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Akamai Technologies, Inc. (AKAM) CEO Tom Leighton on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-28-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $1.1 beats by $0.10 | Revenue of $709.91M (6.02% Y/Y) beats by $8.66M

Earning Call Audio

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Akamai Technologies, Inc. (NASDAQ:AKAM) Q3 2019 Earnings Conference Call October 29, 2019 4:30 PM ET

Company Participants

Tom Barth - Head of Investor Relations

Tom Leighton - Chief Executive Officer and Co Founder

Ed McGowan - Executive Vice President and Chief Financial Officer

Conference Call Participants

Mark Mahaney - RBC

Keith Weiss - Morgan Stanley

Will Power - Baird

Sterling Auty - JPMorgan

Michael Turits - Raymond James

Brad Zelnick - Credit Suisse

Lee Krawl - B. Riley FBR

Alex Henderson - Needham & Company

James Fish - Piper Jaffray

Jeff van Rhee - Craig Hallum

John Blackledge - Cowen & Co

Tim Horan - Oppenheimer

Operator

Good day, ladies and gentlemen. And welcome to the Third Quarter 2019 Akamai Technologies Inc. Earnings Conference Call. At this time, all participants are in a listen-only mode. [Operator Instructions] Please be advised that today's is being recorded.

I would now like to hand the conference over to your speaker today, Tom Barth, Head of Investor Relations. Sir, please begin.

Tom Barth

Thank you, Noran. And good afternoon and thank everyone for joining Akamai's third quarter 2019 earnings conference call. Speaking today will be Tom Leighton, Akamai's Chief Executive Officer; and Ed McGowan, Akamai's Chief Financial Officer.

Before we get started, please note that today's comments include forward-looking statements, including statements regarding revenue and earnings guidance. These forward-looking statements are subject to risk and uncertainties and involve a number of factors that could cause actual results to differ materially from those expressed or implied by such statements.

Additional information concerning these factors is contained in Akamai's filings with the SEC, including our annual report on Form 10-K and quarterly reports on Form 10-Q. The forward-looking statements included in this call represent the company's view on October 28, 2019. Akamai disclaims any obligation to update these statements to reflect future events or circumstances.

As a reminder, we will be referring to some non-GAAP financial metrics during today's call. A detailed reconciliation of GAAP and non-GAAP metrics can be found under the financial portion of the Investor Relations section of akamai.com.

And with that, let me turn the call over to Tom.

Tom Leighton

Thanks Tom. And thank you all for joining us today. Before I cover our financial results, I'd like to say a few words about the significance of this week in internet history. 50 years ago, on October 29, 1969, the first message was transmitted over the Internet. The first message was supposed to be a login, but after the letters L & O reached Stanford from UCL's UCLA, the internet crashed due to a memory overflow. It's stunning to think about how far the Internet has come from those humble beginnings. And I'm looking forward to joining the Internet's leading pioneers tomorrow at the Internet 50 Conference at UCLA, where we'll celebrate 50 years of amazing innovation. And I'll lead a discussion on the future of internet security and privacy.

This week also marks the 20th anniversary of Akamai's IPO on October 29, 1999. Like the internet, Akamai has come a long way since our founding. During the first 10 years of our existence, we essentially created the CDN industry, where we're still the market leader by far. And over the last decade, we pioneered the creation of Edge security services with industry-leading products such as KONA SITE DEFENDER and Bot Manager. Our success over the past 20 years has been achieved through very hard work, tremendous innovation and the development of our unique Edge platform with servers in nearly 4,000 locations across 1,000 cities and 137 countries.

The breadth of our Edge platform means that we're incredibly close to billions of end-users. And being so close means that Akamai is in a unique position to provide the near instant response times, very high quality video experiences and market leading security services that our customers are demanding. As many of you know, there's been a lot of buzz lately about the importance of being at the Edge. Gartner, Forrester, IDC and other leading analyst firms have all published reports explaining why the Edge is so important for end-user performance and security. This has not gone unnoticed by our competitions, who are now trying to play up any connection they can make to the Edge. No matter how slender even when their platforms are really located in core datacenters.

They're now talking about how its computing can be used for tasks such as locating nearby resources, supporting AV testing or enabling real-time streaming. And they're talking about it in a way that suggests that these capabilities are somehow novel. Those of you who've been following Akamai for a while know that Akamai is the one company with a true Edge platform. And that we've been leading the way when it comes to Edge services for nearly two decades. In fact, we launched the world's first suite of Edge services 19 years ago in October of 2000. And 18 years ago, eWeek featured Akamai for its evolution into an ambitious provider of Edge computing to large businesses.

To be clear, Edge computing is not new; at least it's not new for Akamai. We've had thousands of customers using our Edge computing capabilities for well over a decade. And not just for locating nearby resources, supporting AV testing or enabling real-time streaming. Akamai customers have long been using our Edge computing capabilities for a wide variety of tasks that are helpful in managing a state-of-the-art web presence. For example, tasks such as API governance, global traffic management and application load balancing, script management, user prioritization and waiting room, URL redirection and rewrites, phased code deployment, access control, field input validation, adaptive image and video optimization, proxy detection, watermarking, token authentication and revocation, content encryption, bot management, web app firewall and more recently IoT message broker and compute services, and blockchain ledger updates.

All of these capabilities and more are enabled through our platforms highly distributed design which supports real-time data processing and decision making close to the end user. So that every user can have a great experience without overloading expensive cloud datacenters. To be clear, we don't take the competition lightly but when it comes to Edge abilities, we believe that the others have a lot of catching up to do to match what we've been doing and doing profitably for a very long time.

Turning now to our financial results. I'm pleased to report that Akamai delivered another quarter of excellent results in Q3 coming in above expectations on both the top and bottom lines. Revenue was $710 million, up 7% over last year in constant currency. Q3 non-GAAP EPS was $1.10 per diluted share, up 18% in constant currency. Our very strong third quarter results were once again driven by the rapid growth of our cloud security and international businesses. Strong growth in video software and gaming download traffic. And our continued focus on operational excellence.

