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Akamai Technologies, Inc. (NASDAQ: AKAM)

Update: Faced with stiff competition

ACCUMULATE

Jan. 17, 2001

KEY CONSIDERATIONS

- Industry competitors and regulation are forcing Akamai into lawsuits in tech. patents and uncertainty in bandwidth regulations hold the key to Akamai's future revenues.
- Increased competition is inducing Akamai to develop new markets ahead of its competitors and expand its capital and customer base in order to stay on top.
- Apple computers, a major recurring customer of Akamai, is expected to renew its contract, steadying fears of compounding already stunted revenues.
- Akamai is still unprofitable and will be expected to continue to incur losses for the next few years.

Recent Price	27 7/16
52 WK Low	17.68
52 WK High	345.5
Market Capitalization (Mil)	2962.18
Shares Outstanding (Mil)	107.3
Avg Daily Vol (Mil)	3.29
Shares Out (Mil)	107.96
Float (Mil)	38.9
LT Debt/Equity (MRQ)	0.11
Earnings (TTM) $	-6.97
Sales (TTM) $	0.7
Book Value (MRQ) $	25.19
Cash Flow (TTM) $	-1.53
Cash (MRQ) $	4.09

ONE-YEAR PRICE AND VOLUME GRAPH

COMPANY PROFILE

Akamai Technologies is a leader in the content delivery market. Akamai's services are offered on a round-the-clock 365 day basis. Its network of servers deliver web-based information faster and more efficiently, caching information and quickly sending it to heavily trafficked sites. It has continued to develop unique and creative strategies in order to branch out from the Internet market and diversify its revenues. Hoping to wean its revenue from mainly Internet sectors, Akamai has set forth its objectives clearly, obtaining Fortune 500 companies, small business, and testing the individual consumer market for customers. With the foundation of strong management behind it, Akamai should be able to maintain an edge in the market, because of its head start and large capital base.

This report was prepared Aaron J. Huang and David Riavs, Ph.D.

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COMPANY UPDATE

Akamai, which means "cool breeze" in Hawaiian, has been riding the recent hurricane of stock crashes, spiraling downwards to a roughly 17 dollars per share low, from a ballooned market share price of over 345 dollars in the beginning of last year. In addition to their direct sales approach to large, heavily-trafficked websites and Fortune 100 companies, they have recently begun to directly market and sell their services through a telesales force to smaller Web sites and businesses, hoping to expand their revenue base into finance, health care, automotive, and publishing.

Industry growth. As their recurring customers have been dealing with their own revenue woes, Akamai's lead in the content delivery sector is decreasing as it faces stiff competition from rivals that have banded their resources together in order to gain a larger share of the market. Moreover, new technologies developed by these companies are snatching customers away from Akamai. The company acknowledges the difficulty in protecting its patented technologies from domestic and global competitors, especially as it expands to Munich, London, and Paris. Akamai forges on, continuing to focus on expanding its sales and support personnel by expending resources in sales and marketing, explicitly showing its stockholders its commitment to retain and expand its customer base for future financial success and stability.

INDUSTRY OUTLOOK AND COMPETITION

Stock Price. The recent deflation of the NASDAQ and Dow Jones Industrial have hurt Akamai, as demand for its services have decreased due to its customer's economic woes. Because of the unpredictability of demand for Akamai's content delivery services, quarterly earnings may affect stock price adversely, particularly if there is an across-the-board trend of revenue shortfalls as has been the recent case.

Technology Patents. With the emergence of strong competition, Akamai's patented technology is facing rivalry from its competitors' own technology and the subsequent joining of forces of some of its larger competitors in an effort to maintain a foothold in the struggling market to adequately compete with Akamai. Consequently, Akamai could see a spike in its costs in defending its patented technology and intellectual property. Recently Akamai filed suit in federal court against one of its rivals, Digital Island, Inc. for licensed patent infringement and infringement on patents issued to INTERVU, one of their recently acquired companies which is a service provider for Internet audio and video delivery solutions, and has an ongoing 3-year contract with CNN News Group. In return, Digital Island filed a similar lawsuit against Akamai and the case is now pending. Moreover, as Internet regulation laws become more stringent, it is in our belief that Akamai may find obstacles in further expanding its services, particularly in the bandwidth sector.

Recurring Revenues and Apple. The continued edge Akamai has in recurring customer loyalty along with a relatively large customer base is keeping Akamai's revenues afloat, as Apple as well as many of its other 1325 recurring customers will likely renew their contracts with Akamai. We believe the ability of Apple to maintain steady revenues continues to be key in keeping Akamai above the waterline, as Apple represented approximately 16% of Akamai's revenue for the nine months ending September 30, 2000.

