amortized and will be tested for impairment at least annually as required by SFAS No. 142 (see Note 9).

The following table presents the allocation of the purchase price for Netli:

		(In thousands)
Total consideration:		
Value of common stock issued	$	139,387
Fair value of stock options issued		14,117
Transaction costs		847
Total purchase consideration	$	154,351
Allocation of the purchase consideration:		
Current assets, including cash and cash equivalents of $6,160	$	7,835
Property and equipment		1,989
Deferred tax assets		15,241

Identifiable intangible assets	36,500
Goodwill	111,913
Deferred tax liabilities	(13,302)
Other liabilities assumed, including deferred revenue of $1,037	(5,825)
	$ 154,351

66

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following were the identified intangible assets acquired and the respective estimated periods over which such assets will be amortized:

	Amount (In thousands)	Weighted Average useful life (In years)
Completed technologies	$ 17,700	4.4
Customer relationships	18,500	5.9
Non-compete agreements	300	2.5
Total	$ 36,500	

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 Netli 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 16%. 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 Netli.

The customer relationships were valued using the discounted cash flow method of income approach. The key assumptions used in valuing the customer relationships were as follows: discount rate of 16%, tax rate of 40% and estimated average economic life of 11 years.

The relief-from-royalty method was used to value the completed technologies acquired from Netli. 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 40% and estimated average economic life of eight years.

The lost-profits method was used to value the non-compete agreements Akamai entered into with certain members of Netli 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 40% and estimated average economic life of three years.

The total weighted average amortization period for the intangible assets acquired from Netli is 5.1 years. The intangible assets are being amortized based upon the pattern in which the economic benefits of the intangible assets are being utilized, which in general reflects the cash flows generated from such assets. None of the goodwill or identifiable intangible assets resulting from the Netli acquisition is deductible for income tax purposes.

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In connection with the acquisition of Netli, the Company promptly commenced integration activities, which resulted in recognizing, as part of the purchase price allocation, approximately $0.8 million in liabilities for employee termination benefits, most of which was paid in 2008.

Nine Systems

On December 13, 2006, the Company acquired all of the outstanding common and preferred stock, including vested and unvested stock options, of Nine Systems in exchange for approximately 2.7 million shares of Akamai common stock, approximately $4.5 million in cash and options to purchase approximately 400,000 shares of Akamai common stock. The purchase of Nine Systems was intended to increase the quantity and types of rich media management tools sold by the Company.

The aggregate purchase price, net of cash received, was approximately $157.5 million, which consisted of $133.3 million in shares of Akamai common stock, $19.1 million in fair value of Akamai s stock options issued, $4.5 million in cash and $0.6 million of transaction costs, which primarily consisted of fees for financial advisory and legal services. In accordance with EITF No. 99-12, the value of the common stock issued in the transaction was calculated using the average closing price of the Company s common stock for the five-day period beginning two days before and ending two days after the date on which all material aspects of the transaction were agreed to by all parties and the acquisition was announced.

The fair value of the Company s stock options issued to Nine Systems employees was estimated using the Black-Scholes option pricing model with the following weighted-average assumptions:

Expected life (years)	
Risk-free interest rate	5.2%
Expected volatility	67.4%
Dividend yield	

The acquisition was accounted for using the purchase method of accounting. The total purchase consideration was allocated to the assets acquired and liabilities assumed based on their estimated fair values as of the date of acquisition, as determined by management and, with respect to identifiable 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 was recorded as goodwill. The value of the goodwill from this acquisition can be attributed to a number of business factors including, but not limited to, potential sales opportunities of providing Akamai services to Nine Systems customers; a trained technical workforce in place in the United States; an existing sales pipeline and a trained sales force; and cost synergies expected to be realized. In accordance with current accounting standards, goodwill associated with Nine Systems will not be amortized and will be tested for impairment at least annually as required by SFAS No. 142 (see Note 9).

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table presents the allocation of the purchase price for Nine Systems:

	(In thousands)
Total consideration:	
Value of common stock issued	$ 133,313
Cash paid	4,462
Fair value of stock options	19,070
Transaction costs	634
Total purchase consideration	$ 157,479
Allocation of the purchase consideration:	
Current assets	$ 4,553
Property and equipment	912
Deferred tax assets	5,732
Identifiable intangible assets	28,900
Goodwill	139,475
Deferred tax liabilities	(10,463)
Other liabilities assumed, including deferred revenue of $830	(11,630)
	$ 157,479

The following were the identified intangible assets acquired and the respective estimated periods over which the assets will be amortized:

	Amount (In thousands)	Weighted Average Useful Life (In years)
Completed technologies	$ 3,400	1.7
Customer relationships	25,000	4.5
Trademarks	500	2.1
Total	$ 28,900	

In determining the purchase price allocation, the Company considered, among other factors, the Company s intention to use the acquired assets and historical and estimated future demand for Nine Systems services. The fair value of intangible assets was based upon the income approach. The rate used to discount the net cash flows to their present values was based upon a weighted average cost of capital of 18%. 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 Nine Systems.

The customer relationships were valued using the income approach. The key assumptions used in valuing the customer relationships were as follows: discount rate of 18%, tax rate of 40% and estimated average economic life of nine years.

The relief-from-royalty method was used to value the completed technologies acquired from Nine Systems. 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

69

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 were as follows: royalty rate of 10.5%, discount rate of 18%, tax rate of 40% and estimated average economic life of four years.

The relief-from-royalty method was used to value trademarks. The relief-from-royalty method recognizes that the current value of an asset may be premised upon the expected receipt of future economic benefit in the use of trademarks and domain 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 trademarks and domain names. The key assumptions used in valuing trademarks were as follows: royalty rate of 1%, discount rate of 18%, tax rate of 40% and estimated average economic life of five years.

The total weighted average amortization period for the intangible assets is 4.1 years. The intangible assets are being amortized based upon the pattern in which the economic benefit of the intangible assets is being utilized, which in general reflects the cash flows generated from such assets. None of the goodwill or identifiable intangible assets is deductible for income tax purposes.

In connection with the acquisition of Nine Systems, the Company commenced integration activities, which resulted in recognizing approximately $0.6 million in liabilities for employee termination benefits, most of which was paid during 2007.

4. Net Income per Share:

Basic net income per weighted average share is computed using the weighted average number of common shares outstanding during the applicable period. Diluted net income per weighted average 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, deferred stock units, restricted stock units and convertible notes.

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

	For the Years Ended December 31,		
	2008	2007	2006
Numerator:			
Net income	$ 145,138	$ 100,967	$ 57,401
Add back of interest expense on 1% convertible senior notes (net of tax)	1,757	2,840	2,841
Numerator for diluted net income	$ 146,895	$ 103,807	$ 60,242
Denominator:			

Denominator for basic net income per common share	167,673	162,959	155,366
Effect of dilutive securities:			
Stock options	4,009	7,354	7,704
Effect of escrow contingencies	351	1,051	
Restricted stock units and deferred stock units	1,716	798	752
Assumed conversion of 1% convertible senior notes	12,936	12,932	12,945
Denominator for diluted net income per common share	186,685	185,094	176,767
Basic net income per common share	$ 0.87	$ 0.62	$ 0.37
Diluted net income per common share	$ 0.79	$ 0.56	$ 0.34

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Outstanding options to acquire an aggregate of 2.6 million, 1.4 million and 0.5 million shares of common stock as of December 31, 2008, 2007 and 2006, respectively, were excluded from the calculation of diluted earnings per share because the exercise prices of these stock options were greater than the average market price of the Company s common stock during the respective periods. Additionally, 1.9 million, 3.5 million and 2.3 million shares of common stock issuable in respect of outstanding restricted stock units were excluded from the computation of diluted net income per share for the years ended December 31, 2008, 2007 and 2006, respectively, because the performance conditions had not been met as of those dates.

The calculation of assumed proceeds used to determine the diluted weighted average shares outstanding under the treasury stock method in the periods presented was adjusted by tax windfalls and shortfalls associated with all of the Company s outstanding stock awards. Such windfalls and shortfalls are computed by comparing the tax deductible amount of outstanding stock awards to their grant-date fair values and multiplying the results by the applicable statutory tax rate. A positive result creates a windfall, which increases the assumed proceeds, and a negative result creates a shortfall, which reduces the assumed proceeds.

5. Accumulated Other Comprehensive Income (Loss):
Comprehensive income consists of net income and other comprehensive income (loss), which includes foreign currency translation adjustments and changes in unrealized gains and losses on marketable securities. For the purposes of comprehensive income disclosures, the Company does not record tax provisions or benefits for the net changes in the foreign currency translation adjustment, as the Company intends to permanently reinvest undistributed earnings of its foreign subsidiaries. Accumulated other comprehensive income (loss) is reported as a component of stockholders equity and consisted of the following (in thousands):

	December 31,	
	2008	2007
Net unrealized (loss) gain on investments, net of tax of $14,767 at December 31, 2008	$ (23,348)	$ 17
Foreign currency translation adjustments	(1,002)	3,036
Accumulated other comprehensive (loss) income	$ (24,350)	$ 3,053

6. Marketable Securities and Investments:
On January 1, 2008, the Company adopted the provisions of SFAS No. 157 for its financial assets and liabilities. As permitted by FASB Staff Position No. SFAS 157-2, Effective Date of FASB Statement No. 157, the Company elected to defer until January 1, 2009 the adoption of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. The adoption of this accounting pronouncement did not have a material effect on the Company s consolidated financial statements for financial assets and liabilities and any other assets and liabilities carried at fair value. The Company is currently in the process of evaluating the impact of adopting this pronouncement for other non-financial assets and liabilities.

SFAS No. 157 provides a framework for measuring fair value under generally accepted accounting principles in the United States and requires expanded disclosures regarding fair value measurements. SFAS No. 157 defines fair value 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. SFAS No. 157 also establishes a fair value hierarchy that

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

requires an entity to maximize the use of observable inputs, where available, and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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

Level 2 Observable inputs, other than Level 1 prices, such as quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities, including certain pricing models, discounted cash flow methodologies and similar techniques.

The following is a summary of marketable securities and other investment-related assets held at December 31, 2008 and 2007 (in thousands).