Our adjusted EBITDA margin in Q3 was 42%, up one point over Q3 of last year. Non-GAAP operating margin was 29%, up two points over Q3 of last year. We've made excellent progress towards our goal of achieving non-GAAP operating margins of 30% in 2020. As we continue to invest in innovation on new products with the goal of driving our future growth. Our security portfolio continued to be the fastest growing part of our business in Q3 achieving revenue of $216 million, up 29% year-over-year in constant currency. Bot manager and our enterprise security solutions continue to lead the way in Q3 with revenue growing by more than 50% over Q3 of last year.

In addition to selling our enterprise security services directly to major enterprises, we're also now equipping our carrier partners with services that they can sell to small and medium-sized businesses to defend against malware and bot attacks. By embedding our technology in the carrier products such as the recently released Comcast Business Security Edge, we can efficiently reach a much larger number of enterprise customers. The success of our security products was again a key driver for growth in our web division which delivered $390 million of revenue in Q3, up 10% over Q3 of last year in constant currency.

Our leadership in security also helped to limit customer churn to a five-year low in Q3. Keeping customers happy is always job number one and so we were very pleased to see such a strong result. Our media and carrier division also performed well in the third quarter due to strong traffic growth for OTT video services and software and gaming downloads.

Overall, we continue to grow traffic on our platform in Q3 faster than published growth rates for the Internet as a whole meaning that we continued to gain traffic share. We set a new record for peak traffic on October 15th when we delivered 106 terabits per second. This is 66% larger than the peak we saw in Q3 of last year and it's a strong proof point for the enormous capacity of the Akamai Edge platform.

We believe that our ability to provide high quality performance at this scale gives us a strong competitive Edge when it comes to delivering traffic for popular OTT services. On a typical day, we now deliver over 800,000 terabytes of content end users. To put such a large number in context, 800,000 terabytes is about what is contained in 200 million DVDs or 800 billion web pages. And we are now delivering this much traffic almost every day on the Akamai Edge platform. Before handing the call over to Ed, I'd like to say a few words about three recent acquisitions. KryptCo, ChameleonX and Exceda. KryptCo is a very small MIT based startup with some excellent technology for providing truly secure multi-factor authentication or MFA.

The technology is easy to use and has significant security advantages over traditional MFA solutions which can be compromised by phishing attacks. We plan to integrate this technology into our portfolio of enterprise security solutions. ChameleonX is a small Israeli startup with some innovative technology for detecting when a website contains or links to malware that causes end-user data to be compromised. Accidentally incorporating malware from third parties into a website or app is a major problem for enterprises that has already resulted in several large data breaches, which in turn can lead to very large financial penalties from regulators. Our goal in acquiring ChameleonX is to develop a service to stop these attacks.

We expect the deal to close soon. Lastly Exceda is a leading provider of CDN and web security services in Latin America. They've been our largest reseller and an important and fast-growing region and they have a very talented salesforce and professional services team. We've entered into an agreement to acquire Exceda as part of our overall plan to grow our market presence throughout Latin America, including Brazil, Mexico Argentina, Chile, Colombia and Peru. We expect the acquisition to close later in Q4. These three transactions will cost less than $50 million combined. We view them as smart investments that we think will drive significant growth for Akamai in the future.

In general, we plan to continue to be active in M&A which is a key reason why we raised an additional $1.15 billion in convertible debt in August. Of course, we're always judicious in how we spend shareholder capital as we continue to search for compelling opportunities to accelerate profitable revenue growth.

In summary, we're very pleased with the consistency of our results in the first three quarters of 2019. The impressive revenue growth of our security products, the high traffic growth in our CDN business, our strong growth and opportunity in the international markets and our healthy operating margins achieved even as we continue to invest in innovation, new products and acquisition with the goal of driving our future growth. We're especially pleased to have delivered these results the right way. As evidenced by Akamai being named last quarter to both the Dow Jones Sustainability Index and the Global FTSE4Good index.

And for that, I want to thank our hard-working employees for helping Akamai to achieve such strong results and positive recognition. Now, I'll turn the call over to Ed to review our Q3 results and guidance for the remainder of the year. Ed?

Ed McGowan

Thank you, Tom. As Tom outlined, Akamai delivered another excellent quarter in Q3. We were very pleased to exceed the high end of our guidance range on revenue, operating margin and earnings. Q3 revenue was $710 million, up 6% year-over-year or 7% in constant currency, driven by strong security growth and higher than expected video and software traffic. In addition, we didn't see the traditional slowdown in traffic during the summer months as we have seen in the past. Revenue from our web division was $390 million, up 9% year-over-year or 10% in constant currency.

Revenue growth for this group of customers continued to be driven by our security business, where we saw strong performance across multiple security products in several key verticals, including financial services, commerce and high-tech. Revenue from our media and carrier division was $320 million, up 2% year-over-year or 3% in constant currency. The better than expected growth in Q3 came from continued momentum in security and higher than expected OTT video and software traffic as we gain share in several key customers during the quarter.

Revenue from the internet platform customers was $44 million, up 2% from the prior year. Security revenue for the third quarter was $216 million, up 28% year-over-year or 29% in constant currency. Sales in our international markets now represent 42% of total revenue in Q3, up four points from Q3, 2018 and up one point from Q2 levels. International revenue was $297 million, up 15% year-over-year or 18% in constant currency. As Tom outlined earlier, we entered into an agreement in Q3 to acquire Exceda as part of our overall plan to grow our market presence throughout Latin America.

