AKAMAI TECHNOLOGIES INC
Form 10-Q
August 11, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2014

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 0-27275

Akamai Technologies, Inc.

(Exact name of registrant as specified in its charter)

Delaware	04-3432319
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

8 Cambridge Center
Cambridge, MA 02142
(617) 444-3000
(Address, Including Zip Code, and Telephone Number,
Including Area Code, of Registrant's Principal Executive Offices)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act") during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No x
The number of shares outstanding of the registrant's common stock as of August 6, 2014: 178,163,132

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AKAMAI TECHNOLOGIES, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2014

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED BALANCE SHEETS

(in thousands, expect share data)	June 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$254,165	$333,891
Marketable securities	502,608	340,005
Accounts receivable, net of reserves of $6,618 and $3,703 at June 30, 2014 and December 31, 2013, respectively	325,385	271,988
Prepaid expenses and other current assets	88,047	62,096
Deferred income tax assets	29,462	21,734
Total current assets	1,199,667	1,029,714
Property and equipment, net	536,637	450,287
Marketable securities	735,629	573,026
Goodwill	1,049,047	757,368
Acquired intangible assets, net	149,218	77,429
Deferred income tax assets	2,317	2,325
Other assets	96,142	67,536
Total assets	$3,768,657	$2,957,685
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable	$70,534	$73,710
Accrued expenses	158,646	150,385
Deferred revenue	48,182	36,952
Other current liabilities	5,930	2,119
Total current liabilities	283,292	263,166
Deferred revenue	4,056	3,199
Deferred income tax liabilities	40,385	4,737
Convertible senior notes	595,385	—
Other liabilities	72,795	57,152
Total liabilities	995,913	328,254
Commitments and contingencies		
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; 181,546,263 shares issued and 178,270,354 shares outstanding at June 30, 2014 and 178,580,696 shares issued and outstanding at December 31, 2013	1,844	1,808
Additional paid-in capital	4,742,423	4,561,929
Accumulated other comprehensive income (loss)	2,497	(2,091)
Treasury stock, at cost, 3,275,909 shares at June 30, 2014 and no shares at December 31, 2013	(187,491)	—

Accumulated deficit	(1,786,529)	(1,932,215)
Total stockholders’ equity	2,772,744	2,629,431
Total liabilities and stockholders’ equity	$3,768,657	$2,957,685

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

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AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
(in thousands, except per share data)	2014	2013	2014	2013
Revenue	$476,035	$378,106	$929,537	$746,152
Costs and operating expenses:				
Cost of revenue	149,318	124,705	288,930	245,097
Research and development	32,052	20,597	60,286	42,502
Sales and marketing	91,462	67,825	172,527	130,515
General and administrative	81,880	61,351	158,041	116,731
Amortization of acquired intangible assets	8,403	5,734	15,251	11,794
Restructuring charges	569	391	1,304	822
Total costs and operating expenses	363,684	280,603	696,339	547,461
Income from operations	112,351	97,503	233,198	198,691
Interest income	1,740	1,477	3,379	3,085
Interest expense	(4,516)	—	(6,457)	—
Other (expense) income, net	(899)	341	(1,780)	209
Income before provision for income taxes	108,676	99,321	228,340	201,985
Provision for income taxes	35,790	37,426	82,654	68,603
Net income	$72,886	$61,895	$145,686	$133,382
Net income per share:				
Basic	$0.41	$0.35	$0.82	$0.75
Diluted	$0.40	$0.34	$0.80	$0.73
Shares used in per share calculations:				
Basic	178,081	177,891	178,393	177,895
Diluted	180,841	181,388	181,439	181,475

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

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AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
(in thousands)	2014	2013	2014	2013
Net income	$72,886	$61,895	$145,686	$133,382
Other comprehensive income (loss):				
Foreign currency translation adjustments	1,459	(3,746)	2,826	(7,760)
Change in unrealized gain (loss) on investments, net of income tax (provision) benefit of $(514), $913, $(391), and $62 for the three and six months ended June 30, 2014 and 2013, respectively	2,674	(1,626)	1,762	(1,555)
Other comprehensive income (loss)	4,133	(5,372)	4,588	(9,315)
Comprehensive income	$77,019	$56,523	$150,274	$124,067

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

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AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Six Months Ended June 30,	
(in thousands)	2014	2013
Cash flows from operating activities:		
Net income	$145,686	$133,382
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	112,228	86,501
Stock-based compensation	56,792	47,732
Provision for doubtful accounts	464	1,199
Excess tax benefits from stock-based compensation	(19,661)	(9,622)
Provision for deferred income taxes	21,840	—
Amortization of debt discount and issuance costs	6,457	—
Loss from disposal of property and equipment	38	309
Loss on investments	393	—
Change in fair value of contingent consideration	300	—
Gain and other activity related to divestiture of a business	—	(2,281)
Changes in operating assets and liabilities, net of effects of acquisitions and divestitures:		
Accounts receivable	(41,254)	(35,203)
Prepaid expenses and other current assets	(12,998)	(16,208)
Accounts payable and accrued expenses	21,459	23,695
Deferred revenue	4,750	6,612
Other current liabilities	1,419	(223)
Other non-current assets and liabilities	(8,666)	(1,605)
Net cash provided by operating activities	289,247	234,288
Cash flows from investing activities:		
Cash (paid) received for acquired businesses, net of cash acquired	(386,532)	80
Purchases of property and equipment	(97,992)	(102,222)
Capitalization of internal-use software development costs	(56,533)	(35,127)
Purchases of short- and long-term marketable securities	(863,591)	(309,875)
Proceeds from sales of short- and long-term marketable securities	354,313	77,720
Proceeds from maturities of short- and long-term marketable securities	183,809	209,473
Proceeds from the sale of property and equipment	584	426
Other non-currents assets and liabilities	1,444	(362)
Net cash used in investing activities	(864,498)	(159,887)
Cash flows from financing activities:		
Proceeds from the issuance of convertible senior notes, net of issuance costs	678,735	—
Proceeds from the issuance of warrants related to convertible senior notes	77,970	—
Purchase of note hedge related to convertible senior notes	(101,292)	—
Payment of acquired debt and capital leases	(17,862)	—
Proceeds related to the issuance of common stock under stock plans	57,999	28,261
Excess tax benefits from stock-based compensation	19,661	9,622
Employee taxes paid related to net share settlement of stock-based awards	(34,248)	(21,125)
Repurchases of common stock	(187,491)	(82,782)
Net cash provided by (used in) financing activities	493,472	(66,024)
Effects of exchange rate changes on cash and cash equivalents	2,053	(5,501)

Net (decrease) increase in cash and cash equivalents	(79,726)	2,876
Cash and cash equivalents at beginning of period	333,891	201,989
Cash and cash equivalents at end of period	$254,165	$204,865

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AKAMAI TECHNOLOGIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS, continued

	For the Six Months Ended June 30,	
(in thousands)	2014	2013
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$60,360	$35,796
Non-cash financing and investing activities:		
Purchases of property and equipment and capitalization of internal-use software development costs included in accounts payable and accrued expenses	36,146	14,344
Capitalization of stock-based compensation	7,727	6,183
Convertible note receivable received for divestiture of a business	—	18,882

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

AKAMAI TECHNOLOGIES, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Business and Basis of Presentation

Akamai Technologies, Inc. (the “Company”) provides cloud services for delivering, optimizing and securing online content and business applications. The Company's globally distributed platform comprises more than 150,000 servers in over 1,200 networks in over 90 countries. The Company was incorporated in Delaware in 1998 and is headquartered in Cambridge, Massachusetts. The Company currently operates in one industry segment: providing services for accelerating, improving and securing the delivery of content and applications over the Internet.