		Gross Unrealized		Realized		Classified on Balance Sheet	
As of December 31, 2008	**Cost**	**Gains**	**Losses**	**Gains (Losses)**	**Aggregate Fair Value**	**Short-term Marketable Securities**	**Long-term Marketable Securities**
Available-for-sale securities:							
Certificates of deposit	$ 640	$	$	$	$ 640	$ 487	$ 153
Commercial paper	39,357	52			39,409	39,409	
U.S. corporate debt securities	216,883	681	(2,593)		214,971	85,907	129,064
U.S. government agency obligations	110,137	902	(12)		111,027	48,754	62,273
Auction rate securities	210,600		(37,163)		173,437		173,437
	577,617	1,635	(39,768)		539,484	174,557	364,927
Trading securities:							
Auction rate securities	76,500			(12,931)	63,569		63,569
Other investment-related assets:							
Put option related to ARS				12,500	12,500		12,500
	$ 654,117	$ 1,635	$ (39,768)	$ (431)	$ 615,553	$ 174,557	$ 440,996

		Gross Unrealized		Realized		Classified on Balance Sheet	
As of December 31, 2007	**Cost**	**Gains**	**Losses**	**Gains (Losses)**	**Aggregate Fair Value**	**Short-term Marketable**	**Long-term Marketable**

						Securities	Securities
Available-for-sale securities:							
Certificates of deposit	$ 835	$	$	$	$ 835	$ 835	$
Commercial paper	47,669	27	(9)		47,687	47,687	
U.S. corporate debt securities	119,961	305	(423)		119,843	66,190	53,653
U.S. government agency obligations	39,998	118	(1)		40,115	6,429	33,686
Auction rate securities	279,950				279,950	279,950	
	$ 488,413	$ 450	$ (433)	$	$ 488,430	$ 401,091	$ 87,339

72

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Unrealized gains and unrealized temporary losses on investments classified as available for sale are included within accumulated other comprehensive income (loss), net. Upon realization, those amounts are reclassified from accumulated other comprehensive income (loss), net to gain (loss) on investments, net. All gains and losses on investments classified as trading are included within the income statement as gain (loss) on investments, net. Realized gains and losses and other-than-temporary impairments are reflected in the income statement as gain (loss) on investments, net. As of December 31, 2008, the Company s available-for-sale securities with gross unrealized losses have been in a continuous unrealized loss position for less than 12 months.

The following table details the fair value measurements within the fair value hierarchy of the Company s financial assets, including investments and cash equivalents, at December 31, 2008 (in thousands):

	Total Fair Value at December 31, 2008	Fair Value Measurements at Reporting Date Using		
		Level 1	Level 2	Level 3
Money market funds	$ 107,772	$ 107,772	$	$
Certificates of deposit	664	664		
Commercial paper	43,973		43,973	
U.S. government agency obligations	117,995		117,995	
U.S. corporate debt securities	214,971		214,971	
Auction rate securities	237,006			237,006
Put option related to auction rate securities	12,500			12,500
	$ 734,881	$ 108,436	$ 376,939	$ 249,506

The following table reflects the activity for the Company s major classes of assets measured at fair value using Level 3 inputs for the year ended December 31, 2008 (in thousands):

	Auction Rate Securities	Put Option related to auction rate securities	Total
Balance as of December 31, 2007	$	$	$
Transfers in from Level 1	296,850		296,850
Sale of securities	(9,750)		(9,750)
Unrealized losses included in accumulated other comprehensive income (loss)	(37,163)		(37,163)
Realized gain on other investment-related assets		12,500	12,500
Realized loss on auction rate securities	(12,931)		(12,931)
Balance as of December 31, 2008	$ 237,006	$ 12,500	$ 249,506

As of December 31, 2008, the Company had grouped money market funds and certificates of deposit using a Level 1 valuation because market prices are readily available in active markets. As of December 31, 2008, the Company had grouped commercial paper, U.S. government agency obligations and U.S. corporate debt securities using a Level 2 valuation because quoted prices for identical or similar assets are available in markets that are not active. As of December 31, 2008, the fair value of the Company s assets grouped using a Level 3 valuation consisted of ARS as well as a related put option described below. ARS are long-term variable rate bonds tied to short-term interest rates that may reset through a Dutch auction process that are designed to occur every seven to 35 days.

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Historically, the carrying value (par value) of the ARS approximated fair market value due to the resetting of variable interest rates. Beginning in mid-February 2008 and continuing throughout the period ended December 31, 2008, however, the auctions for ARS then held by the Company were unsuccessful. As a result, the interest rates on ARS reset to the maximum rate per the applicable investment offering statements. The Company will not be able to liquidate affected ARS until a future auction on these investments is successful, a buyer is found outside the auction process, the securities are called or refinanced by the issuer, or the securities mature. Due to these liquidity issues, the Company performed a discounted cash flow analysis to determine the estimated fair value of these investments. The discounted cash flow analysis performed by the Company considered the timing of expected future successful auctions, the impact of extended periods of maximum interest rates, collateralization of underlying security investments and the creditworthiness of the issuer. The discounted cash flow analysis performed as of December 31, 2008 assumes a weighted average discount rate of 6.275% and expected term of five years. The discount rate was determined using a proxy based upon the current market rates for similar debt offerings within the AAA-rated ARS market. The expected term was based on management s estimate of future liquidity. As a result, as of December 31, 2008, the Company has estimated an aggregate loss of $50.1 million, of which $37.2 million was related to the impairment of ARS deemed to be temporary and included in accumulated other comprehensive income (loss) within stockholders equity, and of which $12.9 million was related to the impairment of ARS deemed other-than-temporary and included in gain (loss) on investments, net in the consolidated statement of operations.

The Company s ARS are primarily AAA-rated bonds, most of which are collateralized by federally guaranteed student loans as part of the Federal Family Education Loan Program through the United States Department of Education. The Company believes the quality of the collateral underlying these securities will enable it to recover the Company s principal balance.

Despite the failed auctions, the Company continues to receive cash flows in the form of specified interest payments from the issuers of ARS. In addition, except as described below for ARS related to the put option, the Company has the intent and ability to hold its ARS until a recovery of the impairment because it believes it has sufficient cash and other marketable securities on-hand and from projected cash flows from operations such that it does not anticipate a need to sell its ARS prior to a recovery to par value.

In November 2008, the Company entered into an agreement with one of its investment advisors to repurchase the $76.5 million in par value of ARS purchased through such advisor at par value beginning on June 30, 2010. Such agreement created a separate financial instrument between the two companies (the put option). For these particular ARS, Akamai expects to continue to hold these long-term debt instruments until the earlier of the settlement date or the date on which the market allows for active trading of ARS at par value. At any time during the period up until the June 2010, the investment advisor can call the ARS at par value.

The Company elected to apply the fair value option under SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, to the put option. The $12.5 million fair value of the put option is grouped with long-term marketable securities on the Company s consolidated balance sheet with the resultant gain offsetting $12.9 million of the related ARS impairment included in the consolidated statement of operations. The fair value of the put option was determined by comparing the fair value of the related ARS, as described above, to their par values and also considers the credit risk associated with the investment advisor. This put option will be adjusted on each balance sheet date based on its then fair value. The fair value of the put option is based on unobservable inputs and is therefore classified as Level 3 in the hierarchy.

The underlying ARS are carried at fair value and classified as trading securities as of December 31, 2008. Previously, these securities were classified as available-for-sale. Prior to the Company s agreement with its investment advisor, its intent was to hold the ARS until the market recovered. The unrealized loss on these

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

investments previously was included in accumulated other comprehensive income (loss), net of tax. Management s decision to enter into the agreement with the Company s investment advisor resulted in classifying the unrealized loss on these investments as other-than-temporary. As a result, the Company recognized a loss of $12.9 million.

As of December 31, 2007, the Company held $280.0 million of ARS and classified these as short-term investments. As of December 31, 2008, the Company classified all of its ARS as long-term marketable securities on its consolidated balance sheet due to management s estimate of its inability to liquidate these investments within the following twelve months. Expected maturities of the Company s marketable securities and other investment-related assets held at December 31, 2008 and 2007 are as follows:

	December 31,	
	2008	2007
Available-for-sale securities:		
Due in one year or less	$ 174,710	$ 124,243
Due after 1 year through 5 years	191,337	84,237
Due after 5 years	173,437	279,950
Trading securities:		
Due after 5 years	63,569	
Other investment-related assets:		
Due after 1 year through 5 years	12,500	
	$ 615,553	$ 488,430

As of December 31, 2008, $3.6 million of the Company s marketable securities were classified as restricted. These securities primarily represent security for irrevocable letters of credit in favor of third-party beneficiaries, mostly related to facility leases. The letters of credit are collateralized by restricted marketable securities, of which $3.4 million are classified as short-term marketable securities and $0.2 million are classified as long-term marketable securities on the consolidated balance sheets. The restrictions on these marketable securities lapse as the Company fulfills its obligations or such obligations expire under the terms of the letters of credit. These restrictions are expected to lapse at various times through May 2011.

For the year ended December 31, 2008, the Company recorded net losses on investments of $157,000. For the years ended December 31, 2007 and 2006, the Company recorded net gains on investments of $24,000 and $261,000, respectively, on sales of marketable securities.

7. Accounts Receivable:

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

December 31,	
2008	2007

Trade accounts receivable	$ 138,286	$ 113,357
Unbilled accounts	12,596	15,978
Gross accounts receivable	150,882	129,335
Allowance for doubtful accounts	(6,943)	(6,878)
Reserve for cash basis customers	(4,327)	(3,513)
Total accounts receivable reserves	(11,270)	(10,391)
Accounts receivable, net	$ 139,612	$ 118,944

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Property and Equipment:

Property and equipment consisted of the following (dollars in thousands):

	December 31,		Estimated Useful
	2008	2007	Lives in Years
Computer and networking equipment	$ 302,213	$ 264,949	3
Purchased software	26,987	24,776	3
Furniture and fixtures	8,286	6,265	5
Office equipment	3,834	3,870	3
Leasehold improvements	22,095	11,344	5-7
Internal-use software	106,075	73,622	2
	469,490	384,826	
Accumulated depreciation and amortization	(295,007)	(250,280)	
	$ 174,483	$ 134,546	

Depreciation and amortization expense on property and equipment and capitalized internal-use software for the years ended December 31, 2008, 2007 and 2006 were $84.2 million, $60.5 million and $32.1 million, respectively.

During the years ended December 31, 2008 and 2007, the Company wrote off $40.2 million and $25.7 million, respectively, of long-lived asset costs, with accumulated depreciation and amortization costs of $39.0 million and $25.2 million, respectively. These write-offs were primarily related to purchased software and computer and networking equipment that were no longer in use.