Technology. Akamai's patented algorithms and caching solutions will also help keep it a step ahead of its competitors. More importantly, Akamai still has a nice head start in its securement of server space and network infrastructure, whilst most of its competitors still have growing R&D costs. The company still controls well over half of the content delivery market.

Global Arena. A growing arena we see in competition for Akamai in the near future is abroad, particularly because its patents are not protected in the international arena and international competitors can easily copy them and offer their own line of services.

STRATEGIES FOR GROWTH

Partnerships. Akamai's survival still depends largely on forming partnerships, alliances, and acquisitions. Acquisitions could run high costs and be difficult to integrate, causing Akamai to issue additional securities diluting stockholder value and the company's own stake in itself. Akamai has implemented several key initiatives for the third quarter in an effort to maintain their dominant position in the market, and include partnerships with several companies : *Storage Services* in conjunction with SSPs-EDS, EMC, and Scale Eight; *Traffic Management/Monitoring* in conjunction with Resonate; *Digital Rights Management* in conjunction with Reciprocal; *Expanded Product & Services Offering*, a dynamic content delivery service. With a fourth quarter report coming up in the next few weeks, we will be more able to deduce the impact of such new initiatives on Akamai's financial success.

Expansion. It is in our opinion that as Akamai strengthens its customer base of large blue chip and dot-com companies, it will implement new strategies for taking over the individual household market. As bandwidth costs decrease Akamai will have more breathing room to expand its services, which have been hampered by high short-term fixed costs.

Although current revenues from international services comprise only 3% of current revenues, we predict Akamai will continue to expand its international base of customers in an attempt to capture the international market ahead of its competitors. Perceived problems we see could include foreign currency volatility, increased expenses in international marketing, and tariffs among others.

Management and Labor. Akamai should simultaneously focus on hiring and maintaining quality staff and management if they are to keep a focused strategy and lessen the probability of software glitches, which would slow progress and divert resources and management. Their total number of employees increased from 385 at December 31, 1999 to 1,229 as of September 30, 2000. As Akamai consolidates its acquisitions and forges new partnerships, it must be able to improve its ability to effectively manage multiple ventures with its customers, suppliers and other third parties. Failure to take any of the steps necessary to manage its growth properly would have an adverse effect on its business.

Capital Investment. Investment in capital is also crucial in maintaining a competitive edge, with each individual server returning $1,700 on a monthly basis, a fraction of the potential monthly return of $15,000. This would be a significant revenue resource if Akamai can pull all its strings together and continue to dominate the content delivery sector and maintain its software. Deployment of Akamai's global network expanded to include more than 460 networks, up from 335 networks in the third quarter 2000 and the number of deployed Akamai servers was more than 8,000, compared to 6,060 in the third quarter 2000.

KEY RISK FACTORS

Recurring Customer Loyalty. Akamai's key risks continue to be the uncertainty in revenue trends, as revenues have fallen short of predictions on Wall Street. A further risk is Akamai's dependence on Internet-based customers, which account for over 40% of its revenue. Many of the companies are relatively new and face high short term fixed costs of their own. The ability of these companies to pay for services rendered and reign in revenue will determine the fate of Akamai's revenue projections. Akamai is playing a guessing game as to which its recurring customers will be, basing some of their revenue projections off of an unsteady and volatile market, essentially making Akamai a boat in troubled waters.

Regulation and Maintenance. Uncertainty in the feasibility of increases in bandwidth for Akamai's streaming services will also hamper long-term estimates and make short-term fixed costs high. Furthermore, Akamai is teetering on a precarious foothold, noting that any sabotage, vandalism, human error, physical or electronic intrusion and security breaches, fire, earthquake, flood and other natural disasters, power loss and similar events would cause a loss in consumer confidence in their 24-hour year-round guarantee of service. This would result in a consequent loss of financial capital, as customers would switch or cancel service. Akamai has acknowledged that errors have been found in its vast array of software and servers that now number over 8000.

Competitive Atmosphere. Competition from Inktomi, Critical Path, and Digital Island among others, will keep Akamai's stocks in a volatile transition until the natural selection of the market decides who remains. Therefore, we think that the reliability of Akamai to provide quality service in the face of heated competition will decide its fate and the fate of its stock price. Any "mistake" by Akamai could cause it to lose market share, increase cost and decrease revenue, and could ultimately cause Akamai to go under. Thus far Akamai's capital investments and investments in human resources have prevented Akamai from making any fatal software errors.