The accompanying interim consolidated financial statements are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information. These financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in the accompanying financial statements.

Certain information and footnote disclosures normally included in the Company’s annual audited consolidated financial statements and accompanying notes have been condensed in, or omitted from these interim financial statements. Accordingly, the unaudited consolidated financial statements included herein should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company’s annual report on Form 10-K for the year ended December 31, 2013, filed with the Securities and Exchange Commission on March 3, 2014.

The results of operations presented in this quarterly report on Form 10-Q are not necessarily indicative of the results of operations that may be expected for any future periods. In the opinion of management, these unaudited consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, that are necessary for a fair statement of the results of all interim periods reported herein.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued updated guidance and disclosure requirements for recognizing revenue. The new revenue recognition standard provides a five-step analysis of transactions to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective for the Company on January 1, 2017 and may be applied retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is evaluating the potential impact of adopting this new accounting guidance.

Revision of Prior Period Amounts

During the third quarter of 2013, the Company identified immaterial classification errors in its historical consolidated statements of cash flows. The errors relate to the timing of cash payments for property and equipment, cash receipts from employees for common stock related to the Company's employee stock purchase plan and cash payments for lease deposits. The cash flows for these items were improperly reflected as changes in operating assets and liabilities rather than as investing or financing activities. There was no impact to the net change in cash and cash equivalents. The Company concluded these errors are immaterial to all annual and quarterly periods previously presented and has reflected the corrections as a revision to the consolidated statements of cash flows previously filed.

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The effect of the revisions to the consolidated statements of cash flows for the six months ended June 30, 2013, is as follows (in thousands):

	As Previously Reported	Adjustment	As Revised
Cash flows from operating activities:			
Changes in operating assets and liabilities, net of effects from acquisitions:			
Prepaid expenses and other current assets	(19,106)	2,898	(16,208)
Accounts payable and accrued expenses	25,311	(1,616)	23,695
Other non-current assets and liabilities	(1,849)	244	(1,605)
Net cash provided by operating activities	232,762	1,526	234,288
Cash flows from investing activities:			
Purchases of property and equipment	(100,847)	(1,375)	(102,222)
Other non-current assets and liabilities	—	(362)	(362)
Net cash used in investing activities	(158,150)	(1,737)	(159,887)
Cash flows from financing activities:			
Proceeds related to the issuance of common stock under stock plans	28,050	211	28,261
Net cash used in financing activities	(66,235)	211	(66,024)
Net increase in cash and cash equivalents	2,876	—	2,876

2. Fair Value Measurements

The following is a summary of available-for-sale marketable securities held as of June 30, 2014 and December 31, 2013 (in thousands):

		Gross Unrealized			Classification on Balance Sheet	
	Amortized Cost	Gains	Losses	Aggregate Fair Value	Short-Term Marketable Securities	Long-Term Marketable Securities
As of June 30, 2014						
Certificates of deposit	$53	$—	$—	$53	$—	$53
Commercial paper	39,974	—	(9)	39,965	39,965	—
Corporate bonds	923,490	1,404	(475)	924,419	384,619	539,800
U.S. government agency obligations	273,792	94	(86)	273,800	78,024	195,776
	$1,237,309	$1,498	$(570)	$1,238,237	$502,608	$735,629
As of December 31, 2013						
Certificates of deposit	$222	$—	$—	$222	$173	$49
Corporate bonds	736,945	1,197	(281)	737,861	278,318	459,543
U.S. government agency obligations	174,982	51	(85)	174,948	61,514	113,434
	$912,149	$1,248	$(366)	$913,031	$340,005	$573,026

Unrealized gains and unrealized temporary losses on investments classified as available-for-sale are included within accumulated other comprehensive income (loss) in the consolidated balance sheets. Upon realization, those amounts are reclassified from accumulated other comprehensive income (loss) to interest income in the statements of operations. The Company holds for investment one corporate bond, which is classified as an available-for-sale marketable security, in a continuous unrealized loss position for more than 12 months, with an insignificant unrealized

loss and a fair value of $1.9 million as of June 30, 2014. The unrealized loss is attributable to changes in interest rates. The Company does not believe any unrealized losses represent other than temporary impairments based on the evaluation of available evidence. As of December 31, 2013, there were no securities in a continuous unrealized loss position for more than 12 months.

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The following table details the fair value measurements within the fair value hierarchy of the Company's financial assets and liabilities at June 30, 2014 and December 31, 2013 (in thousands):

	Total Fair Value	Fair Value Measurements at Reporting Date Using		
		Level 1	Level 2	Level 3
As of June 30, 2014				
Cash Equivalents and Marketable Securities:				
Money market funds	$1,257	$1,257	$—	$—
Certificates of deposit	53	53	—	—
Commercial paper	39,965	—	39,965	—
Corporate bonds	924,419	—	924,419	—
U.S. government agency obligations	273,800	—	273,800	—
	$1,239,494	$1,310	$1,238,184	$—
Other Liabilities:				
Contingent consideration obligation related to Velocius acquisition	$(2,900)	$—	$—	$(2,900)
As of December 31, 2013				
Cash Equivalents and Marketable Securities:				
Money market funds	$40,482	$40,482	$—	$—
Certificates of deposit	3,418	3,418	—	—
Commercial paper	29,999	—	29,999	—
Corporate bonds	737,861	—	737,861	—
U.S. government agency obligations	174,948	—	174,948	—
	$986,708	$43,900	$942,808	$—
Other Assets:				
Note receivable	$22,879	$—	$—	22,879
Other Liabilities:				
Contingent consideration obligation related to Velocius acquisition	$(2,600)	$—	$—	$(2,600)

As of June 30, 2014 and December 31, 2013, the Company grouped money market funds and certificates of deposit using a Level 1 valuation because market prices for such investments are readily available in active markets. As of June 30, 2014 and December 31, 2013, the Company grouped commercial paper, U.S. government agency obligations and corporate bonds using a Level 2 valuation because quoted prices for identical or similar assets are available in markets that are inactive.

