

AKAMAI TECHNOLOGIES INC

Form DEF 14A

April 09, 2004

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
SCHEDULE 14A
(RULE 14a-101)
INFORMATION REQUIRED IN PROXY STATEMENT
SCHEDULE 14A INFORMATION
Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, For Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to Section 240.14a-12

Akamai Technologies, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

1) Title of each class of securities to which transaction applies:

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April 12, 2004

To our Stockholders:

I am pleased to invite you to attend the 2004 Annual Meeting of Stockholders of Akamai Technologies, Inc. to be held on Tuesday, May 25, 2004 at 10:00 a.m. at the Marriott Hotel Cambridge, Two Cambridge Center, Cambridge, Massachusetts.

At the Annual Meeting, we expect to consider and act upon the following matters:

- (1) To elect three members of our Board of Directors to serve as Class II directors for the ensuing three years;
- (2) To approve an amendment increasing the number of shares of common stock authorized for issuance under Akamai's Second Amended and Restated 1998 Stock Incentive Plan from 41,255,600 shares to 48,255,600 shares;
- (3) To ratify the selection of PricewaterhouseCoopers LLP as the independent auditors of Akamai for the fiscal year ending December 31, 2004; and
- (4) To transact such other business as may properly come before the meeting or any adjournment thereof.

Details regarding admission to the meeting and the business to be conducted at the meeting are more fully described in the accompanying Notice of Annual Meeting and Proxy Statement.

Your vote is important. Whether or not you plan to attend the Annual Meeting, I hope you will vote as soon as possible. Voting by written proxy will ensure your representation at the Annual Meeting if you do not attend in person. Please review the instructions on the proxy card regarding each of these voting options.

Thank you for your ongoing support of and continued interest in Akamai.

Sincerely,

GEORGE H. CONRADES
Chairman and Chief Executive Officer

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AKAMAI TECHNOLOGIES, INC.

**8 Cambridge Center
Cambridge, Massachusetts 02142**

**NOTICE OF 2004 ANNUAL MEETING OF STOCKHOLDERS
*To Be Held On May 25, 2004***

The 2004 Annual Meeting of Stockholders of Akamai Technologies, Inc. will be held on Tuesday, May 25, 2004, at 10:00 a.m., local time, at the Marriott Hotel Cambridge, Two Cambridge Center, Cambridge, Massachusetts, 02142, to consider and act upon the following matters:

- (1) To elect three members of the Board of Directors of Akamai to serve as Class II directors for the ensuing three years;
- (2) To approve an amendment increasing the number of shares of common stock authorized for issuance under Akamai's Second Amended and Restated 1998 Stock Incentive Plan from 41,255,600 shares to 48,255,600 shares;
- (3) To ratify the selection of PricewaterhouseCoopers LLP as the independent auditors of Akamai for the fiscal year ending December 31, 2004; and
- (4) To transact such other business as may properly come before the meeting or any adjournment thereof.

Stockholders of record at the close of business on March 31, 2004 are entitled to notice of, and to vote at, the meeting and any adjournment thereof. The stock transfer books of Akamai will remain open for the purchase and sale of Akamai's common stock.

All stockholders are cordially invited to attend the meeting.

By order of the Board of Directors,

MELANIE HARATUNIAN
*Vice President, General Counsel
and Secretary*

Cambridge, Massachusetts
April 12, 2004

WHETHER OR NOT YOU PLAN TO ATTEND THE ANNUAL MEETING, PLEASE COMPLETE, DATE AND SIGN THE ENCLOSED PROXY CARD AND PROMPTLY MAIL IT IN THE ENCLOSED ENVELOPE IN ORDER TO ASSURE REPRESENTATION OF YOUR SHARES AT THE ANNUAL MEETING. NO POSTAGE NEED BE AFFIXED IF THE PROXY CARD IS MAILED IN THE UNITED STATES. SENDING IN YOUR PROXY WILL NOT PREVENT YOU FROM VOTING YOUR STOCK AT THE ANNUAL MEETING IF YOU DESIRE TO DO SO, AS YOUR PROXY IS REVOCABLE AT YOUR OPTION.

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AKAMAI TECHNOLOGIES, INC.

**8 Cambridge Center
Cambridge, Massachusetts 02142**

PROXY STATEMENT

THIS PROXY STATEMENT IS FURNISHED IN CONNECTION WITH THE SOLICITATION OF PROXIES BY THE BOARD OF DIRECTORS OF AKAMAI TECHNOLOGIES, INC. FOR USE AT THE 2004 ANNUAL MEETING OF STOCKHOLDERS TO BE HELD AT 10:00 A.M. ON MAY 25, 2004 AND AT ANY ADJOURNMENT OR ADJOURNMENTS OF THAT MEETING.

All proxies will be voted in accordance with the instructions contained therein, and if no choice is specified, the proxies will be voted in favor of the matters set forth in the accompanying Notice of Annual Meeting. Any proxy may be revoked by a stockholder at any time before it is exercised by delivery of written revocation to our Secretary or by voting in person at the Annual Meeting. Attendance at the Annual Meeting will not itself be deemed to revoke a proxy unless the stockholder gives affirmative notice at the Annual Meeting that the stockholder intends to revoke the proxy and vote in person.

Our Annual Report for the fiscal year ended December 31, 2003 is being mailed to our stockholders with the mailing of the Notice of Annual Meeting and this Proxy Statement on or about April 12, 2004.

A copy of our Annual Report on Form 10-K for the fiscal year ended December 31, 2003, as filed with the Securities and Exchange Commission, except for exhibits thereto, will be furnished without charge to any stockholder upon written request to Akamai Technologies, Inc., 8 Cambridge Center, Cambridge, Massachusetts 02142, Attn: Director of Investor Relations. Exhibits will be provided upon written request and payment of an appropriate processing fee.

Certain documents referenced in this Proxy Statement are available on our website at www.akamai.com. We are not including the information contained on our website, or any information that may be accessed by links on our website, as part of, or incorporating it by reference into, this Proxy Statement.

Voting Securities and Votes Required

On March 31, 2004, the record date for the determination of, stockholders entitled to notice of, and to vote at, the Annual Meeting, there were issued, outstanding and entitled to vote an aggregate of 122,800,394 shares of our common stock, \$.01 par value per share. Each share of common stock is entitled to one vote.

Under our by-laws, the holders of a majority of the shares of our common stock issued, outstanding and entitled to vote on any matter shall constitute a quorum with respect to that matter at the Annual Meeting. Shares of our common stock present in person or represented by executed proxies received by us (including broker non-votes and shares which abstain or do not vote with respect to one or more of the matters presented for stockholder approval) will be counted for purposes of determining whether a quorum is present. If the shares you own are held in street name, the bank or brokerage firm, as the record holder of your shares, is required to vote your shares in accordance with your instructions. In order to vote your shares held in street name, you will need to follow the directions your bank or brokerage firm provides you.

The affirmative vote of the holders of a plurality of the shares of our common stock voting on the matter is required for the election of directors. The affirmative vote of the holders of a majority of the shares of our common stock present or represented by proxy at the Annual Meeting and voting on the matter is required for (i) approval of the amendment to the Second Amended and Restated 1998 Stock Incentive Plan, which we refer to in this Proxy Statement as the Stock Incentive Plan and (ii) for the ratification of the appointment of PricewaterhouseCoopers LLP as our independent auditors for the fiscal year ending December 31, 2004.

Shares that abstain from voting as to a particular matter and broker non-votes, which are shares held in street name by brokers or nominees who indicate on their proxies that they do not have discretionary

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authority to vote such shares as to a particular matter, will not be counted as votes in favor of such matter and will also not be counted as votes cast or shares voting on such matter. Accordingly, abstentions and broker non-votes will have no effect on the voting of each matter that requires the affirmative vote of a certain percentage of the votes cast or shares voting on a matter.

Security Ownership of Certain Beneficial Owners and Management

The following table includes information as to the number of shares of our common stock beneficially owned as of February 29, 2004 by the following:

each stockholder known by us to beneficially own more than 5% of the outstanding shares of our common stock;

each of our directors;

our chief executive officer and our three other most highly compensated executive officers in 2003 who received compensation in excess of \$100,000 in 2003, referred to as our Akamai Named Executive Officers, as well as our other executive officers; and

all of our executive officers and directors as a group.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission, which we sometimes refer to as the Commission, and includes voting and investment power with respect to shares. Unless otherwise indicated below, to our knowledge, all persons named in the table have sole voting and investment power with respect to shares of common stock identified below, except to the extent authority is shared by spouses under applicable law. Beneficial ownership includes any shares that the person has the right to acquire within 60 days of February 29, 2004 through the exercise of any stock option or any warrant. Unless otherwise indicated in the notes to the table, the address of each director, executive officer and stockholder owning more than 5% of the outstanding shares of common stock is c/o Akamai Technologies, Inc., 8 Cambridge Center, Cambridge, Massachusetts 02142.

| Name of Beneficial Owner | Number of Shares Beneficially Owned | Percentage of Common Stock Outstanding (%) |
|---|--|--|
| Massachusetts Financial Services Company(1) | 10,693,510 | 8.7 |
| F. Thomson Leighton | 7,479,575 | 6.1 |
| George H. Conrades(2) | 6,196,465 | 5.1 |
| Martin M. Coyne II(3) | 39,875 | * |
| C. Kim Goodwin | 0 | * |
| Ronald Graham(4) | 63,000 | * |
| William A. Halter(5) | 41,250 | * |
| Peter J. Kight | 0 | * |
| Frederic V. Salerno(6) | 100,000 | * |
| Naomi O. Seligman(7) | 23,625 | * |
| Robert Cobuzzi(8) | 71,147 | * |
| Melanie Haratunian | 0 | * |
| Michael A. Ruffolo(9) | 513,510 | * |
| Paul Sagan (10) | 1,504,028 | * |
| Chris Schoettle (11) | 281,136 | * |
| All executive officers and directors as a group (14 persons) (12) | 16,313,611 | 13.2 |

* Percentage is less than 1% of the total number of outstanding shares of our common stock.

(1) The information reported is based on a Schedule 13G/ A dated February 11, 2004, filed with the Commission by Massachusetts Financial Services Company, or MFS. MFS reports its address as 500 Boylston Street, Boston, Massachusetts 02116.

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- (2) Includes 8,694 shares issuable upon the exercise of warrants exercisable within 60 days of February 29, 2004.
- (3) Consists of shares issuable upon the exercise of stock options exercisable within 60 days of February 29, 2004.
- (4) Consists of shares issuable upon the exercise of stock options exercisable within 60 days of February 29, 2004.
- (5) Consists of shares issuable upon the exercise of stock options exercisable within 60 days of February 29, 2004.
- (6) Includes 25,000 shares issuable upon the exercise of stock options exercisable within 60 days of February 29, 2004.
- (7) Consists of shares issuable upon the exercise of stock options exercisable within 60 days of February 29, 2004.
- (8) Includes 62,500 shares of our common stock issuable upon the exercise of stock options exercisable within 60 days of February 29, 2004.
- (9) Includes 289,981 shares issuable upon the exercise of stock options exercisable within 60 days of February 29, 2004. Mr. Ruffolo departed as our Chief Operating Officer in April 2004.
- (10) Includes 234,375 shares upon the exercise of stock options exercisable within 60 days of February 29, 2004 and 6 shares held by Mr. Sagan's minor children.
- (11) Includes 175,000 shares issuable upon the exercise of stock options exercisable within 60 days of February 29, 2004.
- (12) Includes 966,425 shares issuable upon the exercise of stock options and warrants exercisable within 60 days after February 29, 2004.

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PROPOSAL ONE

ELECTION OF DIRECTORS

Our Board of Directors currently consists of nine persons, divided into three classes, serving staggered terms of three years, as follows: three Class I directors (with terms expiring at the 2006 annual meeting of our stockholders), three Class II directors (with terms expiring at the 2004 annual meeting of our stockholders) and three Class III directors (with terms expiring at the 2005 annual meeting of our stockholders).

In May 2003, Martin Coyne was named our Lead Director of our Board of Directors. In this role, he presides over meetings of the independent members of our Board of Directors, leads numerous initiatives relating to corporate governance and Board effectiveness and ensures cross communication across Board committees to ensure that all committees have the necessary information to make decisions that are in the best interests of the shareholders. Since the establishment of the Lead Director role, the independent directors have met following each Board meeting and at other times as required. Mr. Coyne, in conjunction with the other independent directors, establishes the most important issues that the Board of Directors will focus on to drive short-term and longer-term businesses performance. Mr. Coyne works with the Chief Executive Officer to prepare Board meeting agendas and ensure that the necessary preparatory materials are provided to Board members prior to meetings. Following each Board meeting, Mr. Coyne solicits feedback from, and shares his views with, the other independent directors and provides feedback to the Chief Executive Officer and other members of management on their performance and other important issues that the Board of Directors believes management should focus on. Mr. Coyne also leads discussions on Chief Executive Officer performance, succession planning for Mr. Conrades and other key management positions.

In January 2004, C. Kim Goodwin was elected to the Board of Directors by its members in order to fill a vacancy created upon the adoption of a resolution increasing the size of the Board of Directors. Ms. Goodwin serves as a Class I Director. In March 2004, Ms. Goodwin was appointed to the Audit Committee to replace William A. Halter and to the Nominating and Corporate Governance Committee. In March 2004, Mr. Halter was appointed to the Compensation Committee.

In March 2004, Peter J. Kight was elected to the Board of Directors by its members in order to fill a vacancy created by upon the adoption of a resolution increasing the size of the Board of Directors. Mr. Kight serves as a Class III director. Mr. Kight has not yet been appointed to any committee.

Three Class II directors are to be elected at the Annual Meeting. Each of the Class II directors elected at the Annual Meeting will hold office until the 2007 annual meeting of our stockholders or until his or her successor has been duly elected and qualified. Based on the recommendation of the Nominating and Corporate Governance Committee, the Board of Directors has nominated Ronald L. Graham, F. Thomson Leighton and Naomi O. Seligman to serve as Class II directors for a term expiring at the 2007 annual meeting of our stockholders.

In the event that any nominee for Class II director becomes unavailable or declines to serve as a director at the time of the Annual Meeting, the proxy holders will vote the proxies in their discretion for any nominee who is designated by the current Board of Directors to fill the vacancy. It is not expected that any of the nominees will be unavailable to serve.