We are pleased with the traction we've seen from prior go-to-market investments overseas and expect the Exceda acquisition once closed will help spur revenue growth internationally. Foreign exchange fluctuations had a negative impact of $2 million on a sequential basis and negative $6 million on a year-over-year basis. Finally, revenue from our US market was $413 million relatively flat year-over-year.

Moving now to costs. Cash gross margin was 78% roughly flat with Q2 two levels and up one point from the same period last year, primarily due to the continued execution of our platform efficiency initiatives. GAAP gross margin which includes both depreciation and stock based compensation was 65%, down one point from Q2 levels. Non-GAAP cash operating expenses were $250 million, down $4 million from Q2 levels and favorable to our guidance due to our continued focus on operational efficiencies, savings generated through our enhanced procurement function and the timing of approximately $2 million of costs related to our new headquarters shifting from Q3 to Q4.

Now moving on to profitability, adjusted EBITDA was $301 million, up $8 million from Q2 levels and up $27 million or 10% from the same period in 2018. Our adjusted EBITDA margin was 42% consistent with Q2, up one point from Q3, 2018 and above the high end of our guidance range. Non-GAAP operating income was $208 million, up $4 million from Q2 levels and up $27 million or 15% from the same period last year. Non-GAAP operating margin came in at 29%, consistent with Q2 levels, up two points from Q3 of last year and above our guidance range.

Capital expenditures in Q3 excluding equity compensation and capitalized interest expense were $154 million. This was below our guidance range due to lower than expected spend on our new headquarters, as well as some costs related to network build-out that shifted into Q4.

Before I move on to earnings, one quick housekeeping item. During Q3, we started to recognize our share of earnings from our previously announced blockchain joint venture with Mitsubishi. Our share of the JV's earnings is a loss of $1.4 million in Q3. It is reflected in our GAAP net income, but it is excluded from our non-GAAP results. GAAP net income for the third quarter was $138 million or $0.84 of earnings per diluted shares. Non-GAAP net income was $181 million or $1.10 of earnings per diluted share, up 17% year, up 18% in constant currency and $0.08 above the high end of our guidance range. Taxes included in our non-GAAP earnings were $34 million based on a Q3 effective tax rate of 16%. This rate is approximately one point lower than our guidance due to higher percentage of foreign earnings.

Now we'll discuss some balance sheet items. We continue to have a very strong balance sheet. As a September 30th, our cash, cash equivalents, marketable securities totaled $2.3 billion, up about $ billion from the end of Q2. This increase was due to $1.15 billion convertible debt offering we closed in August. This brought our total debt at the end of Q3 to $2.3 billion.

Now I'll review our use of capital. During the third quarter, we spent $176 million to repurchase shares, buying back approximately two million shares. We added Q3 with approximately $800 million remaining on our previously announced share repurchase authorization. As Tom mentioned earlier, we plan to remain active and discipline in pursuing additional M&A. In our most recent debt offering, further strengthens our balance sheet for additional strategic flexibility. We believe our discipline and balanced capital allocation approach will allow us to continue to drive shareholder value through investing organically in the business, pursuing M&A and continued share repurchases.

In summary, we're very pleased with our Q3 results and remain confident in our ability to execute on our plans for the long term. I'd now like to provide Q4 guidance and an update to our 2019 guidance. As always, seasonality plays a large role in determining our financial performance for the fourth quarter, driven by seasonal online retail activity for our e-commerce customers, higher than normal traffic for our large media customers, and a higher proportion of carrier software license deals that tend to be signed in the fourth quarter. And finally, this year we'll see the launch of two highly publicized OTT offerings in Q4. All these factors make the fourth quarter the hardest to predict.

We also expect the potential for further foreign currency exchange headwinds in Q4 from the continued strengthening of the US in a potential for additional currency volatility associated with Brexit. At the current spot rates, however, foreign exchange fluctuations are expected to have limited impact on Q4 compared to Q3 levels. But will have a negative impact of $2 million year-over-year. Taking all these factors into account, we are projecting Q4 revenue in the range of $735 million to $755 million, or up 3% to 6% in constant currency over Q4, 2018.

To frame this guidance, if the online holiday season and media traffic demand including the OTT launches is exceptionally strong, we would expect to be near the higher end of the revenue range. If the online holiday season and media traffic demand is not as strong then we would expect to be towards the lower end of the range. At these revenue levels, we expect cash gross margins of 78%. Q4 non-GAAP operating expenses are projected to be $274 million to $278 million. The increase in costs over Q3 levels is due to higher sales incentive compensation costs that we typically see in Q4, two months of operating costs associated with the Exceda acquisition, additional marketing expenses related to our Europe and Asia customer conferences. And increase rent associated with the new headquarters building.

Factoring in the cash gross margin and operating expense expectations I just provided, we anticipate Q4 EBITDA margins in the range of 41% to 42%. Now moving to depreciation, we expect non-GAAP depreciation expense to be between $94 million to $96 million. Factoring in this guidance, we expect non-GAAP operating margin of approximately 28% to 29% for Q4. Moving on to CapEx, we expect to spend approximately $153 million to $165 million, excluding equity compensation in the fourth quarter.

This includes approximately $22 million related to our new headquarters, as well as continued network investments in anticipation of increased OTT traffic in 2020. And with the overall revenue and spend configuration I just outlined, we expect Q4 non-GAAP EPS in the range of $1.10 to $1.15 or 4% to 10% in constant currency. This EPS guidance assumes taxes of $35 million to $37 million based on an estimated quarterly non-GAAP tax rate of approximately 16%. And it also reflects a fully diluted share count of approximately 164 million shares.

Looking into the full year, we are raising both our revenue and EPS guidance. On the revenue side, we expect a range of $2.857 billion to $2.877 billion, which is an increase of approximately $12 million at the midpoint of the range compared to our previous guidance. To the full year, we anticipate adjusted EBITDA margins of 42%. We expect 2019 non-GAAP operating margins of approximately 29%. We expect full year CapEx to be 21% of revenue and included in our 2019 CapEx spend is roughly $100 million of one time costs related to the moving into our new headquarters.