During the years ended December 31, 2008, 2007 and 2006, the Company capitalized $25.0 million, $19.1 million and $12.6 million, net of impairments, respectively, of external consulting fees and payroll and payroll-related costs for the development and enhancement of internal-use software applications. Additionally, during the years ended December 31, 2008, 2007 and 2006, the Company capitalized $7.4 million, $6.4 million and $4.3 million, respectively, of non-cash stock-based compensation related to employees who developed and enhanced internal-use software applications. The internal-use software is used by the Company primarily to operate, manage and monitor its deployed network and deliver its services to customers.

The following table summarizes capitalized internal-use software costs (in thousands):

	December 31,	
	2008	2007
Gross costs capitalized	$ 107,125	$ 74,672
Less: cumulative impairments	(1,050)	(1,050)

	106,075	73,622
Less: accumulated amortization	(56,778)	(38,390)
Net book value of capitalized internal-use software	$ 49,297	$ 35,232

76

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Goodwill and Other Intangible Assets:
The Company acquired goodwill and other intangible assets through business acquisitions during 2008, 2007, 2006, 2005 and 2000. The Company also acquired license rights from the Massachusetts Institute of Technology in 1999. During the year ended December 31, 2008, the Company recorded goodwill of $80.3 million and acquired intangible assets of $19.4 million as a result of the acquisition of acerno. During the year ended December 31, 2007, the Company recorded goodwill of $125.1 million and acquired intangible assets of $40.2 million as a result of the acquisitions of Netli and Red Swoosh.

During 2008, the Company made purchase accounting adjustments of $0.7 million to reflect the return in 2008 of approximately 59,000 shares of Akamai common stock previously held in escrow in connection with its acquisition of Speedera. The shares were previously included in the purchase price. Consequently, the Company reduced stockholders equity by $0.7 million for the value of the shares as of the date of acquisition and reduced goodwill by the same amount.

During 2007, the Company made purchase accounting adjustments to reflect the net deferred tax assets recorded as a result of filing the final pre-acquisition income tax return for Nine Systems. Consequently, the Company increased its net deferred tax assets by $3.0 million and reduced goodwill by the same amount.

The changes in the carrying amount of goodwill for the years ended December 31, 2008 and 2007 were as follows:

	In thousands
Ending balance, December 31, 2006	$ 239,580
Netli acquisition	111,913
Red Swoosh acquisition	13,188
Tax assets recorded in connection with the Nine Systems acquisition	(3,044)
Ending balance, December 31, 2007	361,637
acerno acquisition	80,285
Purchase price adjustment in connection with the Speedera acquisition	(664)
Ending balance, December 31, 2008	$ 441,258

The Company reviews goodwill and other intangible assets for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of these assets may exceed their fair value. The Company concluded that it had one reporting unit and assigned the entire balance of goodwill to this reporting unit as of December 31, 2008 and 2007 for purposes of performing an impairment test. The fair value of the reporting unit was determined using the Company s market capitalization as of December 31, 2008 and 2007. The fair value on December 31, 2008 and 2007 exceeded the net assets of the reporting unit, including goodwill, as of both dates. Accordingly, the Company concluded that no impairment existed as of these dates. Unless changes in events or circumstances indicate that an impairment test is required, the Company will next test goodwill for impairment as of December 31, 2009.

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	December 31, 2008		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Completed technologies	$ 35,031	$ (5,659)	$ 29,372
Customer relationships	88,700	(31,291)	57,409
Non-compete agreements	7,200	(1,529)	5,671
Trademarks and trade names	800	(257)	543
Acquired license rights	490	(490)	
Total	$ 132,221	$ (39,226)	$ 92,995

	December 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Completed technologies	$ 25,831	$ (2,631)	$ 23,200
Customer relationships	84,400	(21,029)	63,371
Non-compete agreements	1,600	(1,108)	492
Trademarks	500	(109)	391
Acquired license rights	490	(444)	46
Total	$ 112,821	$ (25,321)	$ 87,500

Aggregate expense related to amortization of other intangible assets was $13.9 million, $11.4 million and $8.5 million for the years ended December 31, 2008, 2007 and 2006, respectively. Based on current circumstances, amortization expense is expected to be approximately $16.7 million, $16.4 million, $16.4 million, $15.4 million and $12.6 million for the years ending December 31, 2009, 2010, 2011, 2012 and 2013, respectively.

10. Accrued Expenses and Other Current Liabilities:
Accrued expenses and other current liabilities consisted of the following (in thousands):

	December 31,	
	2008	2007
Payroll and other related benefits	$ 26,377	$ 27,381
Bandwidth and co-location	16,642	12,968
Property, use and other taxes	13,317	10,182
Legal professional fees	1,475	1,781
Other	8,321	3,921

Total	$ 66,132	$ 56,233

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. 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 December 2019 and generally require the payment of real estate taxes, insurance, maintenance and operating costs. In October 2007, the Company entered into facility lease agreements with its landlord to expand its corporate headquarters in Cambridge, Massachusetts. As of June 1, 2009, the Company will be occupying an additional 110,000 square feet at its current location in Cambridge. These lease obligations have been included in the future lease commitment table below.

The minimum aggregate future obligations under non-cancelable leases as of December 31, 2008 were as follows (in thousands):

	Operating Leases
2009	$ 18,131
2010	21,281
2011	17,518
2012	15,742
2013	15,243
Thereafter	79,910
Total	$ 167,825

Rent expense for the years ended December 31, 2008, 2007 and 2006 was $14.8 million, $11.0 million and $6.6 million, respectively.

As of December 31, 2008, the Company had outstanding letters of credit in the amount of $8.6 million related to certain of its real estate leases. Approximately $3.6 million of these letters of credit are collateralized by marketable securities that have been restricted as to use (see Note 6). The letters of credit expire as the Company fulfills its operating lease obligations. Certain of the Company s facility leases include rent escalation clauses. The Company normalizes rent expense on a straight-line basis over the term of the lease for known changes in lease payments over the life of the lease. In the event that the landlord provided funding for leasehold improvements to leased facilities, the Company amortizes such amount as part of rent expense on a straight-line basis over the life of the lease.

Purchase Commitments

The Company has long-term commitments for bandwidth usage and co-location with various networks and ISPs. For the years ending December 31, 2009 and 2010, the minimum commitments were, as of December 31, 2008, approximately $42.4 million and $8.0 million, respectively. Additionally, as of December 31, 2008, the Company had entered into purchase orders with various vendors for aggregate purchase commitments of $15.0 million, which are expected to be paid in 2009.

Litigation

Between July 2, 2001 and November 7, 2001, purported class action lawsuits seeking monetary damages were filed in the United States District Court for the Southern District of New York against the Company as well

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

as against the underwriters of its October 28, 1999 initial public offering of common stock. The complaints were filed allegedly on behalf of persons who purchased the Company s common stock during different time periods, all beginning on October 28, 1999 and ending on various dates. The complaints are similar and allege violations of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, primarily based on the allegation that the underwriters received undisclosed compensation in connection with the Company s initial public offering. On April 19, 2002, a single consolidated amended complaint was filed, reiterating in one pleading the allegations contained in the previously filed separate actions. The consolidated amended complaint defines the alleged class period as October 28, 1999 through December 6, 2000. A Special Litigation Committee of the Company s Board of Directors authorized management to negotiate a settlement of the pending claims substantially consistent with a Memorandum of Understanding that was negotiated among class plaintiffs, all issuer defendants and their insurers. The parties negotiated a settlement that was subject to approval by the Court. On February 15, 2005, the Court issued an Opinion and Order preliminarily approving the settlement, provided that the defendants and plaintiffs agree to a modification narrowing the scope of the bar order set forth in the original settlement agreement. The parties agreed to a modification narrowing the scope of the bar order, and on August 31, 2005, the Court issued an order preliminarily approving the settlement. On December 5, 2006, the United States Court of Appeals for the Second Circuit overturned the District Court s certification of the class of plaintiffs who are pursuing the claims that would be settled in the settlement against the underwriter defendants. Thereafter, the District Court ordered a stay of all proceedings in all of the lawsuits pending the outcome of plaintiffs petition to the Second Circuit for rehearing en banc and resolution of the class certification issue. On April 6, 2007, the Second Circuit denied plaintiffs rehearing petition, but clarified that the plaintiffs may seek to certify a more limited class in the District Court. On June 25, 2007, the District Court signed an order terminating the settlement. There were no material developments in these proceedings during the year ended December 31, 2008. The Company believes that it has meritorious defenses to the claims made in the complaint, and it intends to contest the lawsuit vigorously. An adverse resolution of this action could have a material adverse effect on its financial condition and results of operations in the period in which the lawsuit is resolved. The Company is not presently able to estimate potential losses, if any, related to this lawsuit.

In addition, on or about October 3, 2007, a purported Akamai shareholder filed a complaint in the United States District Court for the Western District of Washington, against the underwriters involved in its 1999 initial public offering of common stock, alleging violations of Section 16(b) of the Exchange Act. The complaint alleges that the combined number of shares of the Company s common stock beneficially owned by the lead underwriters and certain unnamed officers, directors and principal shareholders exceeded ten percent of its outstanding common stock from the date of the Company s initial public offering on October 29, 1999, through at least October 28, 2000. The complaint further alleges that those entities and individuals were thus subject to the reporting requirements of Section 16(a) and the short-swing trading prohibition of Section 16(b) and failed to comply with those provisions. The complaint seeks to recover from the lead underwriters any short-swing profits obtained by them in violation of Section 16(b). Akamai was named as a nominal defendant in the action but has no liability for the asserted claims. None of the Company s directors or officers serving in such capacities at the time of its initial public offering are currently named as defendants in this action, but there can be no guarantee that the complaint will not be amended or a new complaint or suit filed to name such directors or officers as defendants in this action or another action alleging a violation of the same provisions of the Securities Exchange Act of 1934, as amended. The Company does not expect the results of this action to have a material adverse effect on its business, results of operations or financial condition.

The Company is party to various other litigation matters that management considers routine and incidental to its business. Management does not expect the results of any of these routine actions to have a material adverse effect on the Company s business, results of operations or financial condition.

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Guarantees

The Company has identified the guarantees described below as disclosable in accordance with FASB Interpretation 45 (FIN 45), Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No. 34. The Company evaluates estimated losses for guarantees under SFAS No. 5, Accounting for Contingencies, as Interpreted by FIN 45. The Company considers such factors as the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. To date, the Company has not encountered material costs as a result of such obligations and has not accrued any liabilities related to such guarantees in its financial statements.