Board Recommendation

Our Board of Directors believes that approval of the election of Ronald L. Graham, F. Thomson Leighton and Naomi O. Seligman to serve as Class II directors is in the best interests of Akamai and our stockholders and, therefore, recommends that the stockholders vote FOR this proposal.

Set forth below are the names and ages of each member of the Board of Directors (including the nominees for election as Class II directors), and the positions and offices held by him or her, his or her principal occupation and business experience during the past five years, the names of other publicly held companies of which he or she serves as a director and the year of the commencement of his or her term as a director of Akamai. Information with respect to the number of shares of our common stock beneficially owned

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by each director, directly or indirectly, as of February 29, 2004, appears above under the heading Security Ownership of Certain Beneficial Owners and Management.

Nominees for Terms Expiring in 2007 (Class II Directors)

Ronald Graham, age 68, has served as a director of Akamai since August 2001. Mr. Graham, a professor at the University of California at San Diego since January 1999, holds the Irwin and Joan Jacobs Endowed Chair of Computer and Information Science, a non-profit society of scholars engaged in scientific and engineering research. Mr. Graham is also the Chief Scientist of the California Institute for Telecommunications and Information Technology, an institute created by the State of California to fund research related to next-generation of Internet technologies. In addition, since July 1996, Mr. Graham has served as the Treasurer of the National Academy of Sciences. From 1962 until December 1999, Mr. Graham served in a variety of positions at AT&T Corp., a global telecommunications corporation, most recently as Chief Scientist.

F. Thomson Leighton, age 47, co-founded Akamai and has served as our Chief Scientist and as a director since August 1998. Dr. Leighton has been a professor of Mathematics at MIT since 1982 and has served as the Head of the Algorithms Group in MIT's Laboratory for Computer Science since its inception in 1996. Dr. Leighton is currently on leave from MIT. Dr. Leighton is a former two-term chair of the 2,000-member Association of Computing Machinery Special Interest Group on Algorithms and Complexity Theory, and a former two-term Editor-in-Chief of the Journal of the Association for Computing Machinery, one of the nation's premier journals for computer science research.

Naomi O. Seligman, age 65, has served as a director of Akamai since November 2001. Ms. Seligman has been a senior partner at Ostriker von Simson, a consulting firm focusing on information technology, since June 1999. The partners of Ostriker von Simson chair the CIO Strategy Exchange, which regularly brings together four vital quadrants of the IT sector: invited chief information officers, or CIOs, from the largest multinational enterprises, premier venture capitalists, CEOs from prominent computer companies and entrepreneurs leading innovative emerging technology firms. Previously, Ms. Seligman served as a co-founder and senior partner of the Research Board, Inc., a private sector institution sponsored by one hundred CIOs from major corporations. Ms. Seligman also serves on the board of directors of The Dun & Bradstreet Corporation, a provider of business information services, and Sun Microsystems, a provider of network hardware, software and services.

Directors Whose Terms Expire in 2006 (Class I Directors)

George H. Conrades, age 65, has served as our Chairman and Chief Executive Officer since April 1999 and as a director since December 1998. Mr. Conrades has also been a venture partner of Polaris Venture Partners, Inc., an early stage investment company, since August 1998. From August 1997 to July 1998, Mr. Conrades served as Executive Vice President of GTE and President of GTE Internetworking, an integrated telecommunication services firm. Mr. Conrades served as Chief Executive Officer of BBN Corporation, a national Internet services provider and Internet technology research and development company, from January 1994 until its acquisition by GTE Internetworking in July 1997. Prior to joining BBN Corporation, Mr. Conrades was a Senior Vice President at International Business Machines Corporation, or IBM, and a member of IBM's Corporate Management Board. Mr. Conrades is currently a director of Cardinal Health, Inc., a provider of services supporting the healthcare industry, and Harley-Davidson, Inc., a motorcycle manufacturer.

Martin M. Coyne II, age 55, has served as a director of Akamai since November 2001. Mr. Coyne was named our Lead Director in 2003. Between 1995 and his retirement in July 2003, Mr. Coyne served in a variety of senior management positions at the Eastman Kodak Company, which develops, manufactures and markets imaging products and services. Mr. Coyne most recently served as Group Executive, Photography Group, and Executive Vice President of Eastman Kodak. Mr. Coyne also serves on the board of directors of Welch Allyn, Inc., a manufacturer of innovative medical diagnostic equipment.

C. Kim Goodwin, age 43, has served as a director of Akamai since January 2004. Since September 2002, Ms. Goodwin has been Chief Investment Officer Equities of State Street Research, a money management

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firm. From September 1997 through August 2002, Ms. Goodwin was Chief Investment Officer U.S. Growth Equities at American Century Investment Management, an investment management company.

Directors Whose Terms Expire in 2005 (Class III Directors)

William A. Halter, age 43, has served as a director of Akamai since August 2001. Since April 2001, Mr. Halter has been a management consultant providing services to corporate enterprises. Between November 1999 and March 2001, Mr. Halter served as Deputy Commissioner, and later as Acting Commissioner, of the United States Social Security Administration, an independent agency of the federal government. From 1993 through November 1999, Mr. Halter was a Senior Advisor in the Office of Management and Budget of the Executive Office of the President of the United States. Mr. Halter is currently a director of InterMune, Inc., a biopharmaceutical company, and webMethods, Inc., an Internet services infrastructure company.

Peter J. Kight, age 47, has served as a director of Akamai since March 2004. Since December 1997, Mr. Kight has been Chairman of the Board of Directors and Chief Executive Officer of CheckFree Corporation, a provider of financial electronic commerce services and products. Mr. Kight also serves on the Board of Directors of Metatec International, Inc., a distributor of information utilizing CD-ROM technology.

Frederic V. Salerno, age 60, has served as a director of Akamai since April 2002. From 1997 until his retirement in September 2002, Mr. Salerno served in a variety of senior management positions at Verizon Communications, Inc., a provider of communications services, and its predecessors. At the time of his retirement, Mr. Salerno had been serving as Vice Chairman and Chief Financial Officer. Mr. Salerno also serves on the board of directors of Bear Stearns & Co., Inc., a financial services company, Consolidated Edison, Inc., an energy company, Gabelli Asset Management Inc., a money management firm, Popular, Inc., a financial holding company, and Viacom, Inc., a media company.

Non-Director Executive Officers of Akamai

Robert Cobuzzi, age 62, joined Akamai in November 2002 as our Chief Financial Officer. Prior to joining Akamai, from July 2000 until June 2002, Mr. Cobuzzi was Executive Vice President and Chief Financial Officer of Network Plus Corp., a competitive local and long distance telecommunications carrier. Network Plus Corporation filed a voluntary petition for bankruptcy protection under Chapter 11 of the United States bankruptcy code in January 2002. Between 1991 and 2000, Mr. Cobuzzi held a number of management positions at Kollmorgen Corporation, a manufacturer of electronic equipment and software controls, serving as Senior Vice President and Chief Financial Officer from February 1999 until July 2000.

Melanie Haratunian, age 44, joined Akamai in September 2003 as our Vice President and General Counsel. From April 2003 until September 2003, Ms. Haratunian was Vice President and Deputy General Counsel of Allegiance Telecom Company Worldwide, the operating company of Allegiance Telecom, Inc., a competitive local, long distance, and data telecommunications carrier. Allegiance Telecom, Inc. and its subsidiaries filed a voluntary petition for bankruptcy protection under Chapter 11 of the United States bankruptcy code in May 2003. Between April 2001 and September 2003, Ms. Haratunian also was the General Counsel for Allegiance Internet, Inc., formerly known as Hosting.com, Inc., the Internet access and web-hosting division of Allegiance Telecom, Inc. Ms. Haratunian was the General Counsel of HarvardNet, Inc., an Internet access and web-hosting company, from November 1998 until April 2001 when Allegiance Telecom Company Worldwide acquired HarvardNet, Inc.

Paul Sagan, age 44, joined Akamai in October 1998 as Vice President and Chief Operating Officer. Mr. Sagan has served as our President since May 1999 and served as Chief Operating Officer until March 2001. From July 1997 to August 1998, Mr. Sagan was Senior Advisor to the World Economic Forum, a Geneva, Switzerland-based organization that provides a collaborative framework for leaders to address global issues. From December 1995 to December 1996, Mr. Sagan was the President and Editor of Time Inc. NewMedia, an affiliate of Time Warner, Inc., a global media and entertainment company.

Chris Schoettle, age 40, joined Akamai in March 2001 as Executive Vice President and Chief Operating Officer. Since March 2002, he has served as Executive Vice President, Technology, Networks and Support,

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responsible for software development, architecture, security, network infrastructure, service operations and global customer support. From August 1998 to March 2001, Mr. Schoettle held several management positions at Lucent Technologies, a communications infrastructure company, serving most recently as President of Broadband Access from May 2000 to March 2001.

No person who served as a director or executive officer of Akamai during the year ended December 31, 2003 has a substantial interest, direct or indirect, in any matter to be acted upon at the Annual Meeting other than the election of Class I directors. Each executive officer serves at the discretion of our Board of Directors and holds office until his or her successor is elected and qualified or until his or her earlier resignation or removal. There are no family relationships among any of our directors or executive officers.

Determination of Independence

Under NASDAQ rules that become applicable to Akamai on the date of our Annual Meeting, a director of Akamai will only qualify as an independent director if, in the opinion of the Board of Directors, that person does not have a relationship which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The Board of Directors has determined that none of our directors, other than Mr. Conrades and Mr. Leighton, has a relationship which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director and that each of these directors is an independent director as defined under Rule 4200(a)(15) of the NASDAQ Stock Market, Inc. Marketplace Rules.

Board and Committee Meetings

The Board of Directors held 12 meetings during the fiscal year ended December 31, 2003 and took two actions by unanimous written consent. Each incumbent director attended at least 75% of the total number of meetings of the Board of Directors and each committee on which he or she served during the fiscal year ended December 31, 2003.

The Board of Directors has an Audit Committee, a Compensation Committee and a Nominating and Corporate Governance Committee. Each committee operates under a charter that has been approved by the Board of Directors. Copies of the charters are posted in the Investors Relations section of our website at .

The Board of Directors has determined that all of the members of each of the Board's three standing committees are independent as defined under the new rules of the NASDAQ Stock Market that become applicable to us on the date of the Annual Meeting, including, in the case of all members of the Audit Committee, the independence requirements contemplated by Rule 10A-3 under the Securities Exchange Act of 1934, as amended, or the Exchange Act. In addition, all of the members of the Audit Committee are independent as defined by the rules of the NASDAQ Stock Market that apply to Akamai until the date of the Annual Meeting.

The Audit Committee currently consists of three directors, Mr. Coyne, Ms. Goodwin and Mr. Salerno. Mr. Salerno serves as Chair of the Audit Committee. Mr. Halter was a member of the Audit Committee throughout 2003 until March 2004. Ms. Goodwin joined the Audit Committee in March 2004. The Audit Committee reviews the professional services provided by our independent accountants, the independence of such accountants from our management, our annual financial statements and our system of internal accounting controls. The Audit Committee also reviews such other matters with respect to our accounting, auditing and financial reporting practices and procedures as it may find appropriate or may be brought to its attention. The Audit Committee held 16 meetings in fiscal year 2003. The Board of Directors has determined that Mr. Salerno is an audit committee financial expert within the meaning of Item 401(h) under Regulation S-K issued by the Commission under the Exchange Act. The charter for the Audit Committee is attached to this proxy statement as Appendix A.

The Compensation Committee currently consists of Mr. Graham, Mr. Halter and Ms. Seligman. Ms. Seligman serves as Chair of the Compensation Committee. Mr. Halter joined the Compensation Committee in March 2004. The Compensation Committee determines the compensation of our Chief

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Executive Officer, administers our bonus, incentive compensation and stock plans, approves stock option grants and approves the salaries and other benefits of our executive officers. In addition, the Compensation Committee consults with our management regarding our benefit plans and compensation policies and practices. The Compensation Committee held three meetings during fiscal year 2003 and took 12 actions by unanimous written consent during that year.

The Nominating and Corporate Governance Committee currently consists of Ms. Goodwin, Mr. Halter and Mr. Salerno. Mr. Halter serves as Chair of the Nominating and Corporate Governance Committee. Ms. Goodwin joined the Nominating and Corporate Governance Committee in March 2004. This committee's responsibilities include identifying individuals qualified to become members of our Board of Directors; recommending to the full Board of Directors the persons to be nominated for election as directors and to each of its committees; and reviewing and making recommendations to the Board of Directors with respect to management succession planning. The Nominating and Corporate Governance was constituted in March 2003 and held four meetings in 2003.

All directors are expected to attend regular Board meetings, Board committee meetings and our annual meeting of stockholders. All directors except Mr. Graham attended the 2003 annual meeting of stockholders.

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Our employees who serve on the Board of Directors are not compensated for their service as directors. Non-employee directors are entitled to annual compensation of \$120,000, of which \$20,000 is paid in cash and \$100,000 is paid in deferred stock units, or DSUs, representing the right to acquire shares of our common stock. The number of DSUs issued is based on the fair market value of our common stock on the date of our annual stockholders meeting. For so long as the person remains a director, one-half the DSUs will vest on the anniversary of the date of grant, with the remainder to vest in equal quarterly installments thereafter. In addition, our Lead Director and the Chair of our Audit Committee are entitled to \$25,000 of additional compensation, of which \$15,000 is paid in cash and \$10,000 is paid in DSUs. Chairs of the two other board committees are entitled to \$10,000 of compensation, of which \$5,000 is paid in cash and \$5,000 is paid in DSUs. Each non-employee director is eligible to receive fair market value options to purchase 50,000 shares of our common stock when he or she joins the Board of Directors. In 2003, all then-serving non-employee directors were issued DSUs representing the right to acquire 30,000 shares of our common stock which vest over a three-year period for so long as the person continues to serve as a director. We also reimburse directors for reasonable out-of-pocket expenses incurred in attending meetings of the Board of Directors.

