Akamai Technologies, Inc. (AKAM)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

Price ($) (5/12/20): 95.76
52WK H-L ($) : 108 - 73
Market Cap (mil): 15,705
Shares Out (mil): 164.0
Float (mil): 158.6
Dividend ($) : 0.00
Yield (%): 0.0

Rating: Outperform
Outperform Higher Risk FY Dec 2019A 2020E 2021E
110 Q1 1.10A 1.20A
Price Target ($) :
10% Q2 1.07A 1.21E
L-Term Rev. Gr Rate Est:
33.6% Q3 1.10A 1.21E
L-Term EPS Gr Rate Est:
6.7% Q4 1.23A 1.33E
Debt/Cap: Total 4.50A 4.95E 5.31E
ROE: FY P/E 21.3x 19.3x 18.0x

Headquartered IPO/Founded
Cambridge, MA 1999 / 1998

Management
CEO: Tom Leighton
CFO: Ed McGowan
IR: Tom Barth

Company Description
Headquartered in Cambridge, Massachusetts, Akamai owns and operates a global content delivery network (CDN), and provides a variety of solutions for accelerating digital content, managing workflows, and analyzing performance and usage trends. The company also provides acceleration services for web-based enterprise applications. Additionally, Akamai offers security solutions that help defend web sites against DDoS attacks and other malicious activity. Akamai is currently the largest CDN, with over 240,000 servers deployed globally.

Revenue Profile

Source: Baird & Co. Estimates, Company Data

Competition
Competitors include Limelight Networks, Level 3, EdgeCast, Amazon CloudFront, Fastly, Cloudflare, and others. Akamai also competes against do-it-yourself solutions, as exemplified by Netflix's OpenConnect solution. In security, Akamai competes against a host of providers like Zscaler, Radware and F5.

William V. Power, CFA
Sr. Research Analyst
wpower@rwbaird.com
214.220.3055

Charles Erlikh, CFA
Research Associate
cerlikh@rwbaird.com
312.609.2553
Quick Summary
We rate the stock Outperform based on the following factors:

- **Beneficiary of higher online traffic.** The potential for higher online traffic as more employees and students work from home could provide a tailwind, in addition to OTT video launches, the U.S. election, etc.
- **Strong profitability and solid cash flow.** AKAM grew EPS 24.0% to $4.50 in 2019, with $496.2 million of FCF, which we expect to stand out further in the current economic climate.
- **Strong security growth.** Security grew 29.0% in 2019 to $848.7 million, with the company conservatively expecting 20%+ growth in 2020. 55% of its customer base currently subscribes to a security product, with just 28% taking more than one product. Bot Manager has been the fastest growing product at $100 million+. Newer enterprise security and identity management products could provide future upside.
- **Media to benefit from OTT traffic.** OTT traffic should benefit from new video offerings like Disney+, Comcast’s Peacock, HBO Max, Apple TV+, etc. Though multi-sourced, we expect AKAM to capture its fair share of that traffic.
- **Margin expansion positive.** The company has increased adjusted operating margin from 24.4% in 2017 to 29.2% in 2019 while continuing to invest in go-to market and R&D, with 29.9% forecast in 2020.

Investment Thesis
**Well entrenched.** Akamai currently has over 240,000 servers deployed in over 1,700 networks across the globe. Akamai has a 32% market share of peak North American CDN traffic, according to DeepFields, and 30% of the cloud-oriented video delivery market as measured by ABI.

**Strong security growth.** Security has become a major theme for Akamai in recent years, with the Prolexic acquisition in December 2013 and the continued evolution of its core Kona product. Security revenue grew 29% in 2019 and represented 29% of total revenue.

**Web acceleration still under pressure.** Akamai’s web performance business, excluding security, has been under pressure from competition, and could face limited growth going forward.

**International opportunity.** International accounted for 42% of total revenue in 2019, up from 38% in 2018. Akamai’s increasing focus on international expansion could translate into greater future international contribution and should serve to further expand its footprint and capacity.

**OTT video a key driver.** Delivering over-the-top video remains a core opportunity for Akamai, and the company recently called out OTT as a source of media traffic growth.

**Media revenue under pressure, though improving.** Core media and enterprise revenue declined roughly 4% in 2017, grew slightly in 2018, and was roughly flat in 2019. With OTT seemingly improving, and media traffic generally improving, trends are starting to look better than they have in recent quarters.

**Margins improving.** Driven by cost cuts and selective investing, EBITDA margins have been rising since the middle of 2017, and are expected to continue in 2020.

**Strong IP.** Notably, Akamai has 208 issued U.S. technology patents and numerous additional patent applications pending, which we believe speaks to the technology strength of the company.

**Ongoing buyback.** Akamai repurchased $750 million of stock in 2018 and $335 million in 2019, and increased its previous authorization during 2018 by $1.1 billion through 2021.

**Strong balance sheet.** AKAM ended 2019 with $532.6 million of net cash, or ~$3.25/share. We expect acquisitions to continue to be a use of cash, followed by further buybacks.
Risks & Caveats

Various competitive threats. Akamai is facing competition from Limelight, Level 3, Amazon, Fastly, Cloudflare, Verizon EdgeCast, along with increasing competition from in-house solutions from its customers. Companies like Netflix and Apple have recently built out their own CDNs, reducing and in some cases eliminating the need for Akamai altogether.

The Amazon factor. Amazon’s CloudFront CDN has been in the market since 2008. Although Amazon has continued to enhance CloudFront, even adding a free tier to complement its AWS free tier, Amazon has generally not been overly disruptive to Akamai’s business. However, given Amazon’s history of competing hard on price, we would not be surprised if Amazon eventually decides to turn up the heat on Akamai.

Acquisition integration risk. Akamai has traditionally been a relatively acquisitive company. Future acquisitions could prove difficult to properly integrate into the core network and/or could be dilutive.

Customer concentration risk. The top six internet customers accounted for 6.5% of total revenue in 2019, compared to 6.4% in 2018 and 8.2% in 2017.

Supplemental Information

AKAM is trading at 19.4x our 2020E EPS forecast and 18.1x 2021E, with EV/EBITDA multiples of 11.0x and 10.0x.

Our $110 target price is based on 21x our 2021 adjusted EPS forecast, above its historical average of about 20x, reflecting accelerating revenue trends.
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