Moving to EPS. We are increasing our non-GAAP earnings per diluted share range to $4.36 to $4.42 for full year 2019 which is up $0.11 at the midpoint compared to our previous guidance. Our guidance assumes non-GAAP effective tax rate of 16%, a fully diluted share count of approximately 165 million shares.

In summary, we are very, very pleased with our business performance, as well as our ability to again increase our guidance for the full year. Thank You. Tom and I would be happy to take your questions. Operator?

Question-and-Answer Session

Operator

[Operator Instructions]

Our first question comes from Mark Mahaney with RBC Capital Markets. Your line is open.

MarkMahaney

Thanks. Two questions. Ed you talked about not seeing the typical slowdown into summer traffic that you have seen historically. Any thoughts on why that is? And then secondly a big-picture question on the streaming opportunity. I know you've got two OTT launches, just talk bigger picture. I think this is the one of the biggest trends we're seeing now in video, music and in gaming too. Just talk about how well leveraged you think Akamai is against the streaming opportunity? Any other examples you could provide other than the two launches that are expected in November. Thank you very much.

EdMcGowan

Sure. So, Marcus this is Ed. Yes, the slowdown in traffic typically in years we don't have events whether it's an Olympics or a World Cup. We do tend to see traffic lighten up especially in Europe during the summer months, usually last couple of weeks of July going through August. And we just didn't see that this year and what was interesting is we did see relatively strong traffic in Europe and really across the board in all different parts of the business, OTT, we saw it in gaming. We saw it in software downloads as well. So it was encouraging not to see that slowdown and we had modeled in some of the slowdown we provided our guidance last quarter that explain some of the over performance.

And then in terms of the streaming OTT launches, I get a couple questions in there how well leveraged are we. I think we're very well leveraged with the most publicized OTT offerings in the sense that we've got great customer relationships with the folks that are coming out with new services. We build out a lot of capacity over the last couple of quarters here that's why you are seeing our CapEx be higher than normal and that provides you a benefit when you're competing in a multi CDN world, having ample capacity and having capacity in the right areas. It's not just about having a total amount of capacity, but having capacity in the right operator networks, in the right cities, in the right locations around the world is critical.

And also we talked about earlier; we had gone through a number of pricing renewals throughout the year with a lot of these folks. So we believe are well-positioned to capture our fair share. Now most of these players are multi CDN and in some cases some of them own their own CDNS, but again we think we're well positioned and are continuing to build out for what we hope will be significant traffic.

Operator

Our next question comes from Keith Weis with Morgan Stanley. Your line is open.

KeithWeiss

Excellent. I was hoping to sneak in two questions. One on the cloud security side of the equation, where it seems like traffic growth continues to hold up really well. Some of those core components that we've been talking about for a while, including sort of bottleneck appear to be growing really well. I was hoping we could get an update on some of the newer acquired assets, some of the access stuff or Janrain which was acquired last year, just to get an update on that side of the equation.

And then the second was on, I was hoping just for a reminder, if you could talk to us about how we should expect the balance between US growth and international growth to trend into 2020. I know the US had some headwinds this year around some pricing events and international has been remarkably strong growth throughout the entire year. Should we expect the US to sort of catch up the international, or is there always going to be some further weight on the US business versus international that we should keep in mind?

TomLeighton

Yes, I'll take the first one, this is Tom. We're really excited about the security business, the flagship products there are Kona Site Defender, which provides the cloud-based web app firewall solution that keeps sites from being taken over or corrupted or data being stolen and Prolexic, which stops the denial of service attacks that come at the IP or the routing layer. And those are the flagship products we've built a ton of capabilities on top of that.

You mentioned Bot Manager, which is just doing incredibly well. We talked about growth more than 50% year-over-year and Bot Manager stops the kinds of attacks where an adversary is trying to buy up all the inventory, it could be an article of clothing, could be tickets to a sports event, stops the price scrapers which can cause a lot of expense for the website, especially travel websites and maybe most importantly stops the accounts effort. And this is the bots that are checking out stolen our guests credentials against your bank account to see if they got the right one, then they can drain your bank account and we've had fabulous success in stopping those kinds of attacks and that's I think a key reason why it's - the revenue is growing so rapidly. And the best news there is, we got a long way to go just in our existing base and of course, also signing up new customers.

You mentioned Janrain, the acquisition we did at the beginning of the year for their identity cloud capabilities, which we're integrating into our platform. I think one of the exciting use cases there is to help our customers manage user data, opt in requirements and to help them be compliant with the laws that are being passed all around the world. I think a lot of people are familiar with GDPR in Europe, especially now that's some multi-hundred million dollar fines have been issued. But you have a law coming into effect in California, CCPA on January 1. Most of our customers probably are not yet compliant. We can help with that. You'll have other states in the US; New York will be passing laws and many other countries around the world. And these laws are all a little bit different and our customers are going to need help making sure that they can be compliant.

And I think we really could help using our identity cloud solution, which we're creating a part through the Janrain acquisition. We've talked about our enterprise security solutions, a notion of zero trust. I think there is a very exciting future there. We're seeing substantial customer wins there, as people start embracing the zero trust concept and methodology. Again, revenue is growing over 50% there as well. We talked about the new acquisitions. Edge integrity, which is the ChameleonX acquisition I think, is very important. This is where we stop things like Magecart that have caused some large data breaches on famous websites. In turn, again huge fines, multi-hundred million dollar fines being imposed when those breaches have happened, and I think Akamai is in a fantastic position to protect our customers against those kinds of attacks.

People don't think about it a lot today, but most of the content you get, when you go to a website, doesn't really start or originate at that website. It's third-party content. Content used for marketing purposes, for performance management, advertising, all sorts of other things. And it turns out that content can often have malware in it or that a website will link to a partner who provides these services and they will be compromised with malware and that results in the end user giving up their private data like a credit card. And Akamai is in a really good position to stop that and we'll be looking forward to introducing a product into the market next year, early next year, which we call page integrity management.