Executive Compensation

Summary Compensation Table. The following table sets forth information with respect to the compensation earned by the Akamai Named Executive Officers for the fiscal years ended December 31, 2003, 2002 and 2001. Mr. Ruffolo departed as our Chief Operating Officer in April 2004. Columns required by the regulations of the Commission have been omitted where no information was required to be disclosed under those columns.

| Name and Principal Position (1) | Year | Annual Compensation | | Long-Term Compensation | | All Other Compensation (2) |
|--|------|---------------------|------------|------------------------------|---------------------------------------|----------------------------|
| | | Salary (\$) | Bonus (\$) | Awards | | |
| | | | | Restricted Stock Awards (\$) | Securities Underlying Options/SARs(#) | |
| George Conrades | 2003 | 20,000 | | | | |
| Chairman and Chief Executive Officer(3) | 2002 | 20,000 | | | 750,000 | |
| | 2001 | 132,500 | | | | |
| Robert Cobuzzi | 2003 | 200,000 | | | | |
| Chief Financial Officer | 2002 | 23,076 | | | | |
| | 2001 | | | | | |
| Michael Ruffolo | 2003 | 400,000 | 270,000 | | 575,000(4) | |
| Chief Operating Officer | 2002 | 400,000 | 72,000(5) | (4) | | 1,000(6) |
| | 2001 | 146,153 | 50,000(7) | | 803,419(3) | |
| Chris Schoettle | 2003 | 300,000 | 170,000 | | 400,000(8) | |
| Executive Vice President, Technology, Networks and Support | 2002 | 300,000 | 109,200(5) | (8) | | 1,000(6) |
| | 2001 | 230,769 | 80,000(7) | | 750,000(8) | 140,319(9) |

(1) Mr. Conrades commenced employment with Akamai in April 1999; Mr. Cobuzzi commenced employment with Akamai in November 2002; Mr. Ruffolo commenced employment with Akamai in August 2001; and Mr. Schoettle commenced employment with Akamai in March 2001.

(2) With the exception of Mr. Schoettle, other compensation in the form of perquisites and other personal benefits has been omitted because these perquisites and other personal benefits constituted less than the lesser of \$50,000 or 10% of the total salary and bonus for each Akamai Named Executive Officer for that year.

(3)

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In April 2001, Mr. Conrades made a voluntary election to reduce his base salary to \$20,000 in an effort to preserve the cash available to Akamai and help us reduce overall expenses, particularly at a time when Akamai was making significant reductions in its work force. In 2002, the Compensation Committee

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approved the issuance of shares of restricted common stock to Mr. Conrades as the central part of a retention plan. The vesting of such shares is tied to the our achievement of specific financial goals. See Report of the Compensation Committee elsewhere in this Proxy Statement.

- (4) In November 2002, Mr. Ruffolo exchanged 750,000 outstanding options to purchase common stock for 175,000 shares of restricted common stock and the right to receive an option to purchase 575,000 additional shares of common stock in May 2003. The shares of restricted common stock vest in full on the second anniversary of the date of grant. We are unable to assess the value of the consideration paid by Mr. Ruffolo for the shares of restricted stock.
- (5) Amounts were earned in the year ended December 31, 2002 but were paid in 2003.
- (6) Consists of contributions to our 401(k) plan made on behalf of the Akamai Named Executive Officer.
- (7) Amounts were earned in the year ended December 31, 2001 but were paid in 2002.
- (8) In November 2002, Mr. Schoettle exchanged 750,000 outstanding options to purchase common stock for 100,000 shares of restricted common stock and the right to receive an option to purchase 400,000 additional shares of common stock in May 2003. The shares of restricted common stock vest in full on the second anniversary of the date of grant. We are unable to assess the value of the consideration paid by Mr. Schoettle for the shares of restricted stock.
- (9) Consists of relocation benefits and \$1,000 in contributions to our 401(k) plan made on behalf of Mr. Schoettle.

Option Grants During Fiscal Year 2003

The following table sets forth each grant of options to purchase our common stock during fiscal year 2003 to each of our Akamai Named Executive Officers. No stock appreciation rights were granted during such fiscal year.

| Name | Individual Grants | | | | Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term (1)(2) | |
|-----------------|---|---|---|-----------------|---|-----------|
| | Number of Securities Underlying Options Granted | Percent of Total Options Granted to Employees in Fiscal Year 2003 (%) | Exercise or Base Price Per Share (\$/Share) | Expiration Date | 5%(\$) | 10%(\$) |
| Michael Ruffolo | 575,000 | 13 | 3.71 | 5/14/2013 | 1,341,589 | 3,399,851 |
| Chris Schoettle | 400,000 | 9 | 3.71 | 5/14/2013 | 933,280 | 2,365,114 |

- (1) The potential realizable value is calculated based on the term of the Akamai stock option at the time of grant, assuming stock price appreciation of 5% and 10% pursuant to rules promulgated by the Commission and does not represent our prediction of the price performance of our stock. The potential realizable values at 5% and 10% appreciation are calculated by assuming that the exercise price on the date of grant appreciates at the indicated rate for the entire term, compounded annually, of the Akamai stock option and that the Akamai stock option is exercised at the exercise price and sold on the last day of its term at the appreciated price.
- (2) Options vest in full on the third anniversary of the grant date subject to the possibility of accelerated vesting based on the achievement of certain financial goals.

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No Akamai Named Executive Officers exercised options during fiscal year 2003. The following table sets forth information with regard to the value of unexercised options at December 31, 2003.

| Name | Number of Securities Underlying Unexercised Options at Fiscal Year-End (#) | | Value of Unexercised In-the-Money Options at Fiscal Year-End (1) | |
|--------------------|--|---------------|--|--------------------|
| | Exercisable | Unexercisable | Exercisable (\$) | Unexercisable (\$) |
| George H. Conrades | 0 | 750,000 | | 7,125,000 |
| Robert Cobuzzi | 50,000 | 200,000 | 482,000 | 1,928,000 |
| Michael Ruffolo | 254,044 | 359,275 | 1,888,594 | 2,532,889 |
| Chris Schoettle | 153,000 | 247,000 | 1,078,650 | 1,741,350 |

- (1) Value is based on the difference between the option exercise price and the fair market value at December 31, 2003, our fiscal-year end, of \$10.76 (the closing price per share on December 31, 2003 as quoted on the NASDAQ Stock Market), multiplied by the number of shares underlying the option.

Employment Agreements

On July 12, 2002, we entered into an employment agreement and a stock option agreement with Mr. Conrades. Under the terms of those agreements, if, following a change in control of Akamai, Mr. Conrades resigns due to a material reduction in his responsibilities or compensation or is terminated for a reason other than cause, he is entitled to a cash payment of \$1.0 million. In addition, any unvested options shall vest as though one-third of such unvested options had vested on each anniversary of the date of grant.

On November 7, 2002, we entered into a letter agreement with Mr. Cobuzzi setting forth his responsibilities and compensation as our Chief Financial Officer. Under the agreement, if Mr. Cobuzzi's employment is terminated by us other than for cause during the first three years of his employment, we will pay him an amount equal to one year of his then-base salary plus certain medical benefits. If such a termination occurs during the first year of Mr. Cobuzzi's employment with us, 25% of his initial stock option grant would be deemed vested at such time. If such a termination occurs during the second year of Mr. Cobuzzi's employment with us, 50% of his initial stock option grant would be deemed vested at such time. If such a termination occurs during the third year of Mr. Cobuzzi's employment with us, 75% of his initial stock option grant would be deemed vested at such time. In addition, if there is a change of control of Akamai and the surviving entity fails to offer to employ Mr. Cobuzzi in a position with responsibilities that are commensurate with his responsibilities with us and, as a result, his employment terminates voluntarily or involuntarily, he shall be entitled to receive payment of an amount equal to one year of his then-base salary. If there is a change of control of Akamai, the number of shares of our common stock as to which Mr. Cobuzzi's options have vested shall be calculated as though the applicable grant date were the date that is one year prior to such grant date.

On July 24, 2001, we entered into a letter agreement with Mr. Ruffolo, which was subsequently amended on July 27, 2001, setting forth his responsibilities, compensation and eligibility to receive certain payments upon his termination. On November 14, 2002, we entered into a restricted stock agreement with Mr. Ruffolo pursuant to which he received 175,000 shares of our common stock which would vest in full upon a change in control of Akamai. On May 14, 2003, we entered into a stock option agreement with Mr. Ruffolo pursuant to which he acquired an option to purchase up to 575,000 shares of our common stock. Under the terms of Mr. Ruffolo's restricted stock agreement and stock option agreement, some or all of the unvested shares of restricted stock and stock options vest upon termination of Mr. Ruffolo's employment under certain circumstances. In April 2004, Mr. Ruffolo departed from the Company. In connection with his departure, we entered into a separation agreement with Mr. Ruffolo that was approved by the Compensation Committee of the Board of Directors and supersedes all prior agreements containing termination benefits. Under the terms of the separation agreement, Mr. Ruffolo received a cash payment of \$400,000 and payment of medical benefits.

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for a period of one year. In addition, vesting of the 175,000 shares of restricted stock held by Mr. Ruffolo was accelerated as of the date of termination.

On February 15, 2001, we entered into a letter agreement with Chris Schoettle setting forth his responsibilities and compensation. The agreement provides that if Mr. Schoettle's employment is terminated by us other than for cause during the first three years of his employment, we will pay him an amount equal to one year of his then-base salary plus certain medical benefits. The agreement also provides that if such a termination were to occur during the first year of Mr. Schoettle's employment with us, 25% of his initial stock option grant would be deemed vested at such time. If such a termination were to occur during the second year of Mr. Schoettle's employment with us, 50% of his initial stock option grant would be deemed vested at such time. If such a termination were to occur during the third year of Mr. Schoettle's employment with us, 75% of his initial stock option grant would be deemed vested at such time. In addition, if there is a change of control of Akamai and the surviving entity fails to offer to employ Mr. Schoettle in a position with responsibilities that are commensurate with his responsibilities with us and, as a result, his employment terminates voluntarily or involuntarily, he shall be entitled to receive payment of an amount equal to one year of his then-base salary. On November 14, 2002, we entered into a restricted stock agreement with Mr. Schoettle pursuant to which he received 100,000 shares of our common stock, which would vest in full upon a change in control of Akamai or upon termination of his employment with Akamai for reasons other than gross misconduct or his voluntary resignation. In May 14, 2003, we entered into a stock option agreement with Mr. Schoettle pursuant to which he acquired the option to purchase up to 400,000 shares of our common stock. Under that agreement, if Mr. Schoettle's employment is terminated for a reason other than cause, as defined in the agreement, all of his unvested options will accelerate as of the termination date. Additionally, if there is a change in control of Akamai, the number of shares of our common stock as to which Mr. Schoettle's options have vested shall be calculated as though the applicable grant date were the date that is one year prior to such grant date.

Ten Year Option Repricings

The following table sets forth information regarding options held by the Akamai Named Executive Officers that were exchanged pursuant to option exchange agreements. The Compensation Committee approved the option exchanges in order to restore the incentive value of such options.

| Date | Number of Securities Underlying Options Repriced or Amended(#) | Market Price of Stock at Time of Repricing or Amendment(\$) | Exercise Price of Option at Time of Repricing or Amendment(\$) | New Exercise Price(\$) |
|----------|--|---|--|------------------------|
| 11/14/02 | 500,000 | \$1.01 | \$5.85 | (2) |
| 11/14/02 | 250,000 | \$1.01 | \$5.49 | (2) |
| 11/14/02 | 425,000 | \$1.01 | \$9.47 | (3) |
| 11/14/02 | 325,000 | | | |

- We also need to complete the back-end portion of the device. To do so, we anticipate spending \$250,000 to purchase off-the-shelf software which we can use with only minor modifications, and spending an additional \$200,000 to develop proprietary software and algorithms. We anticipate that we will complete this work by the end of the first quarter of 2005.
- Once we have fully designed the front-end portion of our device, we intend to submit test protocols in the third quarter of 2005 to the Institutional Review Board (IRB) to review. We plan to coordinate the writing of a number of white papers relating to the effectiveness of our device and publish results in peer review journals. During this period, we also intend to make arrangements with four or more hospitals or clinics to test our device. We anticipate that we will complete this process by the third quarter of 2005. During the course of this period we should complete the back-end

portion of the device, and we will then have the opportunity to use it during the clinical testing with the front-end portion. Our anticipated budget for these activities is \$300,000.

- We need to design a vest which can be used on a 24/7 basis for extended periods of time, while being taken off by the patient intermittently for showers, etc. We must address two engineering issues in developing this vest. First, we need to develop an electrode which can be incorporated into the vest to monitor the patient's heart signal, thus replacing the use of leads and gels currently used in recording ECGs. Second, we need to

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design the vest in such a fashion that it not only holds the electrode against the body at the correct locations and in the proper manner, but it also can be adapted to fit patients with different heights, weights and physiques. We project that we will spend approximately \$230,000 to conduct these development activities, and expect to complete them by the last quarter of 2005.

We have also budgeted \$60,000 to purchase various items of equipment to test the operation of the device over different phases.

We have not entered into any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources and would be considered material to investors.

FINANCIAL STATEMENTS

Our financial statements and notes thereto are filed in a separate section at the end of this annual report.

CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

On December 1, 2003, we dismissed our independent auditor, Burnett + Company, LLC, and on December 2, 2003, we engaged Stonefield Josephson, Inc. as our independent auditor for the fiscal year ending December 31, 2003. The decision to dismiss Burnett + Company was approved by our board of directors.

Burnett + Company's reports on our financial statements as of and for the years ended December 31, 2002 and December 31, 2001 did not contain an adverse opinion or a disclaimer of opinion, nor were they modified as to uncertainty, audit scope, or accounting principles. During the periods ended December 31, 2001 and December 31, 2002, and the interim period from January 1, 2003 through the date of Burnett + Company's dismissal, we did not have any disagreements with Burnett + Company on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to Burnett + Company's satisfaction, would have caused it to make a reference to the subject matter of the disagreements in connection with its reports.

Prior to engaging Stonefield Josephson, we did not consult with Stonefield Josephson regarding the application of accounting principles to a specified completed or contemplated transaction or the type of audit opinion that might be rendered on our financial statements.