As permitted under Delaware law, the Company s Certificate of Incorporation provides that Akamai indemnify each of its officers and directors during his or her lifetime for certain events or occurrences that happen by reason of the fact that the officer or director is or was or has agreed to serve as an officer or director of the Company. In addition, the Company has acquired other companies that had similar director and officer indemnification provisions in their bylaws. The Company has generally become responsible for such indemnification obligations as a result of the acquisition. The maximum potential amount of future payments the Company could be required to make under these indemnification obligations is unlimited; however, the Company has a director and officer insurance policy that limits its exposure and may enable the Company to recover a portion of certain future amounts paid. In the case of obligations assumed as a result of acquisitions, the Company may have the right to be indemnified by the selling stockholders of such acquired companies for director and officer indemnification expenses incurred by the Company for matters arising prior to the acquisition which may eliminate or mitigate the impact of any such obligations.

The Company enters into standard indemnification agreements in the ordinary course of business. Pursuant to these agreements, the Company agrees to indemnify, hold harmless, and reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally Akamai s business partners or customers, in connection with Akamai s provision of its services and software. Generally, these obligations are limited to claims relating to infringement of a patent, copyright or other intellectual property right or the Company s negligence, willful misconduct or violation of the law (provided that there is not gross negligence or willful misconduct on the part of the other party). Subject to applicable statutes of limitation, the term of these indemnification agreements is generally perpetual from the time of execution of the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company carries insurance that covers certain third party claims relating to its services and could limit the Company s exposure. There can, however, be no certainty that such insurance would cover a portion or any amount of such liability.

The Company has acquired all of the stock of numerous companies since 2000. As part of those acquisitions, the Company assumed the liability for undisclosed claims and losses previously incurred by such companies. Subject to applicable statutes of limitations, these obligations are generally perpetual from the time of execution of the agreement. The maximum potential amount of future payments the Company could be required to make in connection with these obligations is unlimited. The Company may have the right to be indemnified by the selling stockholders of such acquired companies for losses and expenses incurred by the Company for matters arising prior to the acquisition, which may eliminate or mitigate the impact of any such obligations.

The Company leases space in certain buildings, including a corporate headquarters building, under operating leases. The Company has standard indemnification arrangements under such operating leases that require it to indemnify each landlord against losses, liabilities, and claims incurred in connection with the premises covered

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

by the Company leases, its use of the premises, property damage or personal injury, and breach of the lease agreement, as well as occurrences arising from the Company s negligence or willful misconduct. The Company also subleases certain space and agrees to indemnify the sublessee for losses caused by the Company s employees on the premises. Subject to applicable statutes of limitation, the terms of these indemnification agreements are generally perpetual from the time of execution of the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company has never incurred costs to defend lawsuits or settle claims related to these indemnification agreements.

The Company entered into three joint ventures in 2001 and 2002, which have since terminated. The terms of the joint venture agreements generally provide that the Company indemnify the joint venture partner against property damage or bodily injury arising from the Company s negligence or willful misconduct; third party claims of copyright infringement or trade secret theft associated with the software or marks licensed from the Company by the partner; and losses arising from any breach by the Company of its representations and warranties. Subject to applicable statutes of limitation, the term of these indemnification agreements is generally perpetual from the time of execution of the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company has never incurred costs to defend lawsuits or settle claims related to these indemnification agreements.

The Company leases certain equipment under operating leases that require it to indemnify the lessor against losses, liabilities and claims in connection with the lease agreement, possession or use of the leased equipment, and in some cases certain tax issues. Subject to applicable statutes of limitation, the term of these indemnification agreements is generally perpetual from the time of execution of the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company has never incurred costs to defend lawsuits or settle claims related to these indemnification agreements.

The Company licenses technology to certain third parties under license agreements that provide for Akamai to indemnify the third parties against claims of patent and copyright infringement. This indemnity generally does not apply in the event that the licensed technology has been modified by the third party or combined with other technology, hardware, or data that the Company has not approved. Subject to applicable statutes of limitation, the term of these indemnification agreements is generally perpetual from the time of execution of the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company has never incurred costs to defend lawsuits or settle claims related to these indemnification agreements.

The Company licenses technology from third parties under agreements that contain standard indemnification provisions that require the Company to indemnify the third party against losses, liabilities and claims arising from the Company s unauthorized use or modification of the licensed technology. Subject to applicable statutes of limitation, the term of these indemnification agreements is generally perpetual from the time of execution of the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. The Company has never incurred costs to defend lawsuits or settle claims related to these indemnification agreements.

Based upon the Company s historical experience and information known as of December 31, 2008, the Company believes its liabilities related to the above guarantees and indemnifications are immaterial.

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. Convertible Notes:

1% Convertible Senior Notes

In January 2004 and December 2003, Akamai issued $200.0 million in aggregate principal amount of 1% convertible senior notes due December 15, 2033 for aggregate proceeds of $194.1 million, net of an initial purchaser s discount and offering expenses of $5.9 million. The initial conversion price of the 1% convertible senior notes was $15.45 per share (equivalent to 64.7249 shares of common stock per $1,000 principal amount of 1% convertible senior notes). During 2007, the Company issued 9,379 shares of common stock in connection with the conversion of $145,000 in aggregate principal amount of its 1% convertible senior notes (at a conversion price of $15.45 per share). As of December 31, 2008, the carrying amount and fair value of the 1% convertible senior notes were $199.9 million and $221.0 million, respectively.

The notes may be converted at the option of the holder in the following circumstances:

- during any calendar quarter commencing after March 31, 2004, if the closing sale price of the common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the preceding calendar quarter is more than 120% of the conversion price in effect on such last trading day;

- if the convertible notes are called for redemption;

- if the Company makes specified distributions on its common stock or engages in specified transactions; and

- during the five trading day period immediately following any ten-consecutive trading day period in which the trading price per $1,000 principal amount of the convertible notes for each day of such ten-day period is less than 95% of the product of the closing sale price per share of the Company s common stock on that day multiplied by the number of shares of its common stock issuable upon conversion of $1,000 principal amount of the convertible notes.

The Company may redeem the 1% convertible senior notes on or after December 15, 2010 at the Company s option at 100% of the principal amount together with accrued and unpaid interest. Conversely, holders of the 1% convertible senior notes may require the Company to repurchase the notes at par value on certain specified dates beginning on December 15, 2010. In the event of a change of control, the holders may require Akamai to repurchase their 1% convertible senior notes at a repurchase price of 100% of the principal amount plus accrued interest. Interest on the 1% convertible senior notes began to accrue as of the issue date and is payable semiannually on June 15 and December 15 of each year. Deferred financing costs of $5.9 million, including the initial purchaser s discount and other offering expenses, for the 1% convertible senior notes are being amortized over the first seven years of the term of the notes to reflect the put and call rights discussed above. Amortization of deferred financing costs of the 1% convertible senior notes was approximately $0.8 million for each of the years ended December 31, 2008, 2007 and 2006. The Company records the amortization of deferred

financing costs using the effective interest method as interest expense in the consolidated statement of operations.

13. Restructurings and Lease Terminations:

As of December 31, 2008, the Company had $1.7 million of accrued restructuring liabilities. In November 2008, the Company announced a workforce reduction of 110 employees from all areas of the Company. The Company recorded $2.0 million as a restructuring charge for the amount of one-time benefits provided to affected employees. Included in these costs is a net reduction in non-cash stock-based compensation of $0.8 million, reflecting a modification to certain stock-based awards previously granted to the affected

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

employees. Additionally, in December 2008, in connection with excess and vacated facilities under long-term non-cancelable leases, the Company recorded $0.5 million as a restructuring charge for the estimated future lease payments, less estimated sublease income, for these vacated facilities. The Company expects that the remaining $1.7 million of these liabilities will be paid in 2009.

As of December 31, 2007, the Company had $0.6 million of accrued restructuring liabilities. In connection with the Speedera, Nine Systems, Netli and Red Swoosh acquisitions, the Company s management committed to plans to exit certain activities of these entities. In accordance with EITF No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination, the Company recorded, as part of the purchase prices, liabilities of $1.4 million related to workforce reductions during the year ended December 31, 2007. These liabilities primarily consisted of employee severance and outplacement costs. As of December 31, 2008, these liabilities had been paid.

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

	Leases	Severance	Total
Ending balance, December 31, 2005	$ 2.3	$ 1.3	$ 3.6
Accrual recorded in purchase accounting		0.5	0.5
Cash payments	(1.4)	(0.6)	(2.0)
Ending balance, December 31, 2006	0.9	1.2	2.1
Accrual recorded in purchase accounting		1.4	1.4
Restructuring benefit	(0.2)		(0.2)
Cash payments	(0.7)	(2.0)	(2.7)
Ending balance, December 31, 2007		0.6	0.6
Restructuring charge	0.5	2.0	2.5
Cash payments	(0.2)	(1.2)	(1.4)
Ending balance, December 31, 2008	$ 0.3	$ 1.4	$ 1.7

14. Rights Plan and Series A Junior Participating Preferred Stock:

On September 10, 2002, the Board of Directors of the Company (the Board of Directors) declared a dividend of one preferred stock purchase right for each outstanding share of the Company s common stock held by stockholders of record at the close of business on September 23, 2002. To implement the rights plan, the Board of Directors designated 700,000 shares of the Company s 5.0 million authorized shares of undesignated preferred stock as Series A Junior Participating Preferred Stock, par value $.01 per share. Each right entitles the registered holder to purchase from the Company one one-thousandth of a share of preferred stock at a purchase price of $9.00 in cash, subject to adjustment. No shares of Series A Junior Participating Preferred Stock are outstanding as of December 31, 2008. In January 2004, the Board of Directors of the Company approved an amendment to the rights plan in which the purchase price of each right issued under the plan increased from $9.00 per share to $65.00 per share.

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

15. Stockholders Equity:

Holders of the Company s common stock are entitled to one vote per share. At December 31, 2008, the Company had reserved approximately 5.9 million shares of common stock for issuance under its 1999 Employee Stock Purchase Plan (the 1999 ESPP) and upon the exercise of options and vesting of deferred stock units and restricted stock units under its other stock incentive plans. Additionally, the Company had reserved approximately 12.9 million shares issuable upon conversion of its 1% senior convertible notes.