FINANCIALS

Revenue. Akamai's net revenue is expected to rise due to its expanding recurrent clients and increasing returns in capital investment, particularly monthly returns from its servers. Expansion into the international market and deals on bandwidth space will also contribute to the company's revenues for 2001. Future acquisitions and partnerships will serve to enhance the quality of Akamai's services, further allowing them to offer their services to a more diverse customer base.

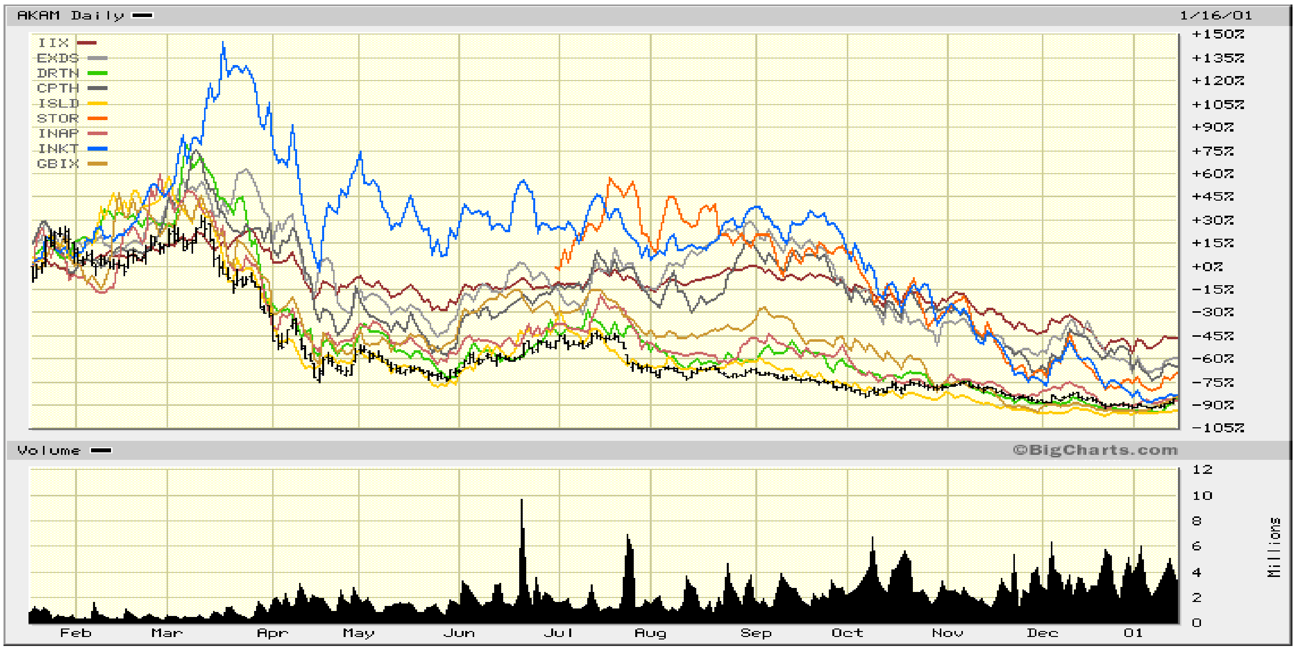
Research and Development. R&D expenses are expected to rise as Akamai continues to consolidate smaller subsidiaries in order to offer a broader range of services. Along with this comes the cost of maintaining quality and qualified staff to lead the company in its new endeavors, as well as the cost of new innovations.

Sales and Marketing. S&M costs will definitely rise because of the rivalry to push a brand name product out on the market. We believe Akamai's customer loyalty is a crucial component of its financial success. As such, Akamai will pursue new clients aggressively, ensured that the quality of their product will be enough to retain and add to their returning customer foundation.

General and Administrative. We expect costs in this sector to rise, given the inherent nature of maintaining and expanding a relatively new Internet company. As acquisitions and partnerships abound, Akamai will increasingly look to its well-trained staff and management to steer it in the right direction.

VALUATION

The recent 40% drop in market value by subsidiary Real Networks have added to Akamai's woes, after warnings that fourth-quarter earnings would fall short of predictions. Along with the shortcomings in earnings, GDP's predicted increase of 2.4% fell short by two tenths of one percent. With internet companies reporting less-than-stellar fourth quarter earnings Akamai's revenues have suffered, something not predicted by analysts on Wall Street who were riding the wave of the bear market.