CONTROLS AND PROCEDURES

As of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer, in consultation with our other members of management and advisors as appropriate, carried out an evaluation of the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-14 promulgated under the Exchange Act. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the date of the evaluation, our disclosure controls and procedures are effective in making known to them on a timely basis material information relating to our company (including any consolidated subsidiaries) required to be included in this report. There were no significant changes in our internal controls or in other factors that could significantly affect these controls, known

to our Chief Executive Officer or Chief Financial Officer, subsequent to the date of the evaluation, including any significant deficiencies or material weaknesses that would require corrective action.

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MANAGEMENT

Identity

The following table identifies our current executive officers and directors, their respective offices and positions, and their respective dates of election or appointment:

| Name And Municipality Of Residence | Age | Office | Initial Election Or Appointment Date |
|---|------------|---|---|
| Marvin H. Fink Los Angeles, California | 67 | Chief Executive Officer, President, Secretary, and Chairman of the Board | October 12, 2003 |
| Budimir S. Drakulic, Ph.D. Los Angeles, California | 54 | Vice President and Chief Technology Officer | October 15, 2003 |
| Charles Dargan Los Angeles, California | 48 | Interim Chief Financial Officer | December 18, 2003 |
| Ellsworth Roston Los Angeles, California | 81 | Director | November 1, 2002 |
| Robert Koblin, M.D. Los Angeles, California | 72 | Director | February 6, 2003 |
| Lowell T. Harmison, Ph.D. Washington, D.C. | 66 | Director | June 6, 2003 |
| Jennifer Black Lake Oswego, Oregon | 48 | Director | January 20, 2004 |

There are no family relationships between any two or more of our directors or executive officers. There are no arrangements or understandings between any two or more of our directors or executive officers.

Business Experience

Marvin H. Fink has served as our Chief Executive Officer, President and Chairman of the Board since October 2002, and our Secretary since November 2003. Prior to joining us, Mr. Fink was president of his own management consulting group from August 2001 until he joined Recom in October 2002. Mr. Fink has 45 years of experience in the management of high technology programs from development stage through production including projects for the Department of Defense, NASA, Teledyne Systems, Litton Industries and Hughes Aircraft. He served as President of Teledyne Electronic Technologies from 1993 until his retirement in August 2001. From 1986 until 1993, he served as President of Teledyne Microelectronics. Mr. Fink serves on the board of R. F. Industries and is a member of the California Bar Association. Mr. Fink holds a bachelors of science degree in electronic engineering from City College of New York, a Masters of Science degree in Electronic Engineering from the University of Southern California, and a Juris Doctor degree from the San Fernando Valley College of Law.

Dr. Budimir S. Drakulic has served as our Vice President and Chief Technology Officer since October 2002. Dr. Drakulic has more than 25 years of experience in the design, development and integration of hardware and software modules for biomedical microelectronics circuits and systems. From 1997 through February of 2002, Dr. Drakulic was involved directly and indirectly with Advanced Heart Technologies, Inc., a corporation controlled by Dr. Drakulic. Dr. Drakulic was the Consultant and Chief Scientist, Medical Device Business Unit for Teledyne Electronic Technologies from 1992 through 1997. Before that, he held numerous positions affiliated with the University of California at Los Angeles, including Visiting Assistant Professor with the Electrical Engineering Department and Director of the Microelectronics Development Lab at the Crump Institute for Medical Engineering. He holds a Bachelor of Science

degree in electrical engineering from the University of Belgrade, Yugoslavia. He also holds a Masters degree and a Ph.D. in Electronic and Biomedical Engineering from the same university.

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Dr. Drakulic was the recipient of the Ralph and Marjorie Crump Prize for Excellence in Medical Engineering from UCLA in 1985, and was a Research Fellow with the Crump Institute for Medical Engineering at UCLA.

Mr. Charles Dargan is providing his services to us on a leased basis through an agency that specializes in providing financial management personnel to businesses on a temporary basis. We are actively recruiting a permanent full-time Chief Financial Officer. Mr. Dargan is also currently employed as the Chief Financial and Accounting Officer of Semotus Solutions, Inc. From April 2000 until his appointment as Chief Financial and Accounting Officer in January 2001, Mr. Dargan served as Semotus Solutions Executive Vice President of Operations. Mr. Dargan was also a director of Semotus Solutions from March 1999 to July 2002. Prior to joining Semotus Solutions, Mr. Dargan served as a Managing Director of Corporate Finance for The Seidler Companies Incorporated, a private brokerage, investment banking and public finance firm. In addition, he was a partner and Chief Financial Officer of the investment banking firm of Ambient Capital; a Managing Director of Corporate Finance at L.H. Friend, Weinress, Frankson & Presson, Inc.; and a First Vice President at Drexel Burnham Lambert, Incorporated. His accounting and financial industry experience has made him an expert in public and private debt and equity finance, mergers and acquisitions and financial management of and planning for emerging growth companies. Mr. Dargan graduated from the University of Southern California with an MBA and an MS in Finance, and possesses an A.B. in Government and Economics from Dartmouth College. He also holds accounting and finance industry certifications of Chartered Financial Analyst (CFA) and Certified Public Accountant (CPA).

Mr. Ellsworth Roston has served as a director since October 2002. Mr. Roston has practiced patent law since 1943, and currently serves as Of Counsel to the patent firm of Fulwider Patton Lee & Utecht since 1997. Mr. Roston has a history of assisting technology companies during their development stages. He was one of three founders of Brooktree Corporation, and served on its board of directors for 15 years. Mr. Roston received his undergraduate degree and his law degree from Yale University.

Dr. Robert Koblin has served as a director since February 2003. Dr. Koblin, a cardiologist, has more than 30 years of medical experience beginning during the time he served in the United States Army as a medic and continuing most recently as a staff physician and instructor at the Cedars-Sinai Medical Center in Los Angeles. He also serves as the Managing Director of the Robertson Diagnostic Center in Beverly Hills, California, and is an assistant clinical professor of medicine at the University of California, Los Angeles (UCLA). Dr. Koblin received his undergraduate degree from New York University and his medical degree from Stanford University.

Dr. Lowell T. Harmison has served as a director since June 2003 and as a Senior Advisor since February of 2003. Dr. Harmison has a very distinguished 35 year career in the field of biomedicine. From 1990 through the present, Dr. Harmison has served as a Senior Advisor and Board Member to pharmaceutical and health companies. He is the holder of the first domestic and foreign patents on the fully implantable artificial heart; has served as CEO of USET, Inc.; and as the Director of a private foundation operating internationally and consisting of 21 operating companies. He has also served as the Principal Deputy Assistant Secretary for Health of the U.S. Public Health Service, Department of Health and Human Services. Dr. Harmison has a Ph.D. from the University of Maryland and a B.S. and M.S. from West Virginia University. He was also given an honorary Doctor of Science degree from the West Virginia University.

Ms. Jennifer Black has served as a director since January 2004. Ms. Black has been President of her own business, Jennifer Black & Associates, since September 2003. Her firm provides independent research for institutional clients. Previously, Ms. Black was with Black & Co. (since 1979), where she was responsible for research coverage on the apparel and specialty retail industries. Ms. Black was President of Black & Co. when it was acquired by First Security Van Kasper in April 2000. Subsequently, Wells Fargo Securities acquired First Security Van Kasper in September 2000. Ms. Black left Wells Fargo Securities in September 2003. Ms. Black serves on the Governors Council of Economic Advisors for the State of Oregon, where she has been re-appointed to a second three-year term. Ms. Black attended Washington State and Portland State Universities.

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Board Of Directors

Our bylaws set the authorized number of directors on our board of directors at not less than three nor more than nine, with the actual number fixed by a resolution of our board. As noted above, there are currently five directors serving on our board, Messrs. Fink, Roston, Koblin and Harmison and Ms. Black. All of the directors will serve until the next annual meeting of shareholders and until their successors are elected and qualified by our shareholders, both common and preferred, voting on a cumulative basis as one class, or until their earlier death, retirement, resignation or removal.

Board Committees And Independence

Our board of directors has established two committees to date, an audit committee comprised of Dr. Koblin and Ms. Black, and a compensation committee comprised of Messrs. Fink and Roston and Dr. Koblin.

Mr. Roston, Dr. Koblin and Ms. Black are each independent directors as that term is defined by the SEC. None of our current directors, including Dr. Koblin and Ms. Black who serve on our audit committee, have the requisite public company accounting background or experience to be considered an audit committee financial expert as that term is defined by the SEC. Due to our development stage status, we believe that both members of the Audit Committee have the requisite financial background and experience to carry out their duties.

Shareholder Nomination Procedures

Approximately 69.6% of our voting shares are held by a single shareholder which, in view of the cumulative voting provision in our bylaws, effectively allows that shareholder to elect at least three of our five directors. Since that shareholder already has ready access to our board of directors and in view of this voting power, our board has not to date adopted formal procedures by which other shareholders could recommend nominees for election or appointment to our board.

Board Compensation

Our current compensation policy for our directors is to compensate them through stock grants under our 2002 Stock Plan pursuant to a director's compensation policy adopted on February 6, 2003. Upon joining our board of directors, each member is granted an option to purchase 50,000 common shares, exercisable at the then trading price of our common stock. These options are fully vested upon grant, and lapse in five years if not exercised. Each director will thereafter be granted options on an annual basis entitling him to purchase an additional 28,000 common shares, which options will vest quarterly based upon the continued provision of services as a director, and lapse in five years if not exercised. The exercise price for these options will be fixed at current market price as of the date of grant.

Upon the adoption of the director's compensation policy on February 6, 2003, we granted directors' options under the 2002 Plan to each of Messrs. Fink and Roston and Dr. Koblin entitling each of them to purchase 150,000 common shares (50,000 shares pre-split) at \$0.88 per share. These options were fully vested upon grant, and will lapse on February 5, 2008. On June 6, 2003, we granted directors' options under the 2002 Plan to Dr. Harmison upon his appointment as a director entitling him to purchase 50,000 common shares at \$4.20 per share. These options were fully vested upon grant, and will lapse on June 5, 2008. On November 3, 2003, shortly after the first anniversary of their respective start dates, we granted directors' options under the 2002 Plan to each of Messrs. Fink and Roston entitling each of them to purchase 28,000 common shares at \$4.40 per share. These options will vest quarterly commencing February 3, 2004 upon the continued provision of services as directors for a period of one year, and will lapse on November 2, 2008. On January 20, 2004, we granted directors' options under the 2002 Plan to Ms. Black upon her appointment as a director entitling her to purchase 50,000 common shares at \$3.60 per share. These options were fully vested upon grant, and will lapse on January 19, 2009.

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Employment And Consulting Agreements With Management

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On October 11, 2002, Recom reached an agreement-in-principle with Mr. Marvin H. Fink to become our Chief Executive Officer and President and to issue him restricted common shares. Pursuant to that understanding, on October 12, 2002, we entered into a four-year employment agreement with Mr. Fink. The essential terms of the employment agreement are as follows:

- Mr. Fink will receive an initial base salary of \$1 per year. Following the one-year anniversary of the agreement, our board of directors may review and adjust the base salary in light of our company's performance.
- Mr. Fink is entitled to a cash bonus for his second through fourth years of employment. The amount of the bonus is 10% of our after tax income exclusive of extraordinary expenses for the second year, and 15% of that amount for the third and fourth years.
- Mr. Fink is granted 2,100,000 restricted common shares (700,000 shares pre-split), to be earned over three years of continuous employment. These shares, which are held in escrow by the company pursuant to the terms of a restricted stock agreement until they are earned, vest in tranches of 174,999 each at the end of the first eleven quarters of Mr. Fink's employment, with the balance vesting at the end of the twelfth quarter. Mr. Fink is entitled to all dividends which may be declared with respect to these shares, even if not vested.
- The agreement contains a gross up provision obligating us to make a cash payment to Mr. Fink to cover any taxes he may incur by reason of receiving any payment or distribution that would constitute an excess golden parachute payment under the federal tax laws. The gross up provision also applies to the 2,100,000 restricted common shares described above, however, Mr. Fink exercised his section 83(b) election under the Internal Revenue Code subjecting him to immediate taxation upon the receipt of the shares notwithstanding their future forfeitability, so our liability, if any, for any taxes imposed under that grant should be nominal.
- Should our common shares be listed on any of the NYSE, AMEX or Nasdaq national stock exchanges or markets, Mr. Fink would be entitled, if then still employed by us, to an additional grant of 600,000 common shares (200,000 shares pre-split).
- In the event of a change in control (as that term is defined in the employment agreement), Mr. Fink would be entitled, if then still employed by us, to an additional grant of common shares having a market value of \$5,000,000, but not to exceed 600,000 common shares (200,000 shares pre-split) in total.
- Mr. Fink is entitled to a number of employee benefits under the agreement, including a \$1,200 per month automobile allowance, individual medical plan reimbursement of up to \$2,000 per month, and the right to participate in all benefit plans established for company employees or executives, including medical, hospitalization, dental, long-term care and life insurance programs.

The employment agreement provides for early termination in the case of Mr. Fink's death or disability, Mr. Fink's termination by Recom for cause as that term is defined in the agreement; Mr. Fink's termination of employment for good reason as that term is defined in the agreement, a change in ownership as that term is defined in the agreement, or sixty days prior notice by Mr. Fink. In the event of an early termination of the agreement for any reason, all compensation and benefits under the agreement will terminate and the unvested portion of the 2,100,000 restricted common share grant shall be deemed forfeit as of the effective termination date, with the following exceptions:

- if the agreement is terminated during years two through four due to Mr. Fink's disability, termination by Mr. Fink for good reason, Recom's termination of Mr. Fink without cause, or a change in ownership, Mr. Fink will nevertheless be entitled to a pro rata portion (based upon the actual number of days of

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employment) of the cash bonus based on our after-tax income that he would have otherwise received for the year of termination had he remained employed until the end of that year;

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- if the agreement is terminated due to Mr. Fink's death, disability, termination by Mr. Fink for good reason, Recom's termination of Mr. Fink without cause, or a change in ownership, the unvested portion of the 2,100,000 restricted common share grant to Mr. Fink will become fully vested and the shares released from escrow; and
- Mr. Fink and his family will be entitled to an additional three years' medical, hospitalization, dental, long-term care and life insurance coverage if the agreement is terminated by Mr. Fink for good reason or terminated by Recom's termination without cause, and an additional one year's coverage if the agreement is terminated due to Mr. Fink's disability.