We talked about KryptCo, another small acquisition, but with some really exciting technology around push-based multi-factor authentication. And the interesting thing there is what a lot of enterprises use for that today is vulnerable to phishing attacks. And that people don't think about it a lot, but that's not very good and with the integration of KryptCo, we're going to be able to stop those attacks for enterprise. So there's a lot of exciting innovation going on in cloud security at Akamai. And we're looking forward to continued strong growth there. And Ed, I'll turn it over to you for the other question.

EdMcGowan

Sure. Keith, your question was around US versus international growth. So let me tackle it this way. Let me just remind everybody on the US side, we have flat year-over-year and then a bit challenge for us - and just as a reminder, that's where we have our Janrain accounts, those were down a couple of million quarter-over-quarter this quarter. And we also have the US commerce vertical in the US number of bankruptcies this year, including a couple this quarters. So still a challenged area. And then also a lot of the repricings for consolidations that we talked about earlier - in earlier quarters or in that area.

But I think the question would be, how - what do you have to believe to see growth accelerate in the US and I think the three main categories. The first one is what Mark mentioned earlier on his first question around OTT growth, but just traffic in general where we're seeing strong traffic in not only just streaming video, but also music, OTT social et cetera, gaming. Then also Janrain, Janrain is a new addition, as Tom talked about, don't have a ton of penetration yet in the US, that's a new security product and then security in general when you look at enterprise, which is really in the early days and also new customer acquisitions. We've done a pretty nice job in the last couple of quarters of increasing our new customer acquisition in most of that's being led by security.

So those would be the things you have to believe in order to start to see the US growth rate increasing as we go into the future. And as far as the international growth, that's been very strong as you pointed out, and a lot of that has to do with the fact that we made some significant investments in GTM, go-to-market over the last couple of years and we're starting to see that pay off. Very strong growth in Asia across all of our products, including media. Our web products as well as security seen very solid growth in EMEA. And then also Latin America and Middle East, we see a big opportunity to continue our growth as evidenced by our Exceda acquisition.

Operator

Our next question comes from Will Power of Baird. Your line is open.

WillPower

Okay. Great. Thanks. Yes, no, great to get to hear the commentary on the expected traffic in Q3 opportunities and Q4. I guess maybe just kind of following up, just to kind of thinking about the media and carrier division, the revenue growth opportunity. We did see the overall media revenue growth decelerate a bit year-over-year, I think up 2% or 3% constant currency. It sounds like, and maybe I'd love to get a little more color on this, how much of that is tied to the pricing renewals? What you're seeing on that front given the positive traffic commentary? Then how do we think about that into Q4? I mean is that - can you start to inflect or are you still going to have pricing renewal pressure? How do we think about that media revenue growth trajectory as we go into Q4 and then into 2020?

EdMcGowan

Yes, good question, Will. I'd say there are two factors when you look at kind of the year-over-year. One is we had a really strong year in media last year. So a little bit tougher comps, but really pricing is the main driver. We've called it out for the last several quarters; it was a number of very large renewals that we went through for consolidations that we hadn't seen of this magnitude in the industry. So that was something that definitely was making the growth cost much harder.

In terms of pricing renewals going into Q4, we factored everything into our guidance. I think if you look at the OTT launches, we factored in some growth associated with that, given that there in November, there's just not a ton of time left in the quarter. So not a huge expectation there and then with our giant customers, we had talked in the earlier quarter about the fact that we had a couple of renewals this quarter and were expected to be down $3 million or $4 million. We actually were only down about $2 million. So it's a little bit better there. And we expect that to be up a couple million next quarters.

WillPower

Okay. If I could maybe just squeeze one more and Tom, you gave a lot of great examples of some of the things you're doing on the Edge today. As you look forward, what are some of the Edge applications that get you most excited? Maybe - is there anything tied to 5G as an example and what better positions you for those applications versus some of your competitors perhaps?

TomLeighton

Yes. Pretty much everything - all of - everything we're doing involves Edge computing in some way. Certainly everything we're doing involves the Edge. And the Edge enhances pretty much everything that we're doing. As we look toward 5G, I think that's really exciting in terms of enabling new kinds of applications around the Internet of Things.

There's been a lot of buzz about IoT, but so far, we haven't seen so many killer applications. But I think that could be in the process of changing. As we look across our customer base, I would say a lot of our customers in several different verticals are now engaged in projects involving IoT. Sensors in sneakers, sensors in clothing or sports equipment, sensors on price tags, obviously cars, obviously mobile devices and gaming, big IoT potential markets and the reason I think 5G is helpful here is because it will allow many billions more of devices to connect.

The latency will be much lower across the air than it is for 3G and 4G and the throughput will be higher. So that means you get more devices can communicate more effectively and that's enabling I think for some of these at the same time people are coming up with these IoT applications and I think that could be very exciting.

Now one of the nice things about 5G is that I think it makes it even more important that you have a real Edge network and not an Edge platform in name only, which we hear a lot from our competition. But a platform where you're really close to the last mile, you are deep inside, the carriers and the cellular networks that are offering this capability and Akamai is really unique in that context.

And once the latency is lower in the last mile, and you have higher throughput, now, you really can take advantage of applications with low latency and high throughput, if you really have an Edge platform and because there you have the capacity in the last mile and you're close to what you have low latency. If you're trying to serve out of the core datacenters, you're still going to have latency problems even when 5G comes. And you're still going to have throughput problems even when you get better throughput in the last mile, and I think that's a key reason why you see Akamai being so much more successful in such a larger scale than some of these other companies that are serving out of core datacenters at, of course, much lower volumes, and it's the Edge platform that makes a difference and that is our competitive - a major competitive advantage. It really is the Edge; it's not just the marketing tool.