16. Stock-Based Compensation:

Equity Plans

In 1998, the Board of Directors adopted the 1998 Stock Incentive Plan (the 1998 Plan) for the issuance of incentive and nonqualified stock options, restricted stock awards and other types of equity awards. Options to purchase common stock and other equity awards are granted at the discretion of the Board of Directors or a committee thereof. In October 2005, the Board of Directors delegated to the Company s Chief Executive Officer the authority to grant equity incentive awards to employees of the Company below the level of Vice President, subject to certain specified limitations. In December 2001, the Board of Directors adopted the 2001 Stock Incentive Plan (the 2001 Plan) for the issuance of nonqualified stock options, restricted stock awards and other types of equity awards. In March 2006, the Board of Directors adopted the Akamai Technologies, Inc. 2006 Stock Incentive Plan (the 2006 Plan) for the issuance of incentive and nonqualified stock options, restricted stock awards, restricted stock units and other types of equity awards. The total numbers of shares of common stock issuable under the 1998 Plan, the 2001 Plan and the 2006 Plan are 48,255,600, 5,000,000 and 7,500,000 shares, respectively. Equity incentive awards may not be issued to the Company s directors or executive officers under the 2001 Plan.

Under the terms of the 1998 Plan and the 2006 Plan, the exercise price of incentive stock options may not be less than 100% (110% in certain cases) of the fair market value of the common stock on the date of grant. Incentive stock options may not be issued under the 2001 Plan. The exercise price of nonqualified stock options issued under the 1998 Plan, the 2001 Plan and the 2006 Plan may be less than the fair market value of the common stock on the effective date of grant, as determined by the Board of Directors, but in no case may the exercise price be less than the statutory minimum. Stock option vesting typically occurs over four years under all of the plans, and options are granted at the discretion of the Board of Directors. Under the 1998 Plan and 2001 Plan, the term of options granted may not exceed ten years, or five years for incentive stock options granted to holders of more than 10% of the Company s voting stock. Under the 2006 Plan, the term of options granted may not exceed seven years.

The Company has assumed certain stock option plans and the outstanding stock options of companies that it has acquired (Assumed Plans). Stock options outstanding as of the date of acquisition under the Assumed Plans have been exchanged for the Company s stock options and adjusted to reflect the appropriate conversion ratio as specified by the applicable acquisition agreement, but are otherwise administered in accordance with the terms of the Assumed Plans. Stock options under the Assumed Plans generally vest over four years and expire ten years from the date of grant.

In August 1999, the Board of Directors adopted the 1999 ESPP. The Company reserved 3,100,000 shares of common stock for issuance under the 1999 ESPP. In May 2002, the stockholders of the Company approved an amendment to the 1999 ESPP that allows for an automatic increase in the number of shares of common stock available under the 1999 ESPP each June 1 and December 1 to restore the number of shares available for

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

issuance to 1,500,000 shares, provided that the aggregate number of shares issued under the 1999 ESPP shall not exceed 20,000,000. In April 2005, the Company s Board of Directors approved amendments to the 1999 ESPP as follows: the duration of the offering periods was decreased from 24 months to six months; the number of times a participant may elect to change his or her percentage during an offering period was changed from four times to two times; the definition of compensation was amended to clarify that it includes cash bonuses and other cash incentive programs; and a provision was added to clarify that upon termination of an offering period, each eligible participant will be automatically enrolled in the next offering period. These amendments became effective in June 2005. The 1999 ESPP allows participants to purchase shares of common stock at a 15% discount from the fair market value of the stock as determined on specific dates at six-month intervals. During the years ended December 31, 2008, 2007 and 2006, the Company issued 348,584, 279,356 and 295,113 shares under the 1999 ESPP, respectively, with a weighted average purchase price per share of $20.66, $34.62 and $22.0, respectively. Total cash proceeds from the purchase of shares under the 1999 ESPP in 2008, 2007 and 2006 were $7.2 million, $9.7 million and $6.5 million, respectively. As of December 31, 2008, approximately $763,000 had been withheld from employees for future purchases under the 1999 ESPP.

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 years ended December 31, 2008, 2007 and 2006 (in thousands):

	For the Years Ended December 31,		
	2008	**2007**	**2006**
Stock-based compensation expense by type of award:			
Stock options	$ 22,381	$ 29,171	$ 24,572
Deferred stock units	1,885	925	1,976
Restricted stock units	37,005	38,958	25,410
Shares issued under the 1999 ESPP	4,064	3,854	1,903
Amounts capitalized as internal-use software	(7,436)	(6,353)	(4,293)
Total stock-based compensation before income taxes	57,899	66,555	49,568
Less: Income tax benefit	(22,069)	(20,380)	(16,011)
Total stock-based compensation, net of tax	$ 35,830	$ 46,175	$ 33,557
Effect of stock-based compensation on income by line item:			
Cost of revenues	$ 2,415	$ 3,349	$ 1,960
Research and development expense	11,088	15,658	11,435
Sales and marketing expense	26,273	26,252	18,403
General and administrative expense	18,123	21,296	17,770
Provision for income taxes	(22,069)	(20,380)	(16,011)
Total cost related to stock-based compensation, net of tax	$ 35,830	$ 46,175	$ 33,557

In addition to the amounts of stock-based compensation reported in the table above, the Company s consolidated statements of operations for the years ended December 31, 2008, 2007 and 2006 also included stock-based compensation reflected as a component of amortization of capitalized internal-use software; such additional stock-based compensation was $4.2 million, $1.8 million and $0.3 million, respectively, before tax.

Akamai has selected the Black-Scholes option pricing model to determine the fair value of the Company s stock option awards. This model requires the input of subjective assumptions, including expected stock price

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

volatility and estimated life of each award. The estimated fair value of Akamai s stock-based awards, less expected forfeitures, is amortized over the awards vesting period on a straight-line basis. Expected volatilities are based on the Company s historical stock price volatility and implied volatility from traded options in its stock. The Company uses historical data to estimate the expected life of options granted within the valuation model. The risk-free interest rate for periods commensurate with the expected life of the option is based on the United States Treasury yield rate in effect at the time of grant.

The grant-date fair values of Akamai s stock option awards granted during the years ended December 31, 2008, 2007 and 2006 were estimated using the Black-Scholes option pricing model with the following weighted-average assumptions:

	For the Years Ended December 31,		
	2008	**2007**	**2006**
Expected life (years)	4.1	4.0	3.9
Risk-free interest rate (%)	2.7	4.5	4.7
Expected volatility (%)	51.5	60.5	67.5
Dividend yield (%)			

For the years ended December 31, 2008, 2007 and 2006, the weighted average fair value of Akamai s stock option awards granted was $12.34 per share, $24.24 per share and $18.10 per share, respectively.

The grant-date fair values of Akamai s ESPP awards granted during the years ended December 31, 2008, 2007 and 2006 were estimated using the Black-Scholes option pricing model with the following weighted-average assumptions:

	For the Years Ended December 31,		
	2008	**2007**	**2006**
Expected life (years)	0.5	0.5	1.1
Risk-free interest rate (%)	1.8	4.6	4.0
Expected volatility (%)	59.2	47.4	77.7
Dividend yield (%)			

For the years ended December 31, 2008, 2007 and 2006, the weighted average fair value of Akamai s ESPP awards granted was $4.58 per share, $6.24 per share and $7.39 per share, respectively.

As of December 31, 2008, total pre-tax unrecognized compensation cost for stock options, restricted stock units, deferred stock units and stock issued under ESPP was $75.9 million. This non-cash expense will be recognized through 2012 over a weighted average period of 1.2 years. Nearly all of the Company s employees have received grants through these equity compensation programs.

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes stock option activity during the years ended December 31, 2008, 2007 and 2006:

	Shares (in thousands)	Weighted Average Exercise Price
Outstanding at December 31, 2005	16,276	$ 8.65
Granted (including those for business acquisitions)	1,932	26.96
Exercised	(4,153)	5.18
Forfeited and expired	(808)	12.19
Outstanding at December 31, 2006	13,247	12.33
Granted (including those for business acquisitions)	1,629	36.97
Exercised	(2,493)	8.80
Forfeited and expired	(349)	26.17
Outstanding at December 31, 2007	12,034	15.83
Granted	1,162	28.20
Exercised	(2,445)	5.84
Forfeited and expired	(371)	38.97
Outstanding at December 31, 2008	10,380	18.76
Exercisable at December 31, 2008	7,994	14.60

The total pre-tax intrinsic value of options exercised during the years ended December 31, 2008, 2007 and 2006 was $63.5 million, $91.7 million and $131.6 million, respectively. The total fair value of options vested for the years ended December 31, 2008, 2007 and 2006 was $15.0 million, $22.7 million and $20.3 million, respectively. The aggregate fair values of stock options vested for the years ended December 31, 2008 and 2007 were calculated net of capitalized stock-based compensation of $7.4 million and $6.4 million, respectively. The aggregate fair value of stock options vested for the year ended December 31, 2006 was calculated net of capitalized stock-based compensation of $4.3 million. Cash proceeds from the exercise of stock options were $14.2 million, $22.0 million and $21.4 million for the years ended December 31, 2008, 2007 and 2006, respectively. Income tax benefits realized from the exercise of stock options during the years ended December 31, 2008, 2007 and 2006 were approximately $44.9 million, $83.2 million and $103.3 million, respectively.

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes stock options that are outstanding and expected to vest and stock options exercisable at December 31, 2008:

	Options Outstanding and Expected to Vest				Options Exercisable			
Range of Exercise Price ($)	Number of Options (In thousands)	Weighted Average Remaining Contractual Life (In years)	Weighted Average Exercise Price	Aggregate Intrinsic Value (In thousands)	Number of Options (In thousands)	Weighted Average Remaining Contractual Life (In years)	Weighted Average Exercise Price	Aggregate Intrinsic Value (In thousands)
0.01-0.92	486	3.8	$ 0.75	$ 6,975	482	3.8	$ 0.75	$ 6,914
0.96-1.65	384	3.9	1.58	5,181	384	3.9	1.58	5,181
2.27-4.08	316	3.9	3.26	3,737	296	3.6	3.27	3,497
4.10-5.44	1,338	4.1	4.84	13,712	1,307	4.1	4.85	13,375
5.49-8.28	59	4.3	6.07	535	49	3.4	5.74	457
8.55-12.81	671	5.8	11.87	2,163	602	5.6	11.82	1,965
12.85-14.90	3,350	5.8	14.29	2,672	3,209	5.8	14.29	2,569
15.22-22.47	673	5.0	17.17		495	4.3	16.97	
22.97-34.45	1,521	8.0	28.85		548	7.0	27.15	
35.05-52.46	945	7.1	43.56		375	6.5	44.58	
54.26-76.06	484	5.7	56.13		233	5.6	56.70	
85.00-93.94	24	1.5	85.65		24	1.5	85.65	
	10,251	5.7	18.59	$ 34,975	8,004	5.2	14.60	$ 33,958
Expected forfeitures	129							
Total options outstanding	10,380							

The aggregate intrinsic value in the preceding table represents the total pre-tax intrinsic value, based on Akamai s closing stock price of $15.09 on December 31, 2008, that would have been received by the option holders had all option holders exercised their in-the-money options as of that date. The total number of shares related to in-the-money options exercisable as of December 31, 2008 was approximately 7.2 million.