Concurrent with entering into the employment agreement, we entered into an indemnification agreement with Mr. Fink.

On October 11, 2002, Recom reached an agreement-in-principle with Dr. Budimir Drakulic to become our Vice President and Chief Technology Officer on a consulting basis through his consulting companies. Pursuant to that understanding, on October 15, 2002, we entered into a loan-out agreement with B World Technologies, Inc. and B Technologies, Inc. relative to the provision of Dr. Drakulic's services. Dr. Drakulic is the president and owner of these companies. The essential terms of the loan-out agreement are as follows:

- The agreement provides for a ten-year initial term. After the initial term, the agreement renews automatically for successive one year terms, unless either party delivers 90-days' written notice to the other of their intent not to renew.
- Dr. Drakulic's services are provided on a mutually-acceptable part-time basis.
- Recom is obligated to pay B Technologies a \$10,000 bonus upon execution, and a monthly service fee of \$15,000 thereafter.
- B World Technologies was granted 600,000 restricted common shares (200,000 shares pre-split), to be earned over five years of continuous provision of services by Dr. Drakulic. These shares, which will be held in escrow with the company pursuant to the terms of a restricted stock agreement until they are earned, vest at the rate of 30,000 shares per quarter with the first 30,000 shares vesting on January 15, 2003. B World Technologies is entitled to all dividends which may be declared with respect to these shares, even if not vested.

The loan-out agreement provides for early termination should B World and B Technologies fail, neglect or refuse to provide Dr. Drakulic's services. In such an event, all compensation under the agreement will terminate and the unvested portion of the 600,000 restricted common share grant shall be deemed forfeit as of the effective termination date.

Since March 1, 2003, Dr. Drakulic has worked for us on a full-time basis even though the loan-out agreement only provides for the provision of part-time services. We have agreed to characterize these additional services as being provided by Dr. Drakulic as an employee, and to pay him \$7,500 annually as compensation for their provision.

On March 10, 2003, as additional incentive for the performance of Dr. Drakulic, we granted to B World Technologies options entitling it to purchase 750,000 common shares at \$0.92 per share. These options vest quarterly over a four year term, and lapse, if not exercised, on March 9, 2008.

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Concurrent with entering into the loan-out agreement, B World Technologies, B Technologies and Dr. Drakulic signed an employment, confidential information, invention assignment and arbitration agreement under which they agreed, among other things, to assign to us all of Dr. Drakulic's right, title and interest in and to any and all inventions, discoveries, etc. which he conceives or develops while engaged by Recom.

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On October 11, 2003, Recom reached an agreement-in-principle with Mr. Ellsworth Roston to provide consulting advice to us relating to engineering, developing and refining our products and technologies; to become a director of the company, and to make an investment into the company. Pursuant to that understanding, on October 30, 2002 we sold Mr. Roston 71,250 common shares (23,750 shares pre-split) for \$190,000 in cash, and on November 1, 2002 we entered into a two year consulting agreement with Mr. Roston documenting the provision of his consulting services and his appointment to our board of directors. The agreement provides for us to grant to Mr. Roston 225,000 common shares (75,000 shares pre-split) and five-year warrants to purchase an additional 450,000 common shares (150,000 shares pre-split) at \$1.67 per share. We consider the grant of common shares to Mr. Roston to be compensation for the provision of his consulting services, and the grant of the common share purchase warrants to be additional consideration for his cash investment pursuant to our original understanding.

Mr. Roston is a patent attorney whose law firm also handles our patent work. The agreement specifically provides that the consulting services provided by Mr. Roston will not include any legal work, for which we will compensate his law firm separately.

Dr. Lowell T. Harmison, one of our directors, provides consulting services to Recom under a three-year agreement dated February 14, 2003. Under this agreement, Dr. Harmison provides advice to us in the areas of technological support and strategy, product development, medical and scientific advisory board development, and FDA regulation. The compensatory terms of the agreement are as follows:

- Recom is obligated to pay Dr. Harmison \$36,000 per year over the term of the agreement, payable quarterly.
- Dr. Harmison was entitled to receive upon execution of the agreement an initial grant of options entitling him to purchase 108,000 common shares (36,000 shares pre-split) at \$0.97 per share, exercisable over five years.
- Dr. Harmison was further entitled to receive upon execution of the agreement an additional grant of options entitling him to purchase 108,000 common shares (36,000 shares pre-split) at \$0.97 per share, vesting in increments of 9,000 common shares each upon the first through twelfth quarterly anniversary dates of the agreement based upon his provision of services. These options are exercisable for a period of five years following vesting.
- Dr. Harmison is entitled to receive grants of common share purchase options in tranches of 20,000 options per milestone for assisting Recom in attaining various milestones determined by our board of directors, including the preparation and filing with the FDA of a 510(k) application for our product as it relates to its incorporation into a vest, approval of that application by the FDA, and market launch of that product.
- Dr. Harmison is entitled to receive a grant of 20,000 common shares in the event of a change in control as that term is defined in the agreement.

In the event the agreement is terminated by Recom for any reason other than negligence, misconduct, breach of its material terms by Dr. Harmison or the failure of Dr. Harmison to render services in a reasonable fashion, all compensation prospectively payable under the agreement will become due and payable in 90 days.

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Summary Compensation Table

| Named Executive Officer and Principal | Year | Annual Compensation (1) | | | Long Term Compensation | | | All Other |
|--|------|-------------------------|-------|-------|---------------------------|---|---------|--------------|
| | | Salary | Bonus | Other | Awards | | Payouts | |
| | | | | | Restricted Stock(8) | Securities Underlying IncentivePlan | | |

| Position | | | Options & SARs | Compensation |
|---|------|---------------|-------------------|--------------|
| Marvin H. Fink (2) <i>Chief Executive Officer</i> | 2003 | \$ 1(4) | \$ \$ \$ | \$ \$ |
| | 2002 | 1 | 14,284(6) | |
| | 2001 | | | |
| Dr. Budimir Drakulic (3) <i>Vice President and Chief Technology Officer</i> | 2003 | \$ 180,000(5) | \$ \$ \$ | \$ \$ |
| | 2002 | 45,000(5) | 3,987(7) | |
| | 2001 | | | |

- (1) Includes, among other things, perquisites and other personal benefits, securities or property which exceed in the aggregate the lesser of either \$50,000 or 10% of the total annual salary and bonus reported for that fiscal year.
- (2) Mr. Fink has served as our Chief Executive Officer since October 12, 2002.
- (3) Dr. Drakulic has served as our Vice President and Chief Technology Officer since October 15, 2002.
- (4) Recom has recorded a non-cash accounting expense in the amount of \$80,000 to reflect the value of Mr. Fink's services.
- (5) These amounts were paid in consulting payments to B Technologies in connection with its provision of Dr. Drakulic's services.
- (6) Reflects the value of an award to Mr. Fink of 2,100,000 restricted common shares (700,000 shares pre-split) in conjunction with the execution of his employment agreement dated October 12, 2002. These shares, which are held in escrow by the company pursuant to the terms of a restricted stock agreement until they are earned, vest in tranches of 174,999 each at the end of the first eleven quarters of Mr. Fink's employment, with the balance vesting at the end of the twelfth quarter. As of December 31, 2003, there were 699,996 shares vested. Mr. Fink is entitled to all dividends which may be declared with respect to these shares, even if not vested.
- (7) Reflects the value of an award to B. World Technologies of 600,000 restricted common shares (200,000 shares pre-split) in conjunction with the execution of a loan-out agreement dated October 12, 2002 by which it provided the services of Dr. Drakulic to Recom. These shares, which will be held in escrow with the company pursuant to the terms of a restricted stock agreement until they are earned, vest at the rate of 30,000 shares per quarter with the first 30,000 shares vesting on January 15, 2003. As of December 31, 2003, there were 90,996 shares vested. B World Technologies is entitled to all dividends which may be declared with respect to these shares, even if not vested.
- (8) There were 2,085,003 unvested or unearned restricted common shares as of December 31, 2003, the aggregate value of which was \$7,818,761 based upon the \$3.75 closing price for our common shares as quoted on the OTCBB for December 31, 2003.

Stock Options And Stock Appreciation Rights Grant Table

The following table provides certain information with respect to individual grants during the 2003 fiscal year to each of our named executive officers of common share purchase options or stock appreciation rights relating to our common shares:

| Name | Common Shares Underlying Grant Of Options Or SARs | As Percentage Of Grants To All Employees(1) | Exercise Or Base Price | FMV At Grant Date | Expiration Date |
|-------------------------|--|--|------------------------------|----------------------------|------------------|
| Marvin H. Fink | 150,000(2) | 7.1% | \$ 0.88(2) | \$ 0.88 | February 5, 2008 |
| Dr. Budimir S. Drakulic | 750,000(3) | 12.0% | \$ 0.92(3) | \$ 0.92 | March 9, 2008 |
| Marvin H. Fink | 28,000 | 1.3% | \$ 4.40 | \$ 4.40 | November 2, 2008 |

- (1) The numerator in calculating this percentage includes common share purchase options granted to each named executive officer in fiscal 2003 in his capacity as an officer (employee) and, if applicable, as a director. The denominator in calculating this percentage is 2,088,000, which represents options granted to all Recom employees during fiscal 2003, including those to the named executive officers.
- (2) 50,000 shares pre-split exercisable at \$2.64 per share.
- (3) 250,000 shares pre-split exercisable at \$2.76 per share.

Table of Contents**Stock Options And Stock Appreciation Rights Exercise And Valuation Table**

The following table provides certain information with respect to each of our named executive officers concerning any common share purchase options or stock appreciation rights they may have exercised in fiscal 2003, and the number and value of any unexercised common share purchase options or stock appreciation rights they may hold as of December 31, 2003:

| Named Executive Officer | Shares Acquired On Exercise | Value Realized (1) | Unexercised In-The-Money Options and SARs at December 31, 2003 | |
|-------------------------|-----------------------------------|-----------------------|---|--|
| | | | Number (Exercisable/ Unexercisable) | Value (2) (Exercisable/ Unexercisable) |
| Marvin H. Fink | | | 150,000/ 0 | \$430,500 / \$0 |
| Dr. Budimir S. Drakulic | | | 187,500 / 562,500 | \$530,625 / \$1,591,875 |

- (1) The dollar amount shown represents the difference between the fair market value of our common stock underlying the options as of the date of exercise and the option exercise price.
- (2) The dollar value provided represents the cumulative difference in the fair market value of our common stock underlying all in-the-money options as of December 31, 2003 and the exercise prices for those options. Options are considered in-the-money if the fair market value of the underlying common shares as of the last trading day in fiscal 2003 exceeds the exercise price of those options. The fair market value of Recom common shares for purposes of this calculation is \$3.75, based upon the closing price for our common shares as quoted on the OTCBB on December 31, 2003.

Compliance With Section 16

None of our securities have been registered on a national securities exchange within the meaning of Section 12(b) of the Exchange Act, nor are they required to be registered under Section 12(g) of the Exchange Act. Accordingly, our executive officers, directors and affiliates are not presently subject to compliance with Section 16 of the Exchange Act.

Code of Ethics

Our Board of Directors adopted a code of ethics on January 20, 2004, which applies to all of our officers, directors and employees. This code may be found in pdf format on our corporate website at www.recom-systems.com.

EQUITY COMPENSATION PLANS**Summary Equity Compensation Plan Data**

The following table sets forth information compiled on an aggregate basis, with respect to equity compensation plans, including individual compensation arrangements, as of December 31, 2003 under which we granted, or are authorized to issue, equity securities to employees or non-employees) in exchange for consideration in the form of goods or services:

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| Plan Category | Number Of Securities To Be Issued Upon | Weighted- Average Exercise Price Of | Number Of Securities Remaining Available For |
|---------------|---|--|---|
|---------------|---|--|---|

| | Exercise Of Outstanding Options, Warrants Or Rights | Outstanding Options, Warrants And Rights | Future Issuance Under Equity Compensation Plans (Excluding Securities To Be Issued Upon Exercise Of Outstanding Options, Warrants And Rights) |
|--|--|---|--|
| Equity compensation plans approved by shareholders | | | (1) |
| Equity compensation plans not approved by shareholders | 450,000 | \$ 1.67 | (1)(2) |
| Total | 450,000 | \$ 1.67 | |

- (1) No formal stock plans under which securities were reserved for issuance had been adopted by Recom as of December 31, 2002.
- (2) Warrants Issued to Mr. Ellsworth Roston under the terms of his consulting agreement with Recom issued on a stand-alone basis.

Description of Equity Compensation Plans Not Approved By Shareholders

Recom has one formal stock plan considered to be an equity compensation plan or arrangement that has not been approved to date by our shareholders, the Recom Managed Systems, Inc. 2003 Nonqualified Stock Option And Stock Plan (the *2003 Stock Plan*). Recom adopted the 2003 Stock Plan, pursuant to which 1,500,000 common shares (500,000 shares pre-split) were originally reserved for issuance, on March 31, 2003. The 2003 Stock Plan was adopted by our board of directors as a vehicle to encourage and provide for the acquisition of an equity interest in Recom by our employees, officers, directors and consultants. Our board believes the plan will enable us to attract and retain the services of key employees, officers, directors and consultants upon whose judgment, interest and special effort the successful conduct of our operations is largely dependent, and to motivate those individuals by providing additional incentives and motivation toward superior performance.

The 2003 Stock Plan allows our board of directors to grant stock options or issue stock from time to time to our employees, officers, directors and consultants. Options granted under the 2003 Plan do not qualify under Section 422 of the Internal Revenue Code as incentive stock options.

The 2003 Plan also provides that our board of directors, or a committee, may issue free-trading or restricted stock pursuant to stock right agreements containing such terms and conditions as our board of directors deems appropriate.

As of December 31, 2003, there were 367,514 common shares issued or reserved for issuance under the 2003 Stock Plan, and 1,132,486 common shares available for issuance.

On March 26, 2003, we filed with the SEC a registration statement on form S-8 for the purpose of registering the common shares issuable under our 2003 Stock Plan under the Securities Act of 1933. We have, to date, principally used the 2003 Stock Plan to grant registered common shares to selected consultants as compensation for services, while utilizing the 2002 Stock Plan for unregistered grants of stock and options to directors, officers, employees and other consultants.