Operator

Thank you. And our next question comes from Sterling Auty of JP Morgan. Your line is open.

SterlingAuty

Yes, thanks. Hi, guys. One question, one follow-up. So on the OTT, before we even get to these two - couple of major launches, can you just set the context and give us an idea how big has OTT gotten within Media and Carrier or however you want to describe it? We've gotten to the point that it's material even before these big launches?

EdMcGowan

Okay, Sterling. This is Ed. Yes, so we've always talked about how video is our largest source of traffic and it's our fastest growing source of traffic. So OTT is a pretty big part of the Media and Carrier business today. We do a ton with live sports; part of the strength we saw in Europe was as a result of folks that have sports rights. I didn't see any slowdown there and see the audience sizes growing. We do several live television offerings, linear television as well as a lot of video on demand. So it's been a very strong part of our business and continuing to grow. We're seeing some pretty good signs in terms of user adoption, bit rates increasing and traffic growing.

SterlingAuty

All right. Great. And then one follow-up would be, I can't remember if you touched on in your prepared remarks, but just the web performance has been in area that has kind of weighed on the Company, but if I try to take a stab at what the security portion is and back that out, it looks like the web performance side is starting to stabilize. Is there any additional color you can give to - is that really the case and what's driving maybe a little bit of improvement there?

EdMcGowan

Yes, I said there are the two things in the web performance business that is driving the performance that you're seeing. One is obviously security that you're right to point out that's been the primary driver, but also we're seeing really strong growth internationally both in Europe and Asia. So US have really been at the problem for us in terms of the US commerce verticals. So we're not ready to declare victory there yet, there is still some room to go there. And as I had mentioned, it was a couple of bankruptcies this quarter, has been probably over 10 so far this year. So still a troubled vertical for us. So until that really stabilizes I think it's tough to say that we're completely out of the woods on that part of the business, but again, we're seeing really strong security and web performance in Europe and Asia has been pretty strong for us.

Operator

Thank you. Our next question comes from Michael Turits with Raymond James. Your line is open.

MichaelTurits

Hey, guys. Good evening. Tom, I wanted to ask you about another security that you didn't mention. I think that you talked about launching a secure web gateway at your conference this summer. So does that put you into competition with some of the other network security providers that are looking to do security from the Internet like Zscaler or Palo Alto, and how are you going about that?

TomLeighton

Yes. Secure web gateway is an important component in our Enterprise Threat Protector solution. And yes, we are in competition with, I would say the largest competitors or the traditional ways of doing things where you have a secure web gateway, that's a piece of hardware that you operate in a datacenter or there is a cloud instance of it and you operate it there.

The legacy way of doing things are the traditional way of doing things as our largest competitor. Zscaler would be our largest competitor; I think in the future way of doing things. And we do compete actively with Zscaler both for Enterprise Threat Protection, which includes a secure web gateway and also Enterprise Application Access which is where you're providing the access or authenticating enterprise employees and devices to get them access and we compete very successfully. Big advantages that Akamai has are our enterprise platform. We have a much larger cloud security business overall. And so we're already engaged and trusted by the CSOs in the large enterprise organizations.

We have our Kona Site Defender service, which I think is critical for really providing enterprise security and zero trust and the competition that you mentioned doesn't have anything like that. And I would say, lastly performance matters for enterprises. And one of the big challenges with enterprise security that often keeps them from using products from some of the companies you mentioned is that when you turn it on, including our secure web gateway, it destroys your performance to the point where the employees objecting, especially if you are a global company and you don't want to use it. And of course that's a problem.

With Akamai being a performance company, when you turn on our security products, your performance gets better. In fact, we recently had some major customer wins where performance was identified the customers a reason that they chose us over the competition. So they get great Akamai security, but now their enterprise apps get faster for employees instead of slower. So yes, we're competing against those companies and I think, successfully.

MichaelTurits

Okay and then just Ed, if you - how far we in terms of having built out the capacity we need for those launches and into 2020, and obviously, you haven't given guidance yet, but are we at the point where next year we can start to get back to the long-term range for CapEx, both, on a network basis and also whether or not there's any HQ left over?

EdMcGowan

Yes, so just on the HQ, we'll be moving into our HQ later this week. So there won't be anything material related to the HQ from a CapEx perspective next year because we don't anticipate anything. And then on the build-out, we've been building out in advance as we've talked about and I think really what it is going to depend on is, how much demand do we see. To the extent that we see significant demand, we may build a little bit more in the first half of the year to be prepared for that. But we have made pretty significant investments, now we'd expect us to be giving guidance, but toward the higher end of our long-term range for CapEx here for the next several quarters.

Operator

Thank you. And our next question comes from Brad Zelnick of Credit Suisse. Your line is open.

BradZelnick

Thank you so much and congrats on a nice quarter, particularly in security. I wanted to follow up on one of Michael Turits' question as it relates to enterprise security and specifically competing with the likes of a Zscaler or a Palo Alto, which by the way, both of those companies, their go-to-market slightly differs from one another. And I wanted to ask more about your routes to market for enterprise security and appreciating you've spoken a bit to this in the past, you've got strong carrier relationships more broadly across Akamai, and you've got the traditional security VAR channel. Can you talk a little bit about how the go-to-market strategy is evolving as you continue to pick up steam in enterprise security?

TomLeighton

Yes, sure. Usually with new products, especially if they are new to the industry in, which they often are with Akamai, will go direct first through betas and really get the product development of established market traction. And then it quickly extends to our channel. In the area of enterprise security, there I think we have even greater channel adoption and potential. I talked earlier about Comcast business' new security Edge product. You may see it advertised on TV, that's Akamai underneath and it provides a version of our Enterprise Threat Protector product that we talked about just a minute ago for small and medium businesses that Comcast business sells to small and medium businesses. So I think you'll see us on the enterprise security side make even greater use of the channel than we already do with all of our other products and in many cases, you'll see our products be white labeled, so you wouldn't initially know it's Akamai, but it's Akamai underneath.