Comparative Analysis Table

AS OF 1/17

Stock	Price	Market Capitalization	Price to Sales Ratio	Gross Margin
Akamai	27.44	2,962.23	39.04	24.06
Critical Path	24.44	1,799.88	11.29	33.92
Data Return	5.34	191.41	6.1	8.06
Digital Island	4.66	371.46	4.65	-89.14
Exodus	21.25	9,078.42	12.72	29.19
Globix	5.81	217.02	2.54	47.7
Inktomi	16.58	2,107.89	8.66	85.73
InterNAP	9.22	1,366.17	26.12	-52.97
Storage Networks	24.63	2,334.70	33.98	NM
AVERAGE	15.48	2269.9	16.12	10.82

Margins. Akamai's gross margins are relatively low because of their commitment to expansion and their business plan of long-term success. They continue to deploy servers, (now numbering over 8000 worldwide) and this investment in capital is reflected in the gross margin. As Akamai trades off its services in return for network bandwidth, we predict operating costs will fall and gross margin will increase.

Price to Sales. From the P/S Ratio given in the above table and the circumstances surrounding Akamai technologies and the content delivery market we believe Akamai has done well in the competitive atmosphere and retains advantages in the market. These advantages include large investments in capital, unique technology, a sound recurring customer base, and a continued quest to expand its services as well as sales and marketing finesse. We hold true to Akamai's ability to innovate and expand as the factor in its high p/s ratio, relative to its closest competitors, many of which are struggling newcomers, some of which are overvalued and forming alliances to compete with Akamai. Akamai still holds well over half of the content delivery market and so we believe Akamai's P/S Ratio is fairly valued.

Cash. Akamai currently has enough cash to meet anticipated needs for working capital and capital expenditures for at least 12 months. Akamai plans on filing a shelf registration with the Securities and Exchange Commission to sell up to $500 million in equity and debt securities. The company said the filing would enable it to sell the securities over the next two years. It is in our opinion that this is a precautionary move for the upcoming fiscal year to ensure the liquidity needed for necessary expansion.

Investment Opinion. We give Akamai a rating of C for the short term because of a slight trend in outperforming the IIX and because of the continued development of the content delivery sector. However, in the long run we see an uncertain 2001 for the content delivery sector, as firms consolidate their services due to unachieved revenue predictions. We remain cautious yet optimistic and recommend the ACCUMULATE rating, looking ahead to their fourth quarter report. Based on our analysis of the content delivery market and Akamai's competitors, we shall set the target price for Dec31, 2001 to be 40$.

For Akamai, their long-term survival stems on their recurring customer base, so far shown to be fairly reliable, even with the inclusion of small Internet firms and businesses. Therefore for FY2001, we rate Akamai at 6, as we believe it will outperform the IIX. Akamai must still defend its intellectual property and patent rights and offer new and innovative services, an increasingly difficult task. However, we believe Akamai technologies will ultimately maintain its edge over the competition and ride the volatile Internet market into the "cool breeze" of success.

	1998A	1999A	2000E	2001E
Revenue	n/a	$3,986	$84,522	202735
Operating expenses:				
Cost of services	31	9,188	61,701	133805
Gross Profit	31	5,202	22,821	68930
Engineering and development (excludes $3,410, $6,244, $3,597 and $7,941, respectively, of equity-related compensation disclosed separately below)	229	12,503	60,855	101368
Sales, general and administrative (excludes $2,870, $3,409, $4,021 and $13,322, respectively, of equity-related compensation disclosed separately below)	435	30,752	166,508	261528
Amortization of intangible assets	n/a	17	640,000	920000
Equity-related compensation	205	10,884	26,202	14191
Total operating expenses	900	63,344	955,266	1430892
Operating loss	869	59,358	870,744	1228157
Interest income (expense), net	10	2302	12,617	6000
Loss before provision for income taxes		57,056	858,127	1222157
Net loss	890	57,056	858,127	1222157
Preferred Dividends	n/a	2,245		
Net loss attributable to common stockholders	890	$59,301	858,127	1222157
Earnings per Share	0.06	$1.37	$9.73	12.28
Weighted average common shares outstanding	15,015	41,715	88,188	99500
Margin Analysis				
Gross Margin	n/a	-131	27	34
Engineering and Development	n/a	314	72	50
General and Administrative	n/a	772	197	129
Equity related compensation	n/a	273	31	7
Operating Margin	n/a	-1488	-1030	-606
Net Margin	n/a	-1516	-1015	-603
Growth				
Total Revenue	n/a	n/m	2021	140
Gross Profit	n/a	-16681	339	202
Operating Expense	n/a	6938	1367	41
Operating **Income**	n/a	6731	1377	25
Net Income	n/a	6311	1404	42
Earnings Per Share	n/a	-2183	-610	-26