The stand-alone grant to Mr. Marvin Fink of 2,100,000 restricted shares under his employment agreement pursuant to which he agreed to become our Chief Executive Officer, President and Chairman of the Board; the stand-alone grant to B Technologies of 600,000 restricted common shares under the terms of the loan-out agreement by which we procured the

services of Mr. Budimir S. Drakulic as our Vice President and Chief

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Technology Officer, and the stand-alone grant to Mr. Ellsworth Roston of 225,000 restricted common shares and warrants entitling him to purchase an additional 450,000 common shares under the terms of his consulting agreement with our company, each constitute an equity compensation plan or arrangement that has not been approved to date by our shareholders. For further information relating to these transactions, see that section of this prospectus captioned

Management Employment And Consulting Agreements With Management .

Description of Equity Compensation Plans Approved By Shareholders

Recom has one equity compensation plan or arrangement that has been approved by our shareholders, the Recom Managed Systems, Inc. 2002 Stock Plan (the *2002 Stock Plan*). Recom adopted the 2002 Stock Plan, pursuant to which 6,000,000 common shares (2,000,000 shares pre-split) were originally reserved for issuance, on November 1, 2002. Shareholder approval was received on June 5, 2003.

The 2002 Stock Plan was adopted by our board of directors as a vehicle to encourage and provide for the acquisition of an equity interest in Recom by our employees, officers, directors and consultants. Our board believes the plan will enable us to attract and retain the services of key employees, officers, directors and consultants upon whose judgment, interest and special effort the successful conduct of our operations is largely dependent, and to motivate those individuals by providing additional incentives and motivation toward superior performance.

The 2002 Stock Plan allows our board of directors, or a committee established by our board, to award restricted stock and stock options from time to time to our employees, officers, directors and consultants. The board has the power to determine at the time an option is granted whether the option will be an incentive stock option (an option which qualifies under Section 422 of the Internal Revenue Code of 1986) or an option which is not an incentive stock option. Incentive stock options may only be granted to persons who are our employees. Vesting provisions are determined by our board at the time options are granted. Options may be exercisable by the payment of cash or by other means as authorized by the committee or our board of directors.

The 2002 Stock Plan also provides that our board of directors, or a committee established by our board, may issue restricted stock pursuant to restricted stock right agreements which will contain such terms and conditions as our board or committee determines.

As of December 31, 2003, there were 3,090,000 common shares issued or reserved for issuance under the 2002 Stock Plan, and 2,910,000 common shares available for issuance.

PRINCIPAL SHAREHOLDERS

The following table sets forth selected information, computed as of January 23, 2004, about the amount and nature of our securities beneficially owned by:

- each of our *executive officers* (defined as our President, Secretary, Chief Financial Officer or Treasurer, any vice-president in charge of a principal business function, such as sales, administration or finance, or any other person who performs similar policy making functions for our company);
- each of our directors;
- each person known to us to own beneficially more than 5% of any class of our securities with voting rights; and
- the group comprised of our current directors and executive officers.

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This information was given to us by our shareholders and the numbers used are based on the definitions by the Securities and Exchange Commission (the "SEC") found in Rules 13d-3 and 13d-5 under the Exchange Act. See footnote (2) to this table. Accordingly, the number of shares listed in the table represent "beneficial ownership

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only for purposes of the reports required by the SEC. We believe that each individual or entity named has sole investment and voting power with respect to the securities indicated as beneficially owned by them, subject to community property laws, where applicable, except where otherwise noted.

| Name (1) | Class Of Stock(2) | | | |
|--|-------------------|-------|------------------------|---|
| | Common | | Series A Preferred (3) | |
| | Amount | % | Amount | % |
| Marvin H. Fink (4)(5)(6) | 2,257,000(7) | 6.8% | 0 | |
| Dr. Budimir S. Drakulic (5) | 621,578(8) | 1.9% | 0 | |
| Ellsworth Roston (4) | 903,250(9) | 2.7% | 0 | |
| Dr. Robert Koblin (4) | 150,000(10) | * | 0 | |
| Dr. Lowell T. Harmison (4) | 200,793(11) | * | 0 | |
| Jennifer Black (4) | 50,000(12) | * | 0 | |
| Tracey Hampton / ARC Finance Group, LLC (6) | 22,950,000(13) | 69.6% | 0 | |
| Directors and executive officers, as a group | 4,182,62(14) | 12.2% | 0 | |

* Less than one percent.

- (1) The address of the shareholders named in this table are: Messrs. Fink, Drakulic, Roston, Koblin and Harmison and Ms. Black c/o Recom Managed Systems, Inc., 4705 Laurel Canyon Boulevard, Suite 203, Studio City, California 91607; and Ms. Hampton and ARC Finance Group LLC 23679 Calabasas Road, Suite 754, Calabasas, CA 91302.
- (2) The determination and calculation of beneficial ownership for purposes of preparing this table is based upon the definition of beneficial ownership in Rules 13d-3 and 13d-5 of the United States Securities Exchange Act of 1934, pursuant to which a person is deemed to beneficially own any securities over which he or she has either investment or voting power. You should note that this method of calculation differs from that used to calculate beneficial ownership for other reports required under the Exchange Act, including section 16 of that act which calculates beneficial ownership based upon pecuniary interests. Pursuant to Rule 13d-3(d) of the Exchange Act, we have also included in each person's share count any shares under any options, warrants, rights or conversion privileges which are or may become exercisable by that person within 60 days of the date of calculation for purposes of this proxy statement. In computing each person's respective percentage ownership, the shares attributable to his or her exercisable securities under the 60-day inclusion rule are treated as being outstanding (i.e., are added to the total outstanding shares of that class for computational purposes), while exercisable securities attributable to the other executive officers, directors or 5% shareholders under the 60-day inclusion rule are disregarded. In computing the percentage ownership our company's officers and directors as a group, all shares attributable to exercisable securities held by the members of that group under the 60-day inclusion rule are treated as being outstanding (i.e., are added to the total outstanding shares of that class for computational purposes). The base number of outstanding shares of our common and series A preferred shares as of the applicable date are 32,993,912 and 1,792,153 shares, respectively.
- (3) Each series A preferred share is convertible into one common share.
- (4) Director.
- (5) Executive officer.
- (6) 5% shareholder.
- (7) Includes 2,100,000 common shares held by the Fink Family Trust, and 157,000 common shares issuable upon exercise of options granted to Mr. Fink in his capacity as a director.
- (8) Includes 600,000 common shares held by B World Technologies, Inc., 4,000 common shares held by B World Technologies, Inc., and 93,750 common shares issuable upon exercise of options granted to B World Technologies

- in connection with services performed by Dr. Drakulic. Both B World Technologies and B Technologies are owned and controlled by Dr. Drakulic.
- (9) Includes 696,250 common shares held by Roston Enterprises, 450,000 common shares issuable upon exercise of warrants granted to Mr. Roston in his capacity as a consultant, and 157,000 common shares issuable upon exercise of options granted to Mr. Roston in his capacity as a director.
- (10) Includes 150,000 common shares issuable upon exercise of options granted to Dr. Koblin in his capacity as a director.
- (11) Includes 144,000 common shares issuable upon exercise of warrants granted to Dr. Harmison in his capacity as a consultant, and 50,000 common shares issuable upon exercise of options granted to Dr. Harmison in his capacity as a director.
- (12) Includes 50,000 common shares issuable upon exercise of options granted to Ms. Black in her capacity as a director.
- (13) Includes 22,950,000 common shares held by ARC Finance Group, Inc. ARC Finance Group is owned and controlled by Ms. Hampton.
- (14) Includes 1,125,578 common shares issuable upon exercise of common share purchase options and warrants.

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**TRANSACTIONS AND BUSINESS RELATIONSHIPS WITH
MANAGEMENT AND PRINCIPAL SHAREHOLDERS**

Summarized below are certain transactions and business relationships between Recom and persons who are or were an executive officer, director or holder of more than five percent of any class of our securities since January 1, 2002:

- On September 19, 2002, as part of the agreements leading to and facilitating the acquisition of the Signal Technologies from ARC Finance Group, Mr. Sim Farar, our president and principal shareholder at that time, invested \$125,000 into the company as working capital in exchange for a warrant entitling him to purchase 600,000 common shares (200,000 shares pre-split) at approximately \$0.21 per share.
- On October 12, 2002 we entered into a four-year employment agreement with Mr. Marvin H. Fink pursuant to which, among other things, we employed Mr. Fink as our Chief Executive Officer and Chairman of the Board, and granted to Mr. Fink 2,100,000 restricted common shares (700,000 shares pre-split) as compensation for those services. For a description of the full terms of that agreement see that section of this annual report captioned *Management Employment And Consulting Agreements With Management* .
- On October 15, 2002 we entered into a ten-year loan-out agreement with Dr. Budimir S. Drakulic and his two companies, B. World Technologies and B Technologies pursuant to which, among other things, we engaged the services of Dr. Drakulic as our Vice President and Chief Technology Officer, and granted B World Technologies 600,000 restricted common shares (200,000 shares pre-split) as compensation for those services. For a description of the full terms of that agreement see that section of this annual report captioned *Management Employment And Consulting Agreements With Management* .
- On October 11, 2002, we reached an agreement-in-principle with Dr. Budimir Drakulic to become our Vice President and Chief Technology Officer on a consulting basis through his consulting companies. In conjunction with that understanding, we also reached an agreement-in-principle with Dr. Drakulic to offer to sell our common shares to certain individuals in order to protect our rights in the Signal Technologies. Pursuant to this understanding, on October 22, 2002, we sold 564,810 common shares (188,270 shares pre-split) to eleven of those individuals, and issued a five-year warrant to purchase 375,000 common shares (125,000 shares pre-split) for \$0.007 per share to one of those individuals, in consideration of their cash investment of \$17,786. We further agreed that should we raise more than \$2 million in certain offerings, to pay 4% of the proceeds of those offerings to those individuals up to the amount of \$480,350. We are currently in discussion with those individuals relative to the payment of this obligation.
- On November 1, 2002, we entered into a two-year consulting agreement with Mr. Ellsworth Roston, who then became one of our directors pursuant to that agreement. Under the terms of that agreement, we granted to Mr. Roston, among other things, 225,000 restricted common shares (75,000 shares pre-split) and five-year warrants

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to purchase an additional 450,000 common shares (150,000 shares pre-split) at \$1.67 per share. For a description of the full terms of that agreement see that section of this annual report captioned

Management Employment And Consulting Agreements With Management .

- In compensation for his consulting services, we granted to Mr. Roston 225,000 restricted common shares (75,000 shares pre-split) and five-year warrants to purchase an additional 450,000 common shares (150,000 shares pre-split) at \$1.67 per share.
- On February 14, 2003, we entered into a three-year consulting agreement with Dr. Lowell T. Harmison, who later became one of our directors. Under the terms of that agreement, we granted to Dr. Harmison, among other things, (1) fully vested options entitling him to purchase 108,000 common shares (36,000 shares pre-split) at \$0.97 per share, and (2) options entitling him to purchase an additional 108,000 common shares (36,000 shares pre-split) at \$0.97 per share subject to vesting over twelve quarters. All of the aforesaid options are exercisable over five years after vesting. For a description of the full terms of that agreement see

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that section of this annual report captioned *Management Employment And Consulting Agreements With Management* .

PRINCIPAL ACCOUNTANT FEES AND SERVICES

Summarized below is the aggregate amount of various professional fees billed by our principal accountants with respect to our last two fiscal years:

| | <u>2003</u> | <u>2002</u> |
|--|-------------|-------------|
| Audit fees | \$ 90,644 | \$ 11,585 |
| Audit-related fees | \$ | \$ |
| Tax fees | \$ | \$ |
| All other fees | \$ | \$ |
| All other fees, including tax consultation and preparation | \$ | \$ |

All audit fees are approved in advance by our audit committee and board of directors. Stonefield Josephson does not provide any non-audit services to Recom.

EXHIBITS AND REPORTS ON FORM 8-K

Exhibits

- 2.1 Plan of Reorganization **
- 3.1 Amended And Restated Certificate Of Incorporation Of Recom Managed System, Inc. filed by the Delaware Secretary of State on November 6, 2000 (1)
- 3.2 Certificate Of Amendment Of Certificate Of Incorporation Of Recom Managed System, Inc. filed by the Delaware Secretary of State on June 20, 2003 (8)
- 3.3 Certificate Of Designation Of Rights, Preferences And Limitations Of Series A Convertible Preferred Stock Of Recom Managed System, Inc. filed by the Delaware Secretary of State on September 9, 2003 (8)
- 3.4 Bylaws Of Recom Managed Systems, Inc. adopted March 31, 2003 (7)

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- 5.1 Specimen common stock certificate (8)
- 5.2 Specimen series A preferred stock certificate (8)
- 5.3 Recom Managed Systems, Inc. 2002 Stock Plan adopted on November 1, 2002 (6)
- 5.4 Form of option issued under Recom Managed Systems, Inc. 2002 Stock (8)
- 5.5 Recom Managed Systems, Inc. 2003 Nonqualified Stock Option And Stock Plan adopted on March 31, 2002 (6)
- 5.7 Warrant To Purchase Common Stock dated September 19, 2002 issued to Sim Farrar (2)
- 5.9 Form of Standard Warrant (8)
- 5.10 Form of Class A Warrant (8)
- 5.11 Form of Class C Warrant (8)