BradZelnick

Thanks, Tom. And if I could just follow up, particularly on M&A, it's nice to see not only the innovation, you've been able to acquire, but it sounds like very efficient use of capital. As we look forward, how should we contemplate the possibility of Akamai making a larger acquisition in security? Now you've got a lot of cash on hand and what directions might you look to build out the portfolio or rather than sharing your blueprints with us, are there any - is there anywhere sacred where you absolutely wouldn't go? Thank you.

EdMcGowan

Yes, obviously, we're going to be very judicious with anything that's a larger acquisition. It's not impossible we do something larger. In the area of security, valuations are pretty high today and you're not going to see us do anything wacky in terms of the financials. We're very happy with our own capabilities where we see good technology that makes sense financially. We're going to buy it. And then we're going to develop it and bring it to market and now with a security business that's at our scale, we're in a really good position to do that.

In terms of direction, I think you'll see us continue to work in them all that we've been working in, things that are a natural adjacencies for us that complement our portfolio, that work - that really benefit well from having a true Edge platform that will be synergistic with our customer base. Now that we're in enterprise security, I think that now extends to most major enterprises. Those are the areas where we'd be looking for.

Obviously, we care a lot about security and that's broadly construed everything from protecting websites, for protecting applications, protecting datacenters, protecting identity, user information, now protecting enterprises. So I think building out in that area is obviously of interest and as you saw, we are purchasing Exceda, which is a leader in a different geography where we want to see a lot more growth in our traditional businesses, content delivery and to some extent web security. So I think what you've seen us do is a good blueprint for what's coming. There will be acquisitions that will fit well and benefit from the Akamai Edge platform and they'll be synergistic. They're not going to be nutty in terms of cost for things given some of the valuations out there.

Operator

Thank you. And our next question comes from Lee Krawl of B. Riley FBR. Your line is open.

LeeKrawl

Great. Thank you for taking my questions. Two quick questions. First, could you maybe provide us a little more commentary around the churn statements you kind of made in the prepared remarks? Curious if that's a function of bundling, or maybe just better customer retention from a customer service standpoint. And then secondly, perhaps could you maybe quantify both the revenue and OpEx associated with the three acquisitions you did in the quarter, maybe in Q3, and perhaps more on annual run rate beyond Q4. Thanks.

TomLeighton

Yes, I think the record low churn over the past five years, there's a lot of factors to that. It's the combination of products, which make a big difference to customers, to get performance and security in a single platform, in a single offer that matters. It's the great quality that we provide both in terms of enhancing the performance of an application and the security that really works. So the services are really strong and much better, than you can get anywhere else on the market, and the great people, with our services and support.

And we find, especially in the area of security with the attack vectors changing so rapidly that our customers, which are major enterprises, they want to have an expert that they can talk to, that they trust in and can be engaged with them to make sure they stay ahead of the attacks because the attack environment is changing so rapidly out there and so our services professionals are highly desired by our enterprise customers. I think all those things put together have helped reduce what was already a very low churn rate. So it was slow to start with. It's not a situation where we had any kind of churn problem; it's always been low single digits, and now even better. And Ed, do you want to talk about the revenue and the acquisitions?

EdMcGowan

Yes, sure. So the ChameleonX and KryptCo acquisitions are immaterial. We're actually going to absorb the headcount into our normal hiring plan. So no real impact on OpEx. As far as revenue goes, we'll be integrating those into our products. So don't expect any material revenue here certainly in Q4 and in 2020. As far as Exceda goes, we talked about Q4 being about $2 million of revenue and about $0.01 dilutive as we go through the integration and then what we've talked about in our press release we issued when we announced the deal about $15 million of revenue for 2020, actually about $0.01 or $0.02 accretive to next year.

Operator

Thank you. And our next question comes from Alex Henderson with Needham. Your line is open.

AlexHenderson

Great. Thank you very much. So I was hoping you could talk a little bit about two things. One, the sequential increase in OpEx is a little steeper. I was just wondering if you could give us a little bit of the waterfall, what's embedded in that than what we've modeled. And then the second one is on the international side, obviously, you're getting some benefit from the web 2.0 growth internationally versus a decline domestically. But can you talk about the split between domestic growths in security versus international, is international security growing faster than domestic and how do you see that playing out over the next year?

And then one last thing, if I could throw it in, isn't 2020 going to be a much stronger year given with election year, Olympics year and all that sort of stuff. Could you talk little bit about how you're feeling about 2020 versus 2019 at the full year? Thanks.

EdMcGowan

Sure, I'll take it - I'll take that those. So first, I'll start with the sequential increase in OpEx. I talked in my prepared remarks that there are a number of things that factor into it. First thing is, historically in Q4, we tend to see a pretty big jump in our sales incentive compensation plans related to folks hitting accelerators. In this year we're having a good year. So we're anticipating a number of folks tripping into accelerators. The other thing I talked about a couple of million dollars of OpEx is related to our building that pushed from Q3 to Q4. And then there is also the rent expense with the new building. So we're moving - and I mentioned, we'd be moving at the end of this week. So we have additional rent costs that go into the building as well.

Those are the main drivers in terms of the sequential uptick in operating expenses. And also we have our customer conference for Europe and Asia. We had our US conference earlier on in the year. In terms of the international versus the US growth rates, we don't break those out, but it's safe to say that both of those are very strong and pretty similar, probably a little bit faster in the international, especially in Asia.