Deferred Stock Units

In May 2008, the Company granted an aggregate of 47,291 deferred stock units (DSUs) to non-employee members of its Board of Directors and its Executive Chairman. During each of 2007 and 2006, the Company granted an aggregate of approximately 56,000 DSUs to non-employee members of its Board of Directors and to the Company s Executive Chairman. Each DSU represents the right to receive one share of the Company s common stock upon vesting. The holder may elect to defer receipt of all or a portion of the vested shares of stock represented by the DSU for a period for at least one year but not more than ten years from the grant date. The DSUs typically vest 50% upon the first anniversary of grant date, with the remaining 50% vesting in equal installments of 12.5% each quarter thereafter.

In September 2006, the Company s Board of Directors adopted a policy (the Policy) with respect to the payment of compensation to a director in good standing upon such director s departure from the Board. Pursuant to the Policy, upon a director s departure from the Board, such director will receive a cash payment equal to the annual cash retainer payable to such director under the Company s non-employee director compensation plan pro-rated through the date of departure and 100% of the unvested shares underlying the DSUs held by such director will accelerate at the time of departure and become exercisable in full. In addition, if a director has completed three years of Board service at the time of departure, 100% of the unvested options initially granted to such director upon joining the Board will accelerate at the time of departure and become fully exercisable.

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the DSU activity for the years ended December 31, 2008, 2007 and 2006 (in thousands, except grant-date fair values):

	Units	Weighted Average Grant-Date Fair Value
Outstanding at December 31, 2005	194	$ 9.34
Granted	34	31.15
Vested and distributed	(30)	40.63
Outstanding at December 31, 2006	198	12.55
Granted	22	42.30
Vested and distributed	(24)	18.87
Outstanding at December 31, 2007	196	15.03
Granted	47	39.86
Vested and distributed	(36)	7.96
Outstanding at December 31, 2008	207	24.86

The total fair value of DSUs that vested during the year ended December 31, 2008 was $1.9 million. The grant-date fair value is calculated based upon the Company s closing stock price on the date of grant. As of December 31, 2008, 52,762 DSUs were unvested, with an aggregate intrinsic value of approximately $3.1 million and a weighted average remaining contractual life of approximately 1.3 years. These units are expected to vest through May 2010. All DSUs vest upon fulfilling service conditions or upon a director s departure from the Board under the terms of the Policy. The total fair value of DSUs that vested during the years ended December 31, 2007 and 2006 was $0.9 million and $1.2 million, respectively.

Restricted Stock Units

The following table summarizes the different types of restricted stock units (RSUs) granted by the Company (in thousands):

	For the Year Ended December 31,		
	2008	2007	2006
RSUs with service-based vesting conditions	1,529	588	834
RSUs with performance-based vesting conditions	898	1,409	2,412
Total	2,427	1,997	3,246

Each RSU represents the right to receive one share of the Company s common stock upon vesting. The fair value of these RSUs was calculated based upon the Company s closing stock price on the date of grant, and the stock-based compensation expense is being recognized over the vesting period. Most RSUs with service-based vesting provisions vest in installments over a

three- or four-year period following the grant date.

The Company also granted performance-based RSUs in 2008, 2007 and 2006 to certain employees. These performance-based RSUs will only vest if the Company exceeds specified cumulative revenue and earnings per share targets over a period of three consecutive fiscal years commencing with the year in which the RSU was granted. For performance-based RSUs granted in 2006 and 2007, the maximum number of performance-based RSUs that may vest is equal to 300% of the number of non-performance-based RSUs granted on the same date.

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For performance-based RSUs granted in 2008, the maximum number of performance-based RSUs that may vest is equal to 50% of the number of non-performance-based RSUs granted on the same date. In each case, such maximum vesting would only occur if the Company meets or exceeds a specified percentage of both its cumulative revenue and earnings per share targets for the three designated fiscal years and no performance-based RSUs will vest if the Company fails to exceed the applicable targets. If the Company s cumulative revenue and/or earnings per share results for the applicable years are between 100% and the specified percentage of the targets, the holder would receive between zero performance-based RSUs and the maximum deliverable amount set forth above. For the years ended December 31, 2008, 2007 and 2006, management measured compensation expense for these performance-based RSUs based upon a review of the Company s expected achievement of future cumulative performance. Such compensation cost is being recognized ratably over three years for each series of grants, as these awards vest only in their entirety upon achievement of the specified targets. Management will continue to review the Company s expected performance and adjust the compensation cost, if needed, at such time.

The following table summarizes the RSU activity for the years ended December 31, 2008, 2007 and 2006 (in thousands, except grant-date fair values):

	Units	Weighted Average Grant-Date Fair Value
Granted	3,246	$ 25.45
Forfeited	(106)	25.54
Outstanding at December 31, 2006	3,140	25.44
Granted	1,997	52.67
Exercised	(286)	26.66
Forfeited	(256)	35.78
Outstanding at December 31, 2007	4,595	36.67
Granted	2,427	30.33
Exercised	(434)	36.96
Forfeited	(389)	39.74
Outstanding at December 31, 2008	6,199	34.64

The grant-date fair value of each RSU is calculated based upon the Company s closing stock price on the date of grant. As of December 31, 2006, 3.1 million RSUs were outstanding and unvested, with an aggregate intrinsic value of $166.8 million and a weighted average remaining contractual life of approximately 2.1 years. As of December 31, 2007, 4.6 million RSUs were outstanding and unvested, with an aggregate intrinsic value of $159.0 million and a weighted average remaining contractual life of approximately 1.5 years. As of December 31, 2008, 6.2 million RSUs were outstanding and unvested, with an aggregate intrinsic value of $93.6 million and a weighted average remaining contractual life of approximately 1.1 years. These RSUs are expected to vest on various dates through November 2011.

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

17. Employee Benefit Plan:

In January 1999, the Company established a savings plan for its employees that is designed to be qualified under Section 401(k) of the Internal Revenue Code. Eligible employees are permitted to contribute to the 401(k) plan through payroll deductions within statutory and plan limits. Participants may select from a variety of investment options. Investment options do not include Akamai common stock. For 2007 and 2006, the Company made matching contributions of 1/2 of the first 2% of employee contributions in each year and then matched 1/4 of the next 4% of employee contributions. The maximum amount of the Company match was $1,000 per employee per year for the years 2007 and 2006. Effective January 1, 2008, the Company amended its matching contribution to 1/2 of the first 8% of employee contributions in each year, with the maximum amount of the Company match at $2,000 per employee per year. The Company s contributions vest 25% per annum. The Company contributed approximately $1.9 million, $0.9 million and $0.6 million of cash to the savings plan for the years ended December 31, 2008, 2007 and 2006, respectively.

18. Income Taxes:

The components of income before provision for income taxes were as follows (in thousands):

	For the Years Ended December 31,		
	2008	**2007**	**2006**
Domestic	$ 225,079	$ 156,219	$ 90,009
Foreign	9,456	11,986	8,460
Income before provision for income taxes	$ 234,535	$ 168,205	$ 98,469

The provision for income taxes consisted of the following (in thousands):

	For the Years Ended December 31,		
	2008	**2007**	**2006**
Current tax provision			
Federal	$ 2,099	$	$
State	2,974	292	203
Foreign	2,626	1,685	2,383
Deferred tax provision (benefit)			
Federal	79,045	51,567	30,624
State	1,776	6,764	8,740
Foreign	825	1,640	(882)
Change in valuation allowance	52	5,290	
	$ 89,397	$ 67,238	$ 41,068

92

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company s effective rate differed from the statutory rate as follows:

	For the Years Ended December 31,		
	2008	**2007**	**2006**
United States federal income tax rate	35.0%	35.0%	35.0%
State taxes	3.8	4.4	4.5
Nondeductible stock-based compensation	1.6	2.7	5.8
United States federal and state research and development credits	(1.3)	(4.6)	(4.2)
Change in state tax rates	0.6		1.7
Foreign earnings		0.1	0.2
Other	(1.6)	(0.7)	(1.5)
Change in the deferred tax asset valuation allowance		3.1	
	38.1%	40.0%	41.5%

The components of the net deferred tax asset and the related valuation allowance were as follows (in thousands):

	December 31,	
	2008	**2007**
Net operating loss and credit carryforwards	$ 150,041	$ 225,324
Depreciation and amortization	68,502	77,893
Compensation costs	40,227	28,089
Impairment loss on marketable securities	14,767	
Other	15,539	17,982
Deferred tax assets	289,076	349,288
Acquired intangible assets not deductible	(36,271)	(34,418)
Internal-use software capitalized	(17,449)	(12,102)
Deferred tax liabilities	(53,720)	(46,520)
Valuation allowance	(7,096)	(11,158)
Net deferred tax assets	$ 228,260	$ 291,610

As of December 31, 2008, the Company had United States federal NOL carryforwards of approximately $319.1 million and state NOL carryforwards of approximately $186.4 million, which expire at various dates through 2026. The Company also had foreign NOL carryforwards of approximately $3.4 million as of December 31, 2008. The majority of the foreign NOL carryforwards have no expiration dates. As of December 31, 2007, the Company had United States federal NOL carryforwards of $539.6 million, state NOL carryforwards of $186.5 million, and foreign NOL carryforwards of $4.5 million. As of December 31, 2008 and 2007,

the Company had United States federal and state research and development tax credit carryforwards of $25.6 million and $24.8 million, respectively, which will expire at various dates through 2028. As of December 31, 2008 and 2007, the Company had foreign tax credit carryforwards of $7.0 million and $5.2 million, respectively, which expire at various dates through 2018.

As of December 31, 2008, the Company had a total valuation allowance of $7.1 million. During the fourth quarter of 2008, the Company recorded a decrease in valuation allowance of $2.9 million against capital loss

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

carryforwards that expired unused. The other $1.1 million reduction in the valuation allowance in 2008 was due to a reclassification of that amount to unrecognized tax benefits of prior periods, as reflected in the table below.