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- 5.12 Form of Agent s Warrant with Maxim Group LLC **
- 10.1 Stock Acquisition and Signal Technologies Transfer Agreement dated September 12, 2002 between Recom and ARC Finance Group, LLC (2)
- 10.2 Employment Agreement dated October 14, 2002 between Recom and Marvin H. Fink (3)
- 10.3 License Agreement dated December 9, 1993 between Dr. Budimir S. Drakulic and Teledyne Electronic Industries, Inc. (8)
- 10.4 Restricted Stock Agreement dated October 14, 2002 between Recom and Marvin H. Fink (3)(4)
- 10.5 Indemnification Agreement dated October 14, 2002 between Recom and Marvin H. Fink (3)(4)
- 10.6 Loan-out Agreement dated October 15, 2002 between Recom and Budimir Drakulic, B World and B Technologies (3)
- 10.7 Restricted Stock Agreement dated October 15, 2002 between Recom and Budimir Drakulic, B World and B Technologies (3)(5)
- 10.7 Consulting Agreement dated November 1, 2002 between Recom and Ellsworth Roston (3)
- 10.9 Employment, Confidential Information, Invention Assignment, And Arbitration Agreement dated October 15, 2002 between Recom and Budimir Drakulic, B World and B Technologies (3)(5)
- 10.10 Consulting Agreement dated February 14, 2003 between Recom and Lowell T. Harmison (8)
- 10.11 Employment Agreement dated March 10, 2003 between Recom and Charles E. McGill (7)

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- 10.12 Investment Banking Agreement dated April 15, 2003 between Recom and Brookstreet Securities Corporation (7)
- 10.13 Investment Banking Agreement dated July 17, 2003 between Recom and Maxim Group, LLC (8)
- 10.14 Form of Registration Rights Agreement for purchasers of Series A Preferred Stock (8)
- 21 List of significant subsidiaries (9)
- 23 Consent of Stonefield Josephson, Inc. *
- 24.1 Power of Attorney signed by Ellsworth Roston*
- 24.2 Power of Attorney signed by Jennifer Black*
- 24.3 Power of Attorney signed by Robert Koblin*
- 24.4 Power of Attorney signed by Lowell T. Harmison*
- 31.1 Certification
- 31.2 Certification
- 32.1 Certification of CEO Pursuant to Section 906 of the Sarbanes-Oxley Act *
- 32.2 Certification of CFO Pursuant to Section 906 of the Sarbanes-Oxley Act *

* Filed herewith

** To be filed at a future date

- (1) Previously filed as an exhibit to our report on form 10-KSB for our fiscal year ended December 31, 2001 filed with the SEC on February 22, 2002.
- (2) Previously filed as an exhibit to our report on form 8-K filed with the SEC on September 25, 2002.
- (3) Previously filed as an exhibit to our report on form 10-QSB for our fiscal quarter ended September 30, 2002 filed with the SEC on November 12, 2002.
- (4) Filed as part of the Employment Agreement for Mr. Fink noted in item 10.2.
- (5) Filed as part of the Loan-Out Agreement for with B World Technologies, B Technologies and Dr. Drakulic noted in item 10.6.
- (6) Previously filed as an exhibit to our report on form 10-KSB for our fiscal year ended December 31, 2002 filed with the SEC on March 26, 2003.
- (7) Previously filed as an exhibit to our report on form 10-QSB for our fiscal quarter ended March 30, 2003 filed with the SEC on May 7, 2003.
- (8) Previously filed as an exhibit to our registration statement on form SB-2 filed with the SEC on December 31, 2003.
- (9) At present we have no significant subsidiaries.

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Reports On Form 8-K

On December 12, 2003, we filed a form 8-K with the SEC in connection with the replacement of our independent auditors. For further information relating to this filing, see that section of this annual report captioned *Changes In And Disagreements With Accountants On Accounting And Financial Disclosure*. No other reports on form 8-K were filed during the three-month period ended December 31, 2003.

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SIGNATURES OF EXECUTIVE OFFICERS

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this annual report on form 10-KSB to be signed on its behalf by the undersigned, thereunto duly authorized on February 9, 2004.

RECOM MANAGED SYSTEMS, INC.

By: */s/ Marvin H. Fink*

Marvin H. Fink,
Chief Executive Officer and President (principal executive officer)

By: */s/ Charles Dargan*

Charles Dargan
Interim Chief Financial Officer
(principal accounting and financial officer)

SIGNATURES OF BOARD OF DIRECTORS

In accordance with the Exchange Act, this annual report on form 10-KSB has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: *Marvin H. Fink* Chief Executive Officer, February 9, 2004

Marvin H. Fink President and Chairman
of the Board
(principal executive officer)

By: *Ellsworth Roston** Director February 9, 2004

Ellsworth Roston

By: *Robert Koblin** Director February 9, 2004

Robert Koblin

By: *Lowell T. Harmison** Director February 9, 2004

Lowell T. Harmison

By: *Jennifer Black** Director February 9, 2004

Jennifer Black

*By: *Marvin H. Fink*

Marvin H. Fink
Agent-In Fact

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INDEPENDENT AUDITORS REPORT

To The Board Of Directors And Stockholders Of Recom Managed Systems, Inc.
Studio City, California

We have audited the accompanying balance sheet of Recom Managed Systems, Inc. as of December 31, 2003 and the related statements of operations, stockholders' equity and cash flows for each of the two years in the period ended December 31, 2003 and from inception of development stage (November 7, 2000) to December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that the Company plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Recom Managed Systems, Inc. as of December 31, 2003 and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2003 and from inception of development stage (November 7, 2000) to December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

/s/ Stonefield Josephson, Inc.

Stonefield Josephson, Inc.
Certified Public Accountants

January 30, 2004

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RECOM MANAGED SYSTEMS, INC.
(A Development Stage Company)
BALANCE SHEET
December 31, 2003

December 31,
2003

ASSETS

CURRENT ASSETS

| | |
|--|--------------|
| Cash and cash equivalents | \$ 3,957,720 |
| Prepaid expenses | 130,749 |
| | <hr/> |
| Total current assets | 4,088,469 |
| Property, plant and equipment, net of accumulated depreciation of \$39,751 | 169,299 |
| Intangible patents, net of accumulated amortization of \$11,146 | 157,828 |
| | <hr/> |
| TOTAL ASSETS | \$ 4,415,596 |
| | <hr/> |
| LIABILITIES AND STOCKHOLDERS S EQUITY | |
| CURRENT LIABILITIES | |
| Accounts payable and accrued expenses | \$ 590,856 |
| | <hr/> |
| STOCKHOLDERS EQUITY | |
| Series A convertible preferred stock, \$.001 par value; 10,000,000 shares authorized; 1,792,921 issued and outstanding | \$ 1,793 |
| Common stock, \$.001 par value; 100,000,000 shares authorized; 32,993,912 shares issued and outstanding | 32,993 |
| Additional paid-in capital | 11,477,573 |
| Deferred compensation | (282,020) |
| Deficit accumulated during development stage | (7,455,599) |
| | <hr/> |
| TOTAL STOCKHOLDERS EQUITY | 3,824,740 |
| | <hr/> |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | \$ 4,415,596 |
| | <hr/> |

The accompanying notes are an integral part of these financial statements.

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RECOM MANAGED SYSTEMS, INC.
(A Development Stage Company)
STATEMENTS OF OPERATIONS
For The Years Ended December 31, 2003 And 2002 And From Inception
Of Development Stage (November 7, 2000) To December 31, 2003

For the Years Ended December
31,

From
Inception
of
Development
Stage

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| | 2003 | 2002 | (Nov. 7, 2000) to Dec. 31, 2003 |
|--|----------------|--------------|---------------------------------------|
| | _____ | _____ | _____ |
| Revenue | \$ | \$ | \$ |
| Research and development | 497,631 | 67,500 | 565,131 |
| General and administrative expenses | 4,813,746 | 144,454 | 5,044,873 |
| Total Expense | 5,311,377 | 211,954 | 5,610,004 |
| Loss Before Income Taxes | (5,311,377) | (211,954) | (5,610,004) |
| Provision for income taxes | | | |
| Net Loss | \$ (5,311,377) | \$ (211,954) | \$ (5,610,004) |
| Preferred Dividend | 1,953,170 | | 1,953,170 |
| Net Loss Attributed to common stockholders | \$ (7,264,547) | \$ (211,954) | \$ (7,563,174) |
| Basic and diluted loss per share | \$ (0.17) | \$ (0.02) | \$ (0.37) |
| Basic and diluted loss per share attributed to common stockholders | \$ (0.23) | \$ (0.02) | \$ (0.49) |
| Weighted average shares outstanding basic and diluted | 31,765,404 | 11,609,162 | 15,311,041 |

The accompanying notes are an integral part of these financial statements.

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RECOM MANAGED SYSTEMS, INC.
(A Development Stage Company)
STATEMENT OF STOCKHOLDERS' EQUITY
From Inception Of Development Stage (November 7, 2000) To December 31, 2003

| | Common Stock | Series A Convertible Preferred Stock | Additional Paid-in Capital | Deferred Compensation | Deficit Accumulated During Development Stage | From Inception (Nov. 7, 2000) To Dec. 31, 2003 |
|-------------------|--------------|--|----------------------------------|--------------------------|--|--|
| Table of Contents | | | | | | 39 |

| | Shares | Amount | Shares | Amount | | | |
|--|-------------------|------------------|-----------|-------------------|-------------------|---------------------|-------------------|
| 2000: | | | | | | | |
| Balance November 7, 2000 (as restated for 3:1 stock split) | 4,139,784 | \$ 4,139 | \$ | \$ (4,139) | \$ | \$ | \$ |
| Contributed capital | | | | 35,000 | | | 35,000 |
| Net loss | | | | | | (36,673) | (36,673) |
| Balance December 31, 2000 | 4,139,784 | 4,139 | | 30,861 | | (36,673) | (1,673) |
| 2001: | | | | | | | |
| Capital contributed | | | | 45,000 | | | 45,000 |
| Shares issued for services July 2001 \$ 0.033 | 150,000 | 150 | | 4,850 | | | 5,000 |
| Net loss | | | | | | (50,000) | (50,000) |
| Balance December 31, 2001 | 4,289,784 | 4,289 | | 80,711 | | (86,673) | (1,673) |
| Capital Contributed | | | | 56,400 | | | 56,400 |
| Warrants issued for Cash | | | | 125,000 | | | 125,000 |
| Issuance of common stock for: | | | | | | | |
| Technology Sept. 2002 \$ 0.006 | 23,400,000 | 23,400 | | 54,623 | | | 78,023 |
| Services rendered Oct. 2002 \$ 0.021 | 2,925,000 | 2,925,000 | | 17,958 | (19,678) | | 1,205 |
| Cash Oct 2002 \$ 0.03 | 564,810 | 565 | | 17,221 | | | 17,786 |
| Cash Nov 2002 \$ 2.66 | 71,250 | 71 | | 189,929 | | | 190,000 |
| Contributed services officer | | | | 20,000 | | | 20,000 |
| Warrants issued for services | | | | 5,324 | | | 5,324 |
| Net loss | | | | | | (211,954) | (211,954) |
| Balance December 31, 2002 | 31,250,844 | \$ 31,250 | \$ | \$ 567,166 | \$(19,678) | \$ (298,627) | \$ 280,111 |

(continued on next page)

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RECOM MANAGED SYSTEMS, INC.
(A Development Stage Company)
STATEMENT OF STOCKHOLDERS' EQUITY
From Inception Of Development Stage (November 7, 2000) To December 31, 2003
(Continued)

| | Common Stock | | Series A Convertible Preferred Stock | | Additional Paid-in Capital | Deferred Compensation | De Accum Du Devel St |
|--|--------------|--------|--------------------------------------|--------|----------------------------|-----------------------|----------------------|
| | Shares | Amount | Shares | Amount | | | |
| 2003: | | | | | | | |
| Issuance of common stock for cash and contributed property April 2003 \$2.22 related party | 112,812 | \$ 113 | | \$ | \$ 249,887 | \$ | \$ |
| Issuance of common stock for cash: | | | | | | | |
| May 2003 \$3.00 | 82,667 | 83 | | | 247,917 | | |
| July 2003 \$3.33 | 75,075 | 75 | | | 249,925 | | |
| Issuance of common stock for services: | | | | | | | |
| April 2003 \$2.80 | 147,192 | 147 | | | 411,654 | | |
| April 2003 \$3.15 | 11,045 | 11 | | | 34,780 | | |
| July 2003 \$3.67 | 111,625 | 112 | | | 410,192 | | |
| August 2003 \$3.68 | 33,188 | 33 | | | 121,103 | | |
| September 2003 \$3.77 | 24,292 | 24 | | | 91,673 | | |
| October 2003 \$4.78 | 15,385 | 15 | | | 73,525 | | |

| | | | | | | | |
|---|--------|------------|-----------|-----------|-----------|---------------|--------------|
| November 2003 | \$3.65 | 18,834 | 19 | | 68,783 | | |
| December 2003 | \$3.60 | 5,953 | 6 | | 21,425 | | |
| Cashless exercise of warrants | | 1,105,000 | 1,105 | | (1,105) | | |
| Contributed services officer | | | | | 80,000 | | |
| Employee stock options issued below market | | | | | 38,400 | | |
| Amortization of deferred compensation | | | | | | 6,668 | |
| Options and Warrants issued for: | | | | | | | |
| Services | | | | | 2,196,068 | (210,010) | |
| Financing cost | | | | | 74,088 | | |
| Issuance of preferred stock for cash | | | 1,792,921 | 1,793 | 5,376,857 | | |
| Series A Preferred offering expense | | | | | (572,785) | | |
| Preferred stock beneficial conversion feature | | | | | 896,474 | | (8) |
| Allocation of fair value to warrants | | | | | 949,121 | | (9) |
| Preferred stock accrued dividend payable | | | | | (107,575) | | |
| Net loss | | | | | | | (5,311,377) |
| Balance December 31, 2003 | | 32,993,912 | \$ 32,993 | 1,792,921 | \$ 1,793 | \$ 11,477,573 | \$ (232,020) |

The accompanying notes are an integral part of these financial statements.

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RECOM MANAGED SYSTEMS, INC.