And then your question on 2020 being a stronger year. We've talked about on some of our earlier calls as we think about 2020. 2020 is an even year and in even years we do tend to have more events. Next year, we have the Olympics, as well as the presidential election. And if I looked back to 2016, the last election we did see a nice uptick in traffic and typically with events like the Olympics that tend to go over several weeks, we do get some additional revenue. Usually there, you're signing up a number of rights holders across the world. So it does tend to be a decent event, nothing overly material, but a decent event that adds to the growth rates and then as we've talked about, obviously there is a couple of OTT launches coming here in the next month, as well as a few that are rumored to be coming in early 2020 and those will help our growth rate in 2020 as well.

Operator

Thank you. And our next question comes from James Fish of Piper Jaffray. Your line is open.

JamesFish

Hey, guys. Great quarter. And thanks for squeezing me in here. Just quickly, last quarter you guys actually gave us greater clarity in the security business around customers across kind of the three main solutions of WAF, DDoS and Bot Management. Any chance if you can update on those customer counts again and also what percentage of customers have one or more security solutions versus kind of stand-alone? And if I can sneak in one more, it doesn't seem like you guys have many customers actually that are using both WAF and DDoS, can you maybe go into why that is?

TomLeighton

Yes, we didn't give the exact counts last quarter. Just wanted to give some kind of idea. We'll probably do that on an annual basis, give you updates there, but probably not every quarter. We are seeing fantastic growth in security and we gave some of the highlights on this call. Penetration, I think we have a lot of room for growth in the existing base because there's several different security capabilities, and I think right now over half the customers have at least one, but our preferred model would be to have several of the security products into all the accounts. So plenty of room for growth in the existing base.

I can also add that we're seeing very strong growth of new customers and that's being led by security. And then I think the third question was customers with Prolexic and Kona maybe. Now Kona Site Defender also provides style of service capabilities at the application layer. Prolexic is sort of specialized and it does denial of service at the routing or IP layer and that really is for protecting datacenters that have other things going on besides the website.

If you just have a website, just have web traffic, then you wouldn't need Prolexic you would simply be using Kona Site Defender and all the capabilities built on top of that. And so that may be why you're looking at a smaller dual penetration. There are sort of different situations that you use them in.

Operator

Thank you. And our next question comes from Jeff Van Rhee of Craig-Hallum. Your line is open.

JeffvanRhee

Great. Just two quick clean-ups for me then. I think you had commented on the network build and some of the CapEx that pushed to Q4. Just curious if that was in response to some variability in terms of demand forecast, maybe an OTT or from others that drove the push. And then the second, for me, I think last quarter you commented on CDN and cloud security and such CDN is flattish and cloud security, I think you bumped to mid to high-20s versus prior being mid-20s. Just comfortable if those are both the right way to think about that?

EdMcGowan

Sure, I'll take this one. On the network build side, it really wasn't a reflection of demand. It's really just the timing of the CapEx in terms of when it actually rides and we reported the CapEx. So nothing there from a demand perspective literally, just timing issue. And then on the CDN being flattish for the year and in the guide on security obviously had a good quarter here and securities, probably closer to the high-20s for security for the year and still flattish on the CDN side.

Operator

Thank you. And our next question comes from Colby Synesael with Cowen & Co. Your line is open.

JohnBlackledge

Great. This is John on for Colby. Thanks for sneaking me in. Just a follow-up on M&A. How should we be thinking about the level of M&A you could do next year and still be able to achieve 30% operating margin target? Thank you.

TomLeighton

Yes. We're committed to doing 30% next year and I don't see anything at this point that would change that. And we're very conscious of operating margins; we make acquisitions and of course as you are seeing we're continuing to make acquisitions. So it's not that we're not going to move forward on deals that we think make a lot of sense that can help our customers, but we're planning to meet 30% operating margins next year.

Operator

Thank you. And our next question comes from Tim Horan of Oppenheimer. Your line is open.

TimHoran

Thanks. You're basically already at your margin kind of goals here. Do you think given the shift in business to security, and other products that margins can kind of continue to trend up for a couple of years?

TomLeighton

We're not making guidance for margins past 2020. As I mentioned, we're committed to delivering 30% next year, and when we get to the beginning of next year, we'll see what we're thinking about in terms of the future. But we're also heavily focused on revenue growth. I think 30% is a good place for the Company to operate. If we can do better, we're certainly going to do that. And I think you on a good point that as security grows as a fraction of our overall revenue that is very helpful for us because that's a very high margin business.

Now of course, at the same time as we make acquisitions and increase our investment for building innovative new security products, that adds a lot of R&D OpEx. So that you have the tension there and right now, we're planning to operate at 30% and if we change that for the future, we'll certainly let you know.

TimHoran

No, that's right. I mean - do you think we've seen at last year a secular shift in seasonality here, given that the base is so much larger or what do you think caused at this summer? And have you seen that in the last couple of years?

TomLeighton

Yes, so as I talked about earlier, Tim, this was kind of an unusual year in terms of what we saw for traffic. Hopefully, that's a trend that continues. Always Q4 is always the biggest seasonal quarter. We talk a lot of, I think most people think about the online shopping season and that is a factor for us. But also we - over the last few years, have seen a really big uptick in seasonality related to media. Some of it has to do with lots of new devices coming online and a lot of firmware updates, as well as sometimes, you'll see some video packages that are bundled in with various hardware platforms and things like that.

Also you tend to see in the fourth quarter, a lot of the gaming publishers try to get new game launches out. So I think we'll always have seasonality in the business as far as Q3 goes. I would be expecting as I think about a normal Q3 without events that would be your seasonally slower quarter and Q4 is always going to be your biggest quarter for traffic.

End of Q&A

Operator

And I'll turn the call back over to management.

Tom Leighton

Okay. Well. Great. Well thank you everyone for joining us this evening. In closing, we'll be presenting at several investor conferences and events throughout the fourth quarter in both the US and Europe. Details of these can be found in the Investor Relations section of akamai.com. Thank you for joining us and have a great evening.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation. You may now disconnect.