When developing fair value estimates, the Company maximizes the use of observable inputs and minimizes the use of unobservable inputs. When available, the Company uses quoted market prices to measure fair value. The valuation technique used to measure fair value for the Company's Level 1 and Level 2 assets is a market approach, using prices and other relevant information generated by market transactions involving identical or comparable assets. If market prices are not available, the fair value measurement is based on models that use primarily market-based parameters including yield curves, volatilities, credit ratings and currency rates. In certain cases where market rate assumptions are not available, the Company is required to make judgments about assumptions market participants would use to estimate the fair value of a financial instrument.

The valuation technique used to measure fair value of the Company's Level 3 liability, which consists of contingent consideration related to the acquisition of Velocius Networks, Inc. ("Velocius") (Note 5), is primarily an income

approach. The significant unobservable input used in the fair value measurement of the Velocius contingent consideration is the likelihood of achieving development milestones to integrate the acquired technology into the Company's technology.

The valuation technique used to measure fair value for the Company's Level 3 asset, which consisted of a $25.0 million face value convertible note receivable, is primarily an income approach, where the expected weighted average future cash flows are discounted back to present value. The significant unobservable inputs used in the fair value measurement of the convertible

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note receivable are the probability of conversion to equity and the fair value of equity into which the note is convertible. In the second quarter of 2014, the note was amended. Under the terms of the amendment, the note became convertible into shares of preferred stock of the issuer valued at $12.5 million at the time of conversion; $6.3 million became due and payable (and was paid) during the second quarter of 2014 and the balance of $6.3 million is due and payable in the third quarter of 2014.

Increases or decreases in the underlying assumptions used to value the Company's Level 3 assets and liabilities held at June 30, 2014 and December 31, 2013, could increase or decrease the fair value estimates recorded in the consolidated balance sheets.

Contractual maturities of the Company’s available-for-sale marketable securities held at June 30, 2014 and December 31, 2013 were as follows (in thousands):

	June 30, 2014	December 31, 2013
Due in 1 year or less	$502,608	$340,005
Due after 1 year through 5 years	735,629	573,026
	$1,238,237	$913,031

The following table reflects the activity for the Company’s major classes of assets and liabilities measured at fair value using Level 3 inputs for the six months ended June 30, 2014 (in thousands):

	Other Assets: Note Receivable	Other Liabilities: Contingent Consideration Obligation
Balance as of January 1, 2014	$22,879	$(2,600)
Unrealized gain on convertible note receivable included in other comprehensive income	2,121	—
Amendment of the convertible note receivable for preferred stock of the issuer and cash	(25,000)	$—
Fair value adjustment to contingent consideration included in general and administrative expense	—	(300)
Balance as of June 30, 2014	$—	$(2,900)

3. Accounts Receivable

Net accounts receivable consisted of the following as of June 30, 2014 and December 31, 2013 (in thousands):

	June 30, 2014	December 31, 2013
Trade accounts receivable	$239,581	$175,391
Unbilled accounts receivable	92,422	100,300
Gross accounts receivable	332,003	275,691
Allowance for doubtful accounts	(774)	(708)
Reserve for cash-basis customers	(5,844)	(2,995)
Total accounts receivable reserves	(6,618)	(3,703)
Accounts receivable, net	$325,385	$271,988

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4. Goodwill and Acquired Intangible Assets

The change in the carrying amount of goodwill for the six months ended June 30, 2014 was as follows (in thousands):

Balance as of January 1, 2014	$757,368
Acquisition of Prolexic Technologies, Inc.	291,679
Balance as of June 30, 2014	$1,049,047

The Company tests goodwill for impairment at least annually. Through the date the consolidated financial statements were issued, no triggering events had occurred that would indicate a potential impairment exists.

Acquired intangible assets that are subject to amortization consist of the following as of June 30, 2014 and December 31, 2013 (in thousands):

	June 30, 2014			December 31, 2013		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Completed technology	$92,431	$(42,299)	$50,132	$65,631	$(35,476)	$30,155
Customer-related intangible assets	173,600	(82,859)	90,741	115,100	(75,563)	39,537
Non-compete agreements	8,890	(3,385)	5,505	7,950	(2,623)	5,327
Trademarks and trade names	4,200	(1,360)	2,840	3,400	(990)	2,410
Acquired license rights	490	(490)	—	490	(490)	—
Total	$279,611	$(130,393)	$149,218	$192,571	$(115,142)	$77,429

Aggregate expense related to amortization of acquired intangible assets for the three and six months ended June 30, 2014 was $8.4 million and $15.3 million, respectively. Aggregate expense related to amortization of acquired intangible assets for the three and six months ended June 30, 2013 was $5.7 million and $11.8 million, respectively. Based on the Company’s acquired intangible assets as of June 30, 2014, aggregate expense related to amortization of acquired intangible assets is expected to be $16.8 million for the remainder of 2014, and $26.8 million, $25.2 million, $23.1 million and $16.2 million for 2015, 2016, 2017 and 2018, respectively.

5. Business Acquisitions

Prolexic Acquisition

On February 18, 2014, the Company acquired all of the outstanding preferred and common stock of Prolexic Technologies, Inc. ("Prolexic") in exchange for $392.1 million in cash and the assumption of unvested stock options. The goal of acquiring Prolexic is to provide customers with a comprehensive portfolio of security solutions designed to defend an enterprise’s Web and IP infrastructure against application-layer, network-layer and data center attacks delivered via the Internet. The consolidated financial statements include the operating results of Prolexic from the date of acquisition. The revenue and earnings included in the Company's consolidated financial statements since the acquisition date are not material. Pro forma results of the operations have not been presented because the effects are not material to the consolidated financial statements. Acquisition-related costs were $4.1 million for the six months ended June 30, 2014.

The allocation of the purchase price has been finalized, with the exception of evaluating certain accrued expenses, property and equipment and tax-related assets and liabilities. The Company is in the process of gathering the facts and circumstances existing as of the acquisition date in order to finalize the valuation of these items. During the second quarter of 2014, the Company made immaterial adjustments to the allocation of the purchase price.

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

Total purchase consideration	$392,104
Allocation of the purchase consideration:	
Cash	$33,072
Accounts receivable	11,208
Property and equipment	12,225
Identifiable intangible assets	87,040
Goodwill	291,679
Deferred tax assets	16,000
Other current and long-term assets	5,850
Total assets acquired	457,074
Other current liabilities	(6,019)
Current deferred revenue	(5,812)
Deferred tax liabilities	(33,723)
Debt, capital leases and other long-term liabilities	(19,416)
Total liabilities assumed	(64,970)
Net assets acquired	$392,104

The value of the goodwill can be attributed to a number of business factors, including a trained technical and sales workforce and the fair value of expected cost synergies to be realized. The total amount of goodwill related to the acquisition of Prolexic expected to be deducted for tax purposes is $62.4 million.