(A Development Stage Company)

STATEMENT OF CASH FLOWS

**For The Years Ended December 31, 2003 And 2002 And From
Inception Of Development Stage (November 7, 2000) To December 31, 2003**

| | For the Years Ended December 31, | | From Inception of Development Stage (Nov. 7, 2000) to Dec. 31, 2003 |
|--|----------------------------------|------------------|---|
| | 2003 | 2002 | |
| Cash flow from operating activities: | | | |
| Net loss | \$ (5,311,377) | \$ (211,954) | \$ (5,610,004) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | | |
| Depreciation | 50,897 | 693 | 51,590 |
| Amortization of deferred compensation | 6,668 | 1,205 | 7,873 |
| Salary as contributed capital | 80,000 | 20,000 | 100,000 |
| Common stock issued for services | 1,383,503 | | 1,388,503 |
| Options and Warrants issued for services and financing | 2,089,546 | 5,324 | 2,094,870 |
| Change in assets and liabilities: | | | |
| Prepaid expenses | (92,934) | (37,815) | (130,749) |
| Accounts Payable and accrued expenses | 470,517 | 2,829 | 483,281 |
| Net cash used in operating activities | (1,323,180) | (219,718) | (1,614,636) |

Cash used in investing activities:

| | | | |
|---------------------------------------|-------------------|-------------------|-------------------|
| Purchase of equipment | (180,703) | (29,041) | (209,744) |
| Capitalized technology cost | (90,951) | | (90,951) |
| | <u> </u> | <u> </u> | <u> </u> |
| Net cash used in investing activities | (271,654) | (29,041) | (300,695) |
| | <u> </u> | <u> </u> | <u> </u> |

Cash flow from financing activities:

| | | | |
|---|-------------------|-------------------|-------------------|
| Capital contributions | | 56,400 | 136,400 |
| Sale of common stock for cash | 598,000 | 207,786 | 805,786 |
| Sale of preferred stock for cash, net of expenses | 4,805,865 | | 4,805,865 |
| Sale of warrants for cash | | 125,000 | 125,000 |
| | <u> </u> | <u> </u> | <u> </u> |
| Net cash provided by financing activities | 5,403,865 | 389,186 | 5,873,051 |
| | <u> </u> | <u> </u> | <u> </u> |

Net increase (decrease) in cash and cash equivalents 3,809,031 140,427 3,957,720

| | | | |
|--|-------------------|-------------------|-------------------|
| Cash and cash equivalents at beginning of period | 148,689 | 8,262 | |
| | <u> </u> | <u> </u> | <u> </u> |

Cash and cash equivalents at end of period \$ 3,957,720 \$ 148,689 \$ 3,957,720

The accompanying notes are an integral part of these financial statements.

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RECOM MANAGED SYSTEMS, INC.

(A Development Stage Company)

STATEMENT OF CASH FLOWS

From

Inception Of Development Stage (November 7, 2000) To December 31, 2003

(Continued)

Supplemental Cash Flow Information:

For the years from inception of development stage (November 7, 2000) to December 31, 2003, the Company paid no interest or income taxes.

Supplement Investing and Financing Activities:

In September 2002, 23,400,000 shares of the Company's common stock were issued for a patent valued at \$78,023.

In October 2002, the Company issued 2,925,000 of the Company's common stock as compensation under employment agreements with multi-year terms. The shares were valued at \$20,883, the fair value of the stock at issuance date. The Company has recognized \$7,873 of compensation expense for these agreements through December 31, 2003.

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In November 2002, the Company issued warrants to a consultant to purchase the Company's common stock under consulting contracts. The value of the warrants, based upon the fair value of the stock using the Black-Scholes option model is \$5,324. The Company recorded compensation expense of \$5,324 for this agreement.

In April 2003, the Company entered into an agreement with a major shareholder in which \$150,000 of common stock was issued for \$33,208 of accrued expenses and \$116,792 of furniture and fixtures and leasehold improvements (see Note 10).

The Company recorded compensation expense of \$80,000 and \$20,000 for the years ended December 31, 2003 and 2002, respectively for the CEO of the Company. This compensation was recorded as additional paid in capital.

During the year ended December 31, 2003, the Company issued 367,514 shares of common stock, for marketing and business services rendered during the period. These services were valued at \$1,236,905 based upon the market value of the shares at the date of issuance.

The accompanying notes are an integral part of these financial statements.

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1. ORGANIZATIONAL MATTERS

Reorganization

On June 26, 2000, Recom Managed Systems, Inc. (the Company) (a Development Stage Company) filed a Voluntary Petition for Reorganization Under Chapter 11 of the Federal Bankruptcy Code and substantially curtailed operations. The Plan of Reorganization was confirmed on November 7, 2000, at which date the Company became a development stage company under the provisions of Statement of Financial Accounting Standards (SFAS) No. 7. This resulted in the post bankruptcy ownership group controlling approximately 87% of the common stock and the elimination of the outstanding liabilities and most assets.

On September 19, 2002, the Company issued 23,400,000 (7,800,000 pre-split) shares of common stock in exchange for intangible technology. The issuance of this stock resulted in a change of control, with the new ownership group controlling approximately 85% of the Company's outstanding stock. See Note 3. The Company is now developing technology in the medical device market focused on cardiac monitors and other diagnostic medical devices which monitor and measure the body's physiological signals in order to detect and prevent medical complications and diseases.

Stock Split

On April 2, 2003, the Board of Directors declared a three-for-one stock split effective as of the close of business on Friday, April 11, 2003. All share amounts, exercise prices relating to share purchase options and warrants, and earnings per share in these financial statements and notes have been presented on a post-split basis unless stated otherwise.

Basis of Presentation

The Company has not generated any revenues to date, and no assurance can be given that the Company will produce successful commercial products or services. Further, no assurance can be given that the regulatory agencies, physicians, patients, or insurance providers will accept the products or services. However, the Company will continue its business plan to develop its line of products, which management currently believes will be ready for market approximately in late 2005. Management also believes that the Company has sufficient capital to fund its operations for up to 24 months of operations. In October 2003, the Company successfully raised approximately \$4,806,000 in a Unit Offering, net of offering expenses (see Note 9, Unit Offering).

2. SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates These financial statements have been prepared in accordance with accounting principles generally accepted in the United States and accordingly, require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and

expenses during the reporting period. Specifically, management has estimated the expected economic life and value of its patents, the net operating loss for tax purposes and common stock, options and warrants related to compensation to consultants and investment banks. Actual results could differ from those estimates.

Fair Value of Financial Instruments For certain of the Company's financial instruments, accounts payable and accrued expenses, the carrying amounts approximate fair value due to their relatively short maturities.

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Cash and Equivalents Cash equivalents are comprised of certain highly liquid investments with maturity of three months or less when purchased. The Company maintains its cash in bank deposit accounts, which at times, may exceed federally insured limits. The Company has not experienced any losses in such account.

Equipment Equipment is recorded at historical cost. Maintenance and repairs are expensed as incurred. Depreciation is provided by the straight-line method over three to five years.

Intangible and Long Lived Assets The Company follows SFAS No. 144, Accounting for Impairment of Disposal of Long-Lived Assets which established a primary asset approach to determine the cash flow estimation period for a group of assets and liabilities that represents the unit of accounting for a long lived asset to be held and used.

Advertising Costs The Company expenses advertising costs as incurred. The Company had advertising costs of \$11,800 for the year ended December 31, 2003 and did not have any advertising costs in the year ended December 31, 2002.

Research and Development Costs Research and development costs consist of expenditures for the research and development of patents, which are not capitalizable. The Company's research and development costs consist mainly of payroll and payroll related expenses, consultants and FDA regulatory expenses.

Stock Based Compensation SFAS No. 123, Accounting for Stock Based Compensation, establishes and encourages the use of the fair value based method of accounting for stock based compensation arrangements under which compensation cost is determined using the fair value of stock based compensation determined as of the date of the grant or the date at which the performance of the services is completed and is recognized over the periods in which the related services are rendered. The statement also permits companies to elect to continue using the current intrinsic value accounting method specified in Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, to account for stock based compensation to employees. The Company has elected to use the intrinsic value based method for its employees and directors and has disclosed the pro forma effect of using the fair value based method to account for its stock based compensation to employees.

The Company uses the fair value method for equity instruments granted to non employees and uses the Black Scholes model for measuring the fair value. The stock based fair value compensation is determined as of the date of the grant or the date at which the performance of the services is completed and is recognized over the periods in which the related services are rendered.

Pro Forma Information

Pro forma information regarding the effects on operations as required by SFAS No. 123 and SFAS No. 148, has been determined as if the Company had accounted for its employee stock options under the fair value method of those statements. Pro forma information is computed using the Black Scholes method at the date of grant based on the following assumptions ranges: (i) risk free interest rate of 1.42% to 3.13%; (ii) dividend yield of 0%; (iii) volatility factor of the expected market price of the Company's common stock of 53.84% to 158.48%; and (iv) an expected life of the options of 1.5 years.

This option valuation model requires input of highly subjective assumptions. Because the Company's employee common stock purchase options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value of estimate, in management's opinion, the existing model does not necessarily provide a reliable single measure of fair value of its employee common stock purchase options.

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The Company's pro forma information is as follows:

| | For the Year Ended December 31, 2003 | For the Year Ended December 31, 2002 |
|---|---|---|
| | | |
| Net loss as reported | \$ (5,311,377) | \$ (211,954) |
| Current period expense calculated under APB 25 | 38,400 | □ |
| Stock compensation calculated under SFAS 123 | (730,865) | □ |
| | | |
| Pro forma net loss | \$ (6,003,842) | \$ (211,954) |
| | | |
| Basic and diluted historical loss per share | \$ (0.17) | \$ (0.02) |
| | | |
| Pro forma basic and diluted loss per share | \$ (0.19) | \$ (0.02) |
| | | |

Income Taxes Deferred income taxes result primarily from temporary differences between financial and tax reporting. Deferred tax assets and liabilities are determined based on the difference between the financial statement bases and tax bases of assets and liabilities using enacted tax rates. A valuation allowance is recorded to reduce a deferred tax asset to that portion that is expected to more likely than not be realized.

Net Loss Per Share The Company uses SFAS No. 128, Earnings Per Share for calculating the basic and diluted loss per share. Basic loss per share is computed by dividing net loss attributable to common stockholders by the weighted average number of shares of common stock outstanding. Diluted loss per share is computed similar to basic loss per share except that the denominator is increased to include the number of additional shares of common stock that would have been outstanding if the potential shares had been issued and if the additional shares were dilutive. Common equivalent shares are excluded from the computation of net loss per share if their effect is anti-dilutive.

The Company reported a net loss per share of \$0.17 for the year ended December 31, 2003 and \$0.02 for the year ended December 31, 2002. For the years ended December 31, 2003 and 2002, 7,121,349 potential shares and 1,800,000 potential shares, respectively, were excluded from the shares used to calculate diluted EPS as their effect is anti-dilutive.

Comprehensive Income Comprehensive income is not presented in the Company's financial statements since the Company did not have any of the items of other comprehensive income in any period presented.

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New Accounting Pronouncements

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities. Interpretation 46 changes the criteria by which one company includes another entity in its consolidated financial statements. Previously, the criteria were based on control through voting interest. Interpretation 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. A company that consolidates a variable interest entity is called the primary beneficiary of that entity.

In December 2003 the FASB concluded to revise certain elements of FIN 46, which will be issued shortly. The FASB also modified the effective date of FIN 46. For all entities that were previously considered special purpose entities, FIN 46 should be applied in periods ending after December 15, 2004. Otherwise, FIN 46 is to be applied for registrants who file under Regulation SX in periods ending after March 15, 2004, and for registrants who file under Regulation SB in periods ending after December 15, 2004. The Company does not expect the adoption to have a material impact on the Company's financial position or results of operations.

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During April 2003, the FASB issued SFAS 149 Amendment of Statement 133 on Derivative Instruments and Hedging Activities, effective for contracts entered into or modified after June 30, 2003, except as stated below and for hedging relationships designated after June 30, 2003. In addition, except as stated below, all provisions of this Statement should be applied prospectively. The provisions of this Statement that relate to Statement 133 Implementation Issues that have been effective for fiscal quarters that began prior to June 15, 2003, should continue to be applied in accordance with their respective effective dates. In addition, paragraphs 7(a) and 23(a), which relate to forward purchases or sales of when issued securities or other securities that do not yet exist, should be applied to both existing contracts and new contracts entered into after June 30, 2003. The Company does not participate in such transactions, however, is evaluating the effect of this new pronouncement, if any, and will adopt FASB 149 within the prescribed time.

During May 2003, the FASB issued SFAS 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective for public entities at the beginning of the first interim period beginning after June 15, 2003. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a freestanding financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. Some of the provisions of this Statement are consistent with the current definition of liabilities in FASB Concepts Statement No. 6, Elements of Financial Statements. The Company is evaluating the effect of this new pronouncement and will adopt FASB 150 within the prescribed time.

3. ASSET ACQUISITION

On September 19, 2002, the Company acquired certain know how, trade secrets and other proprietary intellectual property rights relating to the development of a human biomedical signal amplification equipment and technology, referred to in these financial statement as the Signal Technologies, from ARC Finance Group, LLC (ARC) in exchange for 23,400,000 shares of common stock (7,800,000 shares pre-split). As a result of this transaction, ARC acquired approximately 84.5% of the Company's outstanding shares. The Company has valued the issuance of the common stock at \$78,023, which was ARC's historical cost basis for the patents.

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4. PROPERTY, PLANT AND EQUIPMENT

The Company's property, plant and equipment as of December 31, 2003 are as follows:

| | December 31, 2003 |
|-------------------------------------|------------------------------|
| Computer equipment | \$ 68,070 |
| Leasehold improvements | 66,792 |
| Furniture and fixtures | 50,000 |
| Software | 15,904 |
| Other equipment | 8,284 |
| | <hr/> |
| Total property, plant and equipment | \$ 209,050 |
| Less accumulated depreciation | 39,751 |
| | <hr/> |
| Property, plant and equipment, net | \$ 169,299 |

5. PATENTS AND TECHNOLOGY

The Company has one patent and three patent applications concerning its proprietary amplification technology which enables devices to more accurately discriminate physiological signals from electromagnetic background noise than

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existing amplification technologies. See Note 13, Subsequent Events for a discussion of the recent FDA approval for the Company's 12-lead, 24-hour ECG heart monitoring device. The value of the patent and the technology is \$168,974, with accumulated amortization of \$11,146 as of December 31, 2003. The Company inherited a licensing agreement with the patent acquisition and therefore the patent has been placed in service. The Company is amortizing the initial patent valued at \$78,023 over the estimated useful life of 7 years. The aggregate amortization expense will be \$56,000 over the next five years.

6. OPERATING LEASE

The Company has one operating lease for its office space in Studio City, California. The lease expires on August 31, 2005. As of January 1, 2004, the lease was amended to add contiguous office space