The Company plans to reinvest indefinitely its undistributed foreign earnings. As of December 31, 2008, the Company had approximately $10.8 million of undistributed foreign earnings.

In June 2006, the FASB issued FIN 48, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a two-step process to determine the amount of tax benefit to be recognized. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon external examination. If the tax position is deemed more-likely-than-not to be sustained, the tax position is then assessed to determine the amount of benefit to recognize in the financial statements. The amount of the benefit that may be recognized is the largest amount that has a greater than 50 percent likelihood of being realized upon ultimate settlement. The Company adopted the provisions of FIN 48 on January 1, 2007. As of the date of adoption, the Company had unrecognized tax benefits of $2.1 million, including accrued interest and penalties, and did not record any cumulative effect adjustment to retained earnings as a result of adopting FIN 48.

The following is a roll-forward of the Company s unrecognized tax benefits (in millions):

	For the Years Ended December 31,	
	2008	2007
	(in millions)	
Unrecognized tax benefits at beginning of year	$ 3.2	$ 1.5
Gross increases tax positions of prior periods	1.1	1.3
Gross decreases tax positions of prior periods		(0.6)
Gross increases current-period tax positions	1.0	1.6
Lapse of statute of limitations	(0.5)	(0.6)
Unrecognized tax benefits at end of year	$ 4.8	$ 3.2

As of December 31, 2008 and December 31, 2007, the Company had approximately $6.1 million and $4.0 million, respectively, of total unrecognized tax benefits, including $1.3 million and $0.8 million, respectively, of accrued interest and penalties. Interest and penalties related to unrecognized tax benefits are recorded in income tax expense. If recognized, all amounts of unrecognized tax benefits would have resulted in a reduction of income tax expense, impacting the effective income tax rate.

The Company s foreign subsidiaries file income tax returns in various foreign jurisdictions. Certain of these foreign subsidiaries have unrecognized tax benefits related to transfer pricing policies that existed in prior years. The statute of limitations expired in these foreign jurisdictions in 2008, which resulted in the recognition of approximately $0.5 million of benefit.

Generally, all tax years are open for examination by the major taxing jurisdictions to which the Company is subject including federal, state and foreign jurisdictions due to net operating losses and the limited number of prior year audits by taxing jurisdictions. The Company is currently under tax examination by the U.S. Internal Revenue Service for the tax year ended December 31, 2006.

Table of Contents

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

19. Segment and Geographic Information:

Akamai s chief decision-maker, as defined under SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information (SFAS No. 131), is the Chief Executive Officer and the executive management team. As of December 31, 2008, Akamai operated in one industry segment: providing global 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 by SFAS No. 131.

The Company deploys its servers into networks worldwide. As of December 31, 2008, the Company had approximately $138.6 million and $35.9 million of property and equipment, net of accumulated depreciation, located in the United States and foreign locations, respectively. As of December 31, 2007, the Company had approximately $107.9 million and $26.6 million of property and equipment, net of accumulated depreciation, located in the United States and foreign locations, respectively.

Akamai sells its services and licenses through a sales force located both domestically and abroad. For the years ended December 31, 2008, 2007 and 2006, approximately 25%, 23% and 22%, respectively, of revenues was derived from the Company s operations outside the United States, of which 18%, 17% and 18% of overall revenues, respectively, were related to Europe. Other than the United States, no single country accounted for 10% or more of the Company s total revenues for any reported period.

95

AKAMAI TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

20. Quarterly Financial Results (unaudited):

The following table sets forth certain unaudited quarterly results of operations of the Company for the years ended December 31, 2008 and 2007. In the opinion of management, this information has been prepared on the same basis as the audited consolidated financial statements and all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts below for a fair statement of the quarterly information when read in conjunction with the audited consolidated financial statements and related notes.

	For the Three Months Ended			
	March 31, 2008	June 30, 2008	Sept. 30, 2008	Dec. 31, 2008
	(In thousands, except per share data)			
Revenues	$ 187,019	$ 194,004	$ 197,347	$ 212,554
Cost of revenues	$ 51,575	$ 53,688	$ 56,659	$ 60,688
Net income	$ 36,911	$ 34,334	$ 33,360	$ 40,533
Basic net income per share	$ 0.22	$ 0.21	$ 0.20	$ 0.24
Diluted net income per share	$ 0.20	$ 0.19	$ 0.18	$ 0.22
Basic weighted average common shares	165,959	167,417	168,474	168,843
Diluted weighted average common shares	185,744	187,641	187,769	186,694

	For the Three Months Ended			
	March 31, 2007	June 30, 2007	Sept. 30, 2007	Dec. 31, 2007
	(In thousands, except per share data)			
Revenues	$ 139,274	$ 152,654	$ 161,240	$ 183,238
Cost of revenues	$ 34,480	$ 39,759	$ 43,811	$ 49,394
Net income	$ 19,179	$ 21,646	$ 24,264	$ 35,878
Basic net income per share	$ 0.12	$ 0.13	$ 0.15	$ 0.22
Diluted net income per share	$ 0.11	$ 0.12	$ 0.13	$ 0.20
Basic weighted average common shares	161,569	164,798	165,474	164,768
Diluted weighted average common shares	183,157	185,601	185,106	185,294

Table of Contents

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2008. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2008, our disclosure controls and procedures were (1) effective in that they were designed to ensure that material information relating to us, including our consolidated subsidiaries, is made known to our Chief Executive Officer and Chief Financial Officer by others within those entities, particularly during the period in which this report was being prepared, as appropriate to allow timely discussions regarding required disclosure therein and (2) effective, in that they provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission s rules and forms.

Management s Annual Report on Internal Control over Financial Reporting

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) or 15d-15(f) promulgated under the Exchange Act as a process designed by, or under the supervision of, our principal executive and principal financial officers and effected by the company s board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company s assets that could have a material effect on the financial statements.

To assist management, we have established an internal audit function to verify and monitor our internal controls and procedures. Because of its inherent limitations, however, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2008. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework*.

Based on our assessment, management, with the participation of our Chief Executive Officer and Chief Financial Officer, concluded that, as of December 31, 2008, our internal control over financial reporting was effective based on those criteria at the reasonable assurance level.

Table of Contents

The effectiveness of the Company s internal control over financial reporting as of December 31, 2008 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report, which is included in Item 8 of this annual report on Form 10-K.

Changes in Internal Control over Financial Reporting

No changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None.

Table of Contents

PART III

Item 10. ***Directors, Executive Officers and Corporate Governance***

The complete response to this Item regarding the backgrounds of our executive officers and directors and other information required by Items 401, 405 and 407 of Regulation S-K will be contained in our definitive proxy statement for our 2009 Annual Meeting of Stockholders under the captions Executive Compensation Matters, Section 16(a) Beneficial Ownership Reporting Compliance and Corporate Governance Matters and is incorporated herein.

Our executive officers and directors and their positions as of March 2, 2009, are as follows:

Name	Position
Paul Sagan	President, Chief Executive Officer and Director
George H. Conrades	Executive Chairman of the Board of Directors
F. Thomson Leighton	Chief Scientist and Director
Debra Canner	Senior Vice President Human Resources
Melanie Haratunian	Senior Vice President and General Counsel
Robert W. Hughes	Executive Vice President, Global Sales, Services and Marketing
J. Donald Sherman	Chief Financial Officer
Martin M. Coyne II	Director
C. Kim Goodwin	Director
Ronald L. Graham	Director
Jill A. Greenthal	Director
David W. Kenny	Director
Peter J. Kight	Director
Geoffrey Moore	Director
Frederic V. Salerno	Director
Naomi O. Seligman	Director

We have adopted a written code of business ethics, as amended, that applies to our principal executive officer, principal financial or accounting officer or person serving similar functions and all of our other employees and members of our Board of Directors. The text of our amended code of ethics is available on our website at www.akamai.com. We did not waive any provisions of the code of business ethics during the year ended December 31, 2008. If we amend, or grant a waiver under, our code of business ethics that applies to our principal executive officer, principal financial or accounting officer, or persons performing similar functions, we intend to post information about such amendment or waiver on our website at *www.akamai.com*.

Table of Contents

Item 11. ***Executive Compensation***

The information required by this Item is incorporated by reference herein to our definitive proxy statement for our 2009 Annual Meeting of Stockholders under the sections captioned Executive Compensation Matters, Compensation Committee Interlocks and Insider Participation and Director Compensation.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

The information required by this Item is incorporated by reference herein to our definitive proxy statement for our 2009 Annual Meeting of Stockholders under the sections captioned Security Ownership of Certain Beneficial Owners and Management and Securities Authorized for Issuance Under Equity Compensation Plans.

Item 13. ***Certain Relationships, Related Transactions, and Director Independence***

The information required by this Item is incorporated by reference herein to our definitive proxy statement for our 2009 Annual Meeting of Stockholders under the sections captioned Certain Relationships and Related Party Transactions, Corporate Governance Matters and Compensation Committee Interlocks and Insider Participation.

Item 14. ***Principal Accountant Fees and Services***

The information required by this Item is incorporated by reference herein to our definitive proxy statement for our 2009 Annual Meeting of Stockholders under the section captioned Ratification of Selection of Independent Auditors.

Table of Contents

PART IV

Item 15. ***Exhibits and Financial Statement Schedules***

(a) The following documents are included in this annual report on Form 10-K.

1. Financial Statements (see Item 8 Financial Statements and Supplementary Data included in this annual report on Form 10-K).

2. The schedule listed below and the Report of Independent Registered Public Accounting Firm on Financial Statement Schedule are filed as part of this annual report on Form 10-K:

	Page
Schedule II Valuation and Qualifying Accounts	S-1

All other schedules are omitted as the information required is inapplicable or the information is presented in the consolidated financial statements and the related notes.

3. The exhibits required by Item 601 of Regulation S-K and Item 15(b) of this Annual Report on Form 10-K are listed in the Exhibit Index immediately preceding the exhibits and are incorporated herein.

(b) The exhibits required by Item 601 of Regulation S-K are listed in the Exhibit Index immediately preceding the exhibits and are incorporated herein.

(c) Not applicable.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

March 2, 2009 AKAMAI TECHNOLOGIES, INC.