The following were the identified intangible assets acquired and their respective weighted average useful lives (in thousands, except for years):

	Gross Carrying Amount	Weighted Average Useful Life (in years)
Completed technologies	$26,800	6.9
Customer-related intangible assets	58,500	10.4
Non-compete agreements	940	3.0
Trademark	800	4.9
Total	$87,040	

Velocius Acquisition

On November 8, 2013, the Company acquired Velocius in exchange for $4.3 million in cash. In addition, the Company recorded a liability of $2.6 million for contingent consideration related to expected achievement of post-closing milestones. The maximum potential payout of the contingent consideration is $3.0 million and as of June 30, 2014, the fair value of the liability is $2.9 million.

The Company acquired Velocius with a goal of complementing its hybrid cloud optimization strategy for optimizing IP application traffic across the Internet for remote and branch-end users. The Company allocated $5.4 million of the cost of the acquisition to goodwill and $2.5 million to acquired intangible assets. The allocation of the purchase price was finalized in the first quarter of 2014. The total weighted average useful life of the intangible assets acquired from Velocius is 7.9 years. The value of the goodwill from the acquisition can be attributed to a number of business factors,

including a trained technical workforce and cost synergies. The total amount of goodwill related to the acquisition of Velocius expected to be deducted for tax purposes is $0.3 million.

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Strategic Network Transaction

On November 30, 2012, the Company entered into a strategic alliance with AT&T Services, Inc. ("AT&T"). Under the agreement, AT&T became a reseller of the Company's services and the Company acquired certain assets and contracted to purchase bandwidth, co-location and related services from AT&T. The total consideration was $55.0 million, of which $27.5 million was paid during the third quarter of 2013 and $27.5 million was paid during the first quarter of 2014.

6. Convertible Senior Notes

In February 2014, the Company issued $690.0 million par value of convertible senior notes due 2019 (the "Notes"). The Notes are senior unsecured obligations of the Company, do not bear regular interest and mature on February 15, 2019, unless repurchased or converted prior to maturity.

At their option, holders may convert their Notes prior to the close of business on the business day immediately preceding August 15, 2018 only under the following circumstances:

- during any calendar quarter commencing after the calendar quarter ended June 30, 2014 (and only during such calendar quarter), if the last reported sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during the period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;

- during the five business day period after any five consecutive trading day period in which the trading price per $1,000 principal amount of Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the conversion rate on each such trading day; or

- upon the occurrence of specified corporate events.

On or after August 15, 2018, holders may convert all or any portion of their Notes at any time prior to the close of business on the second scheduled trading day immediately preceding the maturity date, regardless of the foregoing circumstances.

Upon conversion, the Company, at its election, may pay or deliver to holders cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock. The initial conversion rate is 11.1651 shares of the Company's common stock per $1,000 principal amount, which is equivalent to an initial conversion price of approximately $89.56 per share, subject to adjustments in certain events, and represents a potential conversion into 7.7 million shares.

In accounting for the issuance of the Notes, the Company separated the Notes into liability and equity components. The carrying cost of the liability component was calculated by measuring the fair value of a similar debt obligation that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the par value of the Notes. The difference between the principal amount of the Notes and the proceeds allocated to the liability component (“debt discount”), is amortized to interest expense using the effective interest method over the term of the Notes. The equity component is recorded in additional paid-in capital in the consolidated balance sheet and will not be remeasured as long as it continues to meet the conditions for equity classification.

In accounting for the transaction costs related to the issuance of the Notes, the Company allocated the total transaction costs incurred to the liability and equity components based on their relative values. Transaction costs attributable to

the liability component are being amortized to interest expense over the term of the Notes, and transaction costs attributable to the equity component are netted with the equity component of the Notes in stockholders’ equity.

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The Notes consist of the following components (in thousands):

	June 30, 2014
Liability component:	
Principal	$690,000
Less: debt discount, net of amortization	(94,615)
Net carrying amount	$595,385
Equity component:	$101,276

The estimated fair value of the Company's Notes at June 30, 2014 was $705.8 million. The fair value was determined based on data points other than quoted prices that are observable, either directly or indirectly, and has been classified as Level 2 within the fair value hierarchy. Based on the closing price of the Company's common stock of $61.06 on June 30, 2014, the value of the Notes if converted to common stock was less than the principal amount of $690.0 million.

The Company used $62.0 million of the proceeds from the offering to repurchase shares of its common stock, concurrently with the issuance of the Notes. The repurchase was made in accordance with the stock repurchase plan previously approved by the Board of Directors (Note 7). Additionally, $23.3 million of the proceeds was used for the net cost of convertible note hedge and warrant transactions. The Company intends to use the remaining net proceeds for working capital and other general corporate purposes, as well as for potential acquisitions and strategic transactions.

Note Hedge

To minimize the impact of potential dilution upon conversion of the Notes, the Company entered into convertible note hedge transactions with respect to its common stock. The Company paid $101.3 million for the note hedge transactions. The note hedge transactions cover approximately 7.7 million shares of the Company’s common stock at a strike price that corresponds to the initial conversion price of the Notes, also subject to adjustment, and are exercisable upon conversion of the Notes. The note hedge transactions are intended to reduce dilution in the event of conversion of the Notes.

Warrants

Separately, the Company entered into warrant transactions, whereby the Company sold warrants to acquire, subject to anti-dilution adjustments, up to 7.7 million shares of the Company’s common stock at a strike price of approximately $104.49 per share. The Company received aggregate proceeds of $78.0 million from the sale of the warrants. The convertible note hedge and warrant transactions will generally have the effect of increasing the conversion price of the Notes to approximately $104.49 per share.

Interest Expense

The Notes do not bear regular interest, but have an effective interest rate of 3.2% attributable to the conversion feature. The following table sets forth total interest expense included in the statement of operations related to the Notes (in thousands):

	For the Three Months Ended June 30,	For the Six Months Ended June 30,

	2014	2014
Amortization of debt discount	$442	$630
Amortization of debt issuance costs	4,671	6,661
Capitalization of interest expense	(597)	(834)
Total interest expense	$4,516	$6,457

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7. Stockholders’ Equity

Share Repurchase Program

In January 2013, the Board of Directors authorized a $150.0 million extension of its share repurchase program, effective for a twelve-month period beginning February 1, 2013. In October 2013, the Board of Directors authorized a new $750.0 million share repurchase program, effective from October 16, 2013 through December 31, 2016. During the three and six months ended June 30, 2014, the Company repurchased 1.3 million and 3.3 million shares of its common stock for $71.3 million and $187.5 million, respectively. During the three and six months ended June 30, 2013, the Company repurchased 1.1 million and 2.2 million shares of its common stock for $42.5 million and $82.8 million, respectively.

Stock-Based Compensation

The following table summarizes stock-based compensation included in the Company’s consolidated statements of operations for the three and six months ended June 30, 2014 and 2013 (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2014	2013	2014	2013
Cost of revenue	$3,076	$2,718	$5,871	$5,345
Research and development	5,061	3,867	9,538	8,236
Sales and marketing	12,796	9,799	23,328	19,230
General and administrative	10,745	8,417	18,055	14,921
Total stock-based compensation	31,678	24,801	56,792	47,732
Provision for income taxes	(10,156)	(9,345)	(18,380)	(16,309)
Total stock-based compensation, net of income taxes	$21,522	$15,456	$38,412	$31,423

In addition to the amounts of stock-based compensation reported in the table above, the Company’s consolidated statements of operations for the three and six months ended June 30, 2014 and 2013, respectively, include stock-based compensation reflected as a component of amortization of capitalized internal-use software of $2.0 million and $3.9 million, respectively, before income taxes.

8. Accumulated Other Comprehensive Income (Loss)

The following table summarizes the changes in accumulated other comprehensive income (loss), which is reported as a component of stockholders' equity, for the six months ended June 30, 2014 (in thousands):

	Foreign Currency Translation Adjustments	Net Unrealized Gain on Investments	Total
Balance as of January 1, 2014	$(6,715)	$4,624	$(2,091)
Other comprehensive income	2,826	1,762	4,588
Balance as of June 30, 2014	$(3,889)	$6,386	$2,497

The tax effect on accumulated unrealized gain on investments was insignificant as of June 30, 2014 and December 31, 2013. Amounts reclassified from accumulated other comprehensive income (loss) to net income were insignificant for the six months ended June 30, 2014.

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9. Income Taxes

The Company's effective income tax rate, including discrete items, was 36.2% and 34.0% for the six months ended June 30, 2014 and 2013, respectively. The effective income tax rate is based upon estimated income for the year, the estimated composition of the income in different jurisdictions and discrete adjustments, if any, in the applicable quarterly periods, including retroactive changes in tax legislation, settlements of tax audits or assessments, the resolution or identification of tax position uncertainties and acquisitions of other companies. The discrete items in the first six months of 2014 include a deferred tax charge, the tax effect of certain stock options and interest and penalties related to uncertain tax positions.

For the six months ended June 30, 2014, the effective income tax rate was higher than the federal statutory tax rate mainly due to the effects of accounting for stock-based compensation in accordance with the authoritative guidance for share-based payments and state income tax, partially offset by income from foreign jurisdictions with lower tax rates. For the six months ended June 30, 2013, the effective income tax rate was lower than the federal statutory tax rate mainly due to the composition of income in foreign jurisdictions that is taxed at lower rates compared to the statutory tax rates in the United States, as well as the reinstatement of the federal research and development credit at the beginning of 2013, which included a one-time retroactive impact for fiscal year 2012.

10. Net Income per Share

Basic net income per share is computed using the weighted average number of common shares outstanding during the applicable period. Diluted net income per share is computed using the weighted average number of common shares outstanding during the period, plus the dilutive effect of potential common stock. Potential common stock consists of shares issuable pursuant to stock options, restricted stock units ("RSUs"), deferred stock units, convertible senior notes and warrants issued by the Company. The dilutive effect of outstanding awards and convertible securities is reflected in diluted earnings per share by application of the treasury stock method.

The following table sets forth the components used in the computation of basic and diluted net income per share for three and six months ended June 30, 2014 and 2013 (in thousands, except per share data):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2014	2013	2014	2013
Numerator:				
Net income	$72,886	$61,895	$145,686	$133,382
Denominator:				
Shares used for basic net income per share	178,081	177,891	178,393	177,895
Effect of dilutive securities:				
Stock options	1,242	1,724	1,312	1,750
RSUs and deferred stock units	1,518	1,773	1,734	1,830
Convertible senior notes	—	—	—	—
Warrants related to issuance of convertible senior notes	—	—	—	—
Shares used for diluted net income per share	180,841	181,388	181,439	181,475
Basic net income per share	$0.41	$0.35	$0.82	$0.75
Diluted net income per share	$0.40	$0.34	$0.80	$0.73

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For the three and six months ended June 30, 2014 and 2013, certain potential outstanding shares from stock options, service-based RSUs, convertible notes and warrants were excluded from the computation of diluted net income per share because the effect of including these items would be anti-dilutive. Additionally, certain performance-based RSUs were excluded from the computation of diluted net income per share because the underlying performance conditions for such RSUs had not been met as of these dates. The number of potentially outstanding shares excluded from the computation of diluted net income per share for the three and six months ended June 30, 2014 and 2013 are as follows (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2014	2013	2014	2013
Stock options	474	1,888	563	2,018
Service-based RSUs	1,008	159	761	327
Performance-based RSUs	575	1,148	575	1,148
Convertible senior notes	7,704	—	7,704	—
Warrants related to issuance of convertible senior notes	7,704	—	7,704	—

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.

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

This quarterly report on Form 10-Q, particularly Management’s Discussion and Analysis of Financial Condition and Results of Operations set forth below, and notes to our unaudited consolidated financial statements included herein contain “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are subject to risks and uncertainties and are based on the beliefs and assumptions of our management as of the date hereof based on information currently available to our management. Use of words such as “believes,” “expects,” “anticipates,” “intends,” “plans,” “estimates,” “should,” “forecasts,” “if,” “continues,” “goal,” “likely” or similar expressions i forward-looking statement. Forward-looking statements are not guarantees of future performance and involve risks, uncertainties and assumptions. Actual results may differ materially from the forward-looking statements we make. See “Risk Factors” elsewhere in this quarterly report on Form 10-Q for a discussion of certain risks associated with our business. We disclaim any obligation to update forward-looking statements as a result of new information, future events or otherwise.

Our management’s discussion and analysis of our financial condition and results of operations is based upon our unaudited consolidated financial statements included elsewhere in this quarterly report on Form 10-Q, which we have prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP, for interim periods and with Regulation S-X promulgated under the Securities Exchange Act of 1934, as amended, or the Exchange Act. The preparation of these unaudited consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related items, including, but not limited to, revenue recognition, accounts receivable and related reserves, valuation and impairment of marketable securities, goodwill and acquired intangible assets, capitalized internal-use software costs, impairment and useful lives of long-lived assets, income tax, and stock-based compensation. We base our estimates and judgments on historical experience and on various other assumptions that we believe to be reasonable under the circumstances at the time they are made. Actual results may differ from our estimates. See the section entitled “Application of Critical Accounting Policies and Estimates” in our annual report on Form 10-K for the year ended December 31, 2013 for further discussion of our critical accounting policies and estimates.

Overview

We provide cloud services for delivering, optimizing and securing online content and business applications. We primarily derive income from sales of services to customers executing contracts with terms of one year or longer. We believe that this emphasis on longer-term contracts generally allows us to have a consistent and predictable base level of revenue which is important to our financial success. Accordingly, to be successful, we must maintain our base of recurring revenue contracts by minimizing customer cancellations or terminations and limiting the impact of price reductions reflected in contract renewals and build on that base by adding new customers and increasing the amount and value of services, features and functionalities that our existing customers purchase. Accomplishing these goals requires that we compete effectively in the marketplace on the basis of quality, price and overall attractiveness of our services and technology.