By: /s/ J. DONALD SHERMAN
J. Donald Sherman

Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ PAUL SAGAN **Paul Sagan**	President and Chief Executive Officer and Director (Principal executive officer)	March 2, 2009
/s/ J. DONALD SHERMAN **J. Donald Sherman**	Chief Financial Officer (Principal financial and accounting officer)	March 2, 2009
/s/ GEORGE H. CONRADES **George H. Conrades**	Director	March 2, 2009
/s/ MARTIN M. COYNE II **Martin M. Coyne II**	Director	March 2, 2009
/s/ C. KIM GOODWIN **C. Kim Goodwin**	Director	March 2, 2009
/s/ RONALD L. GRAHAM **Ronald L. Graham**	Director	March 2, 2009
/s/ JILL A. GREENTHAL **Jill A. Greenthal**	Director	March 2, 2009
/s/ DAVID W. KENNY **David W. Kenny**	Director	March 2, 2009

/s/ Peter J. Kight	Director	March 2, 2009
Peter J. Kight		
/s/ F. Thomson Leighton	Director	March 2, 2009
F. Thomson Leighton		
/s/ Geoffrey Moore	Director	March 2, 2009
Geoffrey Moore		
/s/ Frederic V. Salerno	Director	March 2, 2009
Frederic V. Salerno		
/s/ Naomi O. Seligman	Director	March 2, 2009
Naomi O. Seligman		

Table of Contents

AKAMAI TECHNOLOGIES, INC.

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

Description	Balance at beginning of period	Charged to operations	Other	Deductions	Balance at end of period
Year ended December 31, 2006:					
Allowances deducted from asset accounts:					
Reserves for accounts receivable	$ 4,815	3,019[2]	115	(2,481)[3]	$ 5,468
Deferred tax asset valuation allowance	$ 6,861		4,439[1]	(4,962)	$ 6,338
Year ended December 31, 2007:					
Allowances deducted from asset accounts:					
Reserves for accounts receivable	$ 5,468	6,434[2]	337	(1,848)[3]	$ 10,391
Deferred tax asset valuation allowance	$ 6,338	5,290	75[1]	(545)	$ 11,158
Year ended December 31, 2008:					
Allowances deducted from asset accounts:					
Reserves for accounts receivable	$ 10,391	7,303[2]	(308)	(6,116)[3]	$ 11,270
Deferred tax asset valuation allowance	$ 11,158	52	(1,109)[1]	(3,005)	$ 7,096

1 Amounts related to items with no income statement effect such as the impact of stock options, acquired intangible assets and acquired net operating losses.

2 Amounts represent charges to bad debt expense and reductions to revenue for increases to the allowance for doubtful accounts and to the reserve for cash-basis customers.

3 Amounts represent cash collections from customers for accounts previously reserved and write-offs of accounts receivable recorded against the allowance for doubtful accounts or the reserve for cash-basis customers.

S-1

Table of Contents

EXHIBIT INDEX

3.1(A)	Amended and Restated Certificate of Incorporation of the Registrant
3.2(B)	Amended and Restated By-Laws of the Registrant, as amended
3.3(C)	Certificate of Designations of Series A Junior Participating Preferred Stock of the Registrant
4.1(D)	Specimen common stock certificate
4.2(E)	Indenture, dated as of December 12, 2003 by and between the Registrant and U.S. Bank National Association
4.3(F)	Rights Agreement, dated September 10, 2002, by and between the Registrant and Equiserve Trust Company, N.A.
4.4(G)	Amendment No. 1, dated as of January 29, 2004, to the Rights Agreement, dated as of September 10, 2002, between the Registrant and EquiServe Trust Company, N.A., as Rights Agent
10.1(H)@	Second Amended and Restated 1998 Stock Incentive Plan of the Registrant, as amended
10.2(I)@	Amended and Restated 1999 Employee Stock Purchase Plan of the Registrant, as amended
10.3(J)@	2001 Stock Incentive Plan of the Registrant
10.4(K)	2006 Stock Incentive Plan of the Registrant
10.5(L)	Speedera Networks, Inc. 1999 Stock Incentive Plan
10.6(M)	Nine Systems Corporation (formerly known as Streaming Media Corporation) 2002 Stock Option Plan
10.7(N)	Netli, Inc. Amended and Restated Stock Option Plan
10.8(N)	Netli, Inc. 2002 Equity Incentive Plan
10.9(D)@	Form of Incentive Stock Option Agreement granted under the 1998 Stock Incentive Plan of the Registrant
10.10(D)@	Form of Nonstatutory Stock Option Agreement granted under the 1998 Stock Incentive Plan of the Registrant
10.11(O)@	Form of Incentive Stock Option Agreement granted under the 2006 Stock Incentive Plan of the Registrant
10.12(O)@	Form of Nonstatutory Stock Option Agreement granted under the 2006 Stock Incentive Plan of the Registrant
10.13	Form of Deferred Stock Unit Agreement for Directors of the Registrant
10.14@	Form of Restricted Stock Unit Agreement with Annual Vesting
10.15@	Form of Restricted Stock Unit Agreement with Performance-Based Vesting
10.16@	Form of Restricted Stock Unit Agreement with Annual Performance-Based Vesting
10.17(P)	Amended and Restated 1999 Stock Compensation Plan of Acerno Intermediate Holdings, Inc.
10.18(R)	

	Summary of the Registrant s Compensatory Arrangements with Non-Employee Directors
10.19	Summary of the Registrant s Compensatory Arrangements with Executive Officers
10.20(W)@	Form of Incentive Stock Option Agreement with Financial Performance-Related Vesting Provisions

Table of Contents

10.21	Office Lease Agreement dated March 31, 2008 between the Registrant and Locon San Mateo, LLC
10.22(Q)	Four Cambridge Center Lease Agreement dated October 1, 2007
10.23(Q)	Eight Cambridge Center Lease Agreement dated October 1, 2007
10.24(D)	Patent and Copyright License Agreement, dated as of October 26, 1998, between the Registrant and Massachusetts Institute of Technology
10.25(Q)@	Incentive Stock Option Agreement, dated February 8, 2008, by and between the Registrant and Robert W. Hughes
10.26(R)@	Incentive Stock Option Agreement, dated as of September 19, 2002, by and between the Registrant and Paul Sagan
10.27(S)@	Employment Offer Letter Agreement dated January 4, 2005 by and between the Registrant and Paul Sagan
10.28(T)@	Amendment to Employment Agreement dated August 9, 2006 between the Registrant and Paul Sagan
10.29@	Amendment to Employment Agreement dated December 31, 2008 between the Registrant and Paul Sagan
10.30(T)@	Incentive Stock Option Agreement dated February 14, 2005 between the Registrant and Paul Sagan
10.31(U)@	Employment Offer Letter Agreement dated October 14, 2005 between the Registrant and J. Donald Sherman
10.32(V)@	Form of J. Donald Sherman Restricted Stock Unit Agreement
10.33@	Form of 2009 Executive Bonus Plan
10.34@	Akamai Technologies, Inc. Executive Severance Pay Plan
10.35@	Form of Executive Change of Control and Severance Agreement
10.36(T)@	Akamai Technologies, Inc. Policy on Departing Director Compensation
10.37@	Form of Robert W. Hughes 2009 Executive Bonus Plan
21.1(R)	Subsidiaries of the Registrant
23.1	Consent of Independent Registered Public Accounting Firm
31.1	Certification of Chief Executive Officer pursuant to Rule 13a- 14(a)/Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification of Chief Financial Officer pursuant to Rule 13a- 14(a)/Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.1	Agreement and Plan of Merger dated October 20, 2008, by and among the Registrant, Arrow Acquisition Corp., IB Holdco Inc., I-Behavior, Inc., IB Spinco LLC and the representative of the selling equity holders.

(A) Incorporated by reference to the Registrant s Quarterly Report on Form 10-Q filed with the Commission on August 14, 2000.
(B) Incorporated by reference to the Registrant s Quarterly Report on Form 10-Q filed with the Commission on May 12, 2008.
(C) Incorporated by reference to the Registrant s Quarterly Report on Form 10-Q filed with the Commission on November 14, 2002.
(D) Incorporated by reference to the Registrant s Registration Statement on Form S-1 (File No. 333-85679), as amended, filed with the Commission on August 20, 1999.
(E) Incorporated by reference to the Registrant s Current Report on Form 8-K filed with the Commission on December 16, 2003.
(F) Incorporated by reference to the Registrant s Current Report on Form 8-K filed with the Commission on September 11, 2002.
(G) Incorporated by reference to the Registrant s Current Report on Form 8-K filed with the Commission on February 2, 2004.
(H) Incorporated by reference to the Registrant s Quarterly Report on Form 10-Q filed with the Commission on August 9, 2004.
(I) Incorporated by reference to the Registrant s Annual Report on Form 10-K filed with the Commission on March 16, 2006.
(J) Incorporated by reference to the Registrant s Annual Report on Form 10-K filed with the Commission on February 27, 2002.
(K) Incorporated by reference to the Registrant s Current Report on Form 8-K filed with the Commission on May 26, 2006.
(L) Incorporated by reference to the Registrant s Registration Statement on Form S-8 filed with the Commission on June 24, 2005.
(M) Incorporated by reference to the Registrant s Registration Statement on Form S-8 (File No. 333-139408) filed with the Commission on December 15, 2006.
(N) Incorporated by reference to the Registrant s Registration Statement on Form S-8 (File No. 333-141854) filed with the Commission on April 3, 2007.
(O) Incorporated by reference to the Registrant s Annual Report on Form 10-K filed with the Commission on March 1, 2007.
(P) Incorporated by reference to the Registrant s Registration Statement on Form S-8 filed with the Commission on November 18, 2008.
(Q) Incorporated by reference to the Registrant s Annual Report on Form 10-K filed with the Commission on March 3, 2008.
(R) Incorporated by reference to the Registrant s Quarterly Report on Form 10-Q filed with the Commission on November 14, 2002.
(S) Incorporated by reference to the Registrant s Annual Report on Form 10-K filed with the Commission on March 16, 2005.
(T) Incorporated by reference to the Registrant s Quarterly Report on Form 10-Q filed with the Commission on November 9, 2006.
(U) Incorporated by reference to the Registrant s Current Report on Form 8-K filed with the Commission on October 20, 2005.
(V) Incorporated by reference to the Registrant s Current Report on Form 8-K filed with the Commission on March 8, 2006.
(W) Incorporated by reference to the Registrant s Current Report on Form 8-K filed with the Commission on July 27, 2005.
@ Management contract or compensatory plan or arrangement filed as an exhibit to this Annual Report on Form 10-K pursuant to Item 15(b) of this Annual Report.
Confidential Treatment has been requested as to certain portions of this Exhibit. Such portions have been omitted and filed separately with the Securities and Exchange Commission.