Our revenue is impacted by a number of factors, including our ability to maintain our base of committed recurring revenues, the timing and variability of customer-specific one-time events, the prices we are able to charge for our services, the amount of traffic we serve on our network and the impact of seasonal variations on our business. We have observed the following trends related to our revenue in recent years:

- On a consistent basis, we have been able to offset lost committed recurring revenue by adding new customers and increasing sales of incremental services to our existing customers. We have also experienced increases in the rate of traffic delivered to our customers that use our solutions for video, gaming, social media and software downloads.

- The unit prices paid by some of our customers have declined, reflecting the impact of competition. These price reductions have primarily impacted customers for which we deliver high volumes of traffic over our network, such as media customers.

- We have experienced variations in certain types of revenue from quarter to quarter; in particular, we experience higher revenue in the fourth quarter of the year for some of our solutions as a result of the holiday season. We also experience lower revenue in the summer months, particularly in Europe, from both e-commerce and media customers because overall Internet use declines during that time. In addition, we experience quarterly variations in revenue attributable to the nature and timing of software and gaming releases by our customers using our software download solutions.

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Our profitability is also impacted by our expense levels, including direct costs to support our revenue, such as co-location and bandwidth costs, and expenses incurred to support strategic initiatives that we anticipate will generate revenue in the future. We have observed the following trends in recent years:

- We have increased headcount to support our revenue growth and strategic initiatives, and as a result, our payroll and related compensation costs have increased. We increased our headcount by more than 800 employees in 2013 to 3,908 employees at year end, which is net of approximately 70 employees who were part of the divestiture of our Advertising Decision Solutions, or ADS, business in the first quarter of 2013. We hired an additional 650 employees during the first half of 2014, including approximately 200 employees who were part of the acquisition of Prolexic Technologies, Inc., or Prolexic. We expect to continue to hire additional employees and expand globally in support of our strategic initiatives.

- We have continued to reduce our network bandwidth costs per unit and to invest in internal-use software development with the goal of improving the performance and efficiency of our network. Our total bandwidth costs may increase in the future as a result of expected higher traffic levels, but we believe such costs would be partially offset by anticipated continued reductions in bandwidth costs per unit. To achieve these lower bandwidth costs per unit, we must effectively route traffic over our network through lower cost providers and continue to reduce our overall bandwidth pricing.

- Co-location costs are a significant percentage of total cost of revenue. By improving our internal-use software and managing our hardware deployments to enable us to use servers more efficiently, we have been able to manage the growth of co-location costs. We expect to continue to scale our network in the future and will need to manage our co-location costs to maintain current levels of profitability.

In February 2014, we completed the acquisition of Prolexic. Prolexic is expected to be slightly dilutive to our earnings per share in its first full year. Revenues and expenses from the acquisition have been included in our earnings since the acquisition date of February 18, 2014. Also in February 2014, we completed an offering of $690.0 million par value of convertible senior notes. The notes do not bear regular interest, but have an effective interest rate of 3.2% attributable to the conversion feature.

Results of Operations

The following table sets forth, as a percentage of revenue, consolidated statements of operations data for the periods indicated:

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2014		2013		2014		2013	
Revenue	100.0	%	100.0	%	100.0	%	100.0	%
Cost of revenue	31.4		33.0		31.1		32.8	
Research and development expense	6.7		5.4		6.5		5.7	
Sales and marketing expense	19.2		17.9		18.6		17.5	
General and administrative expense	17.2		16.2		17.0		15.6	
Amortization of acquired intangible assets	1.8		1.5		1.6		1.6	
Restructuring charges	0.1		0.1		0.1		0.1	
Total costs and operating expenses	76.4		74.1		74.9		73.3	
Income from operations	23.6		25.9		25.1		26.7	
Interest income	0.4		0.4		0.4		0.4	
Interest expense	(0.9	)	—		(0.7	)	—	

Other (expense) income, net	(0.2)	0.1	(0.2)	—
Income before provision for income taxes	22.9	26.4	24.6	27.1
Provision for income taxes	7.5	9.9	8.9	9.2
Net income	15.4 %	16.5 %	15.7 %	17.9 %

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Revenue

Revenue during the periods presented was as follows (in thousands):

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2014	2013	% Change		2014	2013	% Change	
Revenue	$476,035	$378,106	25.9	%	$929,537	$746,152	24.6	%

During the three- and six-month periods ended June 30, 2014, the increase in our revenue as compared to the same periods in 2013 was driven by continued strong demand for our services across all of our solutions and geographies. For the three- and six-month periods ended June 30, 2014 and 2013, no single customer accounted for 10% or more of revenue.

For each of the three- and six-month periods ended June 30, 2014 and 2013, approximately 28% of our revenue was derived from our operations located outside of the United States. No single country outside of the United States accounted for 10% or more of revenue during any of these periods.

During the first half of 2014, we experienced strong revenue growth from our operations in the Asia Pacific region and continued improvement in revenue growth from our operations in Europe, the Middle East and Africa, primarily driven by strength in our Performance and Security Solutions. Changes in foreign currency exchange rates positively impacted our revenue by $3.0 million and $1.3 million during the three- and six-month periods ended June 30, 2014, respectively, as compared to the same periods in 2013.

For the three- and six-month periods ended June 30, 2014, resellers accounted for 25% and 24%, respectively, of revenue as compared to 20% of revenue for the same periods in 2013. The increase in revenue from resellers was attributable to continued traction with our carrier channel partners, as well as contributions from Prolexic's reseller relationships.

The following table quantifies the contribution to revenue during the periods presented from our solution categories (in thousands):

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2014	2013	% Change		2014	2013	% Change	
Media Delivery Solutions	$216,174	$179,418	20.5	%	$431,007	$360,606	19.5	%
Performance and Security Solutions	217,415	167,881	29.5		415,392	324,523	28.0	
Service and Support Solutions	42,446	31,429	35.1		83,138	58,894	41.2	
Advertising Decision Solutions and other	—	(622)	(100.0)		—	2,129	(100.0)	
Total revenue	$476,035	$378,106	25.9	%	$929,537	$746,152	24.6	%

The increase in Media Delivery Solutions revenue for the three- and six-month periods ended June 30, 2014, as compared to the same periods in 2013, was due to strong demand across most of our customer base. We experienced particularly strong growth from our software download, gaming, video and social media customers.

The increase in Performance and Security Solutions revenue for the three- and six-month periods ended June 30, 2014, as compared to the same periods in 2013, was partially due to increased revenue attributable to Prolexic.

Additionally, there was an increase in demand for our web performance and cloud security solutions.

The increase in the Service and Support Solutions revenue for the three- and six-month periods ended June 30, 2014, as compared to the same periods in 2013, was due to increases in sales of our services and support offerings due to strong service attachment rates for customers of our Media Delivery and Performance and Security Solutions.

The ADS business was divested in the first quarter of 2013.

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Cost of Revenue

Cost of revenue consisted of the following for the periods presented (in thousands):

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2014	2013	% Change	2014	2013	% Change
Bandwidth fees	$29,411	$25,996	13.1 %	$58,247	$50,710	14.9 %
Co-location fees	28,874	27,972	3.2	56,894	55,442	2.6
Network build-out and supporting services	11,250	8,333	35.0	21,297	17,948	18.7
Payroll and related costs	36,274	27,521	31.8	67,692	52,748	28.3
Stock-based compensation, including amortization of prior capitalized amounts	4,995	4,584	9.0	9,620	9,031	6.5
Depreciation of network equipment	25,660	20,026	28.1	50,451	38,497	31.1
Amortization of internal-use software	12,854	10,273	25.1	24,729	20,721	19.3
Total cost of revenue	$149,318	$124,705	19.7 %	$288,930	$245,097	17.9 %
As a percentage of revenue	31.4 %	33.0 %		31.1 %	32.8 %	

The increase in total cost of revenue for the three- and six-month periods ended June 30, 2014 as compared to the same periods in 2013 was primarily due to increases in:

- payroll and related costs of service personnel due to headcount growth to support our Service and Support Solutions revenue growth, as well as headcount growth to support our other solution categories;
- amounts paid to network providers for bandwidth fees to support the increase in traffic served on our network; and
- depreciation and amortization of network equipment and internal-use software as we continued to invest in our infrastructure.

In recent years, we have reduced our network bandwidth costs per unit and have successfully managed our co-location fees, which contributed to the decrease in our cost of revenue as a percentage of revenue during the three- and six-month periods ended June 30, 2014 as compared to the same periods in 2013.

We have long-term purchase commitments for bandwidth usage and co-location services with various network and Internet service providers. Our minimum commitments related to bandwidth usage and co-location services may vary from period to period depending on the timing and length of contract renewals with our service providers. There have been no significant changes to the commitments reported in our annual report on Form 10-K for the year ended December 31, 2013, other than normal period to period variations.

We believe that cost of revenue will increase during the remainder of 2014 as compared to the first six months of 2014, primarily because we expect to deploy more servers and deliver more traffic on our network, which will result in higher expenses associated with the increased traffic and additional co-location fees. Such costs are likely to be partially offset by lower bandwidth costs per unit and continued efficiency in network deployment. Additionally, for the remaining quarters of 2014, we anticipate amortization of internal-use software development costs to increase, along with higher payroll and related costs associated with an increase in headcount of our network and professional services personnel. We plan to continue to make investments in our network in the expectation that our customer base and sales of services to our existing customers will continue to grow.

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Research and Development Expenses

Research and development expenses consisted of the following for the periods presented (in thousands):

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2014	2013	% Change	2014	2013	% Change
Payroll and related costs	$46,373	$32,482	42.8 %	$88,804	$64,304	38.1 %
Stock-based compensation	5,061	3,867	30.9	9,538	8,237	15.8
Capitalized salaries and related costs	(22,056)	(16,950)	30.1	(42,056)	(32,446)	29.6
Other expenses	2,674	1,198	123.2	4,000	2,407	66.2
Total research and development	$32,052	$20,597	55.6 %	$60,286	$42,502	41.8 %
As a percentage of revenue	6.7 %	5.4 %		6.5 %	5.7 %	

The increase in research and development expenses during the three- and six-month periods ended June 30, 2014, as compared to the same periods in 2013, was due to increases in payroll and related costs as a result of continued growth in headcount to support investments in new product development, partially offset by increases in capitalized salaries and related costs.

Research and development costs are expensed as incurred, other than certain internal-use software development costs eligible for capitalization. These development costs consist of external consulting expenses and payroll and related costs for personnel involved in the development of internal-use software used to deliver our services and operate our network. During the three- and six-month periods ended June 30, 2014, we capitalized $3.5 million and $6.9 million, respectively, of stock-based compensation. During the three- and six-month periods ended June 30, 2013, we capitalized $3.1 million and $5.9 million, respectively, of stock-based compensation. These capitalized internal-use software costs are amortized to cost of revenue over their estimated useful lives of two years.

We believe that research and development expenses will increase in absolute dollars during the remainder of 2014 as we expect to continue to hire additional development personnel in order to make improvements to our core technology and develop new and enhanced services.

Sales and Marketing Expenses

Sales and marketing expenses consisted of the following for the periods presented (in thousands):

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2014	2013	% Change	2014	2013	% Change
Payroll and related costs	$62,093	$44,124	40.7 %	$116,777	$85,198	37.1 %
Stock-based compensation	12,796	9,799	30.6	23,328	19,230	21.3
Marketing programs and related costs	7,259	6,514	11.4	17,779	14,361	23.8
Other expenses	9,314	7,388	26.1	14,643	11,726	24.9
Total sales and marketing	$91,462	$67,825	34.8 %	$172,527	$130,515	32.2 %
As a percentage of revenue	19.2 %	17.9 %		18.6 %	17.5 %	

The increase in sales and marketing expenses during the three- and six-month periods ended June 30, 2014, as compared to the same periods in 2013, was primarily due to higher payroll and related costs, as we invested in our sales and marketing organization, and an increase in marketing programs and related costs in support of our go-to-market strategy and ongoing geographic expansion.

We believe that sales and marketing expenses will increase in absolute dollars during the remainder of 2014 as compared to the first six months of 2014 due to an expected increase in payroll and related costs as a result of continued headcount growth in our sales and marketing organization.

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General and Administrative Expenses

General and administrative expenses consisted of the following for the periods presented (in thousands):

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2014	2013	% Change	2014	2013	% Change
Payroll and related costs	$35,714	$24,569	45.4 %	$68,024	$48,398	40.6 %
Stock-based compensation	10,745	8,417	27.7	18,055	14,921	21.0
Depreciation and amortization	9,876	6,228	58.6	18,049	11,804	52.9
Facilities-related costs	12,478	10,315	21.0	25,472	19,937	27.8
Provision for doubtful accounts	274	167	64.1	171	530	(67.7)
Acquisition-related costs	444	(1,073)	141.4	3,836	(736)	621.2
Professional and other fees	12,349	12,728	(3.0)	24,434	21,877	11.7
Total general and administrative	$81,880	$61,351	33.5 %	$158,041	$116,731	35.4 %
As a percentage of revenue	17.2 %	16.2 %		17.0 %	15.6 %	

The increase in general and administrative expenses for the three- and six-month periods ended June 30, 2014, as compared to the same periods in 2013, was primarily due to the expansion of company infrastructure to support investments in engineering, go-to-market capacity and enterprise expansion initiatives. In particular, we increased general and administrative headcount and our facility footprint, which increased payroll and related costs, facilities-related costs and depreciation and amortization. In addition, acquisition-related costs increased for the six-month period ended June 30, 2014 due to the acquisition of Prolexic.

During the remainder of 2014, we expect general and administrative expenses to increase in absolute dollars as compared to the first six months of 2014 due to anticipated higher payroll and related costs and facilities-related costs attributable to increased hiring, investment in information technology and planned facility expansion.

Amortization of Acquired Intangible Assets

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
(in thousands)	2014	2013	% Change	2014	2013	% Change
Amortization of acquired intangible assets	$8,403	$5,734	46.5 %	$15,251	$11,794	29.3 %
As a percentage of revenue	1.8 %	1.5 %		1.6 %	1.6 %	

The increase in amortization of acquired intangible assets for the three- and six-month periods ended June 30, 2014 as compared to the same periods in 2013 was primarily due to the amortization of assets related to the acquisition of Prolexic. Based on our intangible assets at June 30, 2014, we expect amortization of acquired intangible assets to be approximately $16.8 million for the remainder of 2014, and $26.8 million, $25.2 million, $23.1 million and $16.2 million for 2015, 2016, 2017 and 2018, respectively.

Restructuring Charges

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
(in thousands)	2014	2013	% Change	2014	2013	% Change

Restructuring charges	$569		$391		45.5	%	$1,304		$822		58.6	%
As a percentage of revenue	0.1	%	0.1	%			0.1	%	0.1	%		

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The restructuring charges for the three- and six-month periods ended June 30, 2014 consisted of severance and related expenses as a result of the acquisition of Prolexic, in addition to a contract termination fee during the three months ended June 30, 2014. The charges for the three- and six-month periods ended June 30, 2013 consisted of pending workforce claims prior to 2013.

Interest Income

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
(in thousands)	2014	2013	% Change	2014	2013	% Change
Interest income	$1,740	$1,477	17.8 %	$3,379	$3,085	9.5 %
As a percentage of revenue	0.4 %	0.4 %		0.4 %	0.4 %	

For the periods presented, interest income consists of interest earned on invested cash balances and marketable securities.

Interest Expense

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
(in thousands)	2014	2013	% Change	2014	2013	% Change
Interest expense	$(4,516)	$—	100.0 %	$(6,457)	$—	100.0 %
As a percentage of revenue	(0.9)%	— %		(0.7)%	— %	

For the periods presented, interest expense consists of the amortization of the debt discount and debt issuance costs related to our convertible senior notes issued in February 2014.

Other (Expense) Income, Net

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
(in thousands)	2014	2013	% Change	2014	2013	% Change
Other (expense) income, net	$(899)	$341	(363.6)%	$(1,780)	$209	(951.7)%
As a percentage of revenue	(0.2)%	0.1 %		(0.2)%	— %	

Other (expense) income, net primarily represents net foreign exchange gains and losses incurred and other non-operating expense and income items. The fluctuations in other expense, net for the three- and six-month periods ended June 30, 2014, as compared to the same periods in 2013, were primarily due to foreign currency exchange rate fluctuations on inter-company and other non-functional currency transactions. Other (expense) income, net may fluctuate in the future based upon changes in foreign exchange rates or other events.

Provision for Income Taxes

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
(in thousands)	2014	2013	% Change	2014	2013	% Change
Provision for income taxes	$35,790	$37,426	(4.4)%	$82,654	$68,603	20.5 %
As a percentage of revenue	7.5 %	9.9 %		8.9 %	9.2 %	
Effective income tax rate	32.9 %	37.7 %		36.2 %	34.0 %	

For the six months ended June 30, 2014, our effective income tax rate was higher than the statutory rate due primarily to the effects of accounting for stock-based compensation in accordance with the authoritative guidance for share-based payments and state income taxes, partially offset by income from foreign jurisdictions that is taxed at lower rates compared to the statutory tax

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rates in the United States. For the six-month period ended June 30, 2013, our effective income tax rate was lower than the federal statutory tax rate mainly due to the reinstatement of the federal research and development credit at the beginning of 2013, which included a one-time retroactive impact for fiscal year 2012, as well as the composition of income in foreign jurisdictions that is taxed at lower rates. The effective income tax rate is based upon the estimated income for the year, the estimated composition of the income in different jurisdictions and discrete adjustments, if any, in the applicable quarterly periods, including settlements of tax audits or assessments, the resolution or identification of tax position uncertainties and acquisitions of other companies.

The increase in the provision for income taxes in the six-month period ended June 30, 2014 as compared to the same period in 2013 was mainly due to the increase in operating income in 2014, a change in the composition of projected income in different jurisdictions and the expiration of the federal research and development credit at the end of 2013, partially offset by the domestic production activities deduction.

While we expect our effective income tax rate to decrease during the remainder of 2014, due to discrete items in the first quarter of 2014 that had a negative impact on our tax rate, this expectation does not take into consideration the effect of potential other one-time discrete items that may be recorded in the future. The effective tax rate could be materially different depending on the nature and timing of dispositions of incentive stock options and other employee equity awards. 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.

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 net operating loss 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 these matters may be materially greater or less than the amount that we have estimated.

Non-GAAP Financial Measures

In addition to providing financial measurements based on GAAP, we publicly discuss additional financial measures that are not prepared in accordance with GAAP, or non-GAAP financial measures. Management uses non-GAAP financial measures, in addition to GAAP financial measures, to understand and compare operating results across accounting periods, for financial and operational decision making, for planning and forecasting purposes and to evaluate our financial performance. These non-GAAP financial measures are non-GAAP income from operations, non-GAAP operating margin, non-GAAP net income, non-GAAP net income per diluted share, Adjusted EBITDA and Adjusted EBITDA margin, as discussed below.

Management believes that these non-GAAP financial measures reflect our ongoing business in a manner that allows for meaningful comparisons and analysis of trends in our business, as they exclude expenses and gains that may be infrequent, unusual in nature or otherwise not reflective of our ongoing operating results. Management also believes that these non-GAAP financial measures provide useful information to investors in understanding and evaluating our operating results and future prospects in the same manner as management and in comparing financial results across

accounting periods and to those of peer companies.

The non-GAAP financial measures do not replace the presentation of our GAAP financial measures and should only be used as a supplement to, not as a substitute for, our financial results presented in accordance with GAAP.

The non-GAAP adjustments, and our basis for excluding them from non-GAAP financial measures, are outlined below:

- Amortization of acquired intangible assets – We have incurred amortization of intangible assets, included in our GAAP financial statements, related to various acquisitions we made. The amount of an acquisition's purchase price allocated to intangible assets and the term of its related amortization can vary significantly and are unique to

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each acquisition; therefore, we exclude amortization of acquired intangible assets from non-GAAP financial measures to provide investors with a consistent basis for comparing pre- and post-acquisition operating results.

- Stock-based compensation and amortization of capitalized stock-based compensation – Although stock-based compensation is an important aspect of the compensation we pay to our employees and executives, the expense varies with changes in the stock price and market conditions at the time of grant, varying valuation methodologies, subjective assumptions and the variety of award types. This makes the comparison of our current financial results to previous and future periods difficult to interpret; therefore, we believe it is useful to exclude stock-based compensation and amortization of capitalized stock-based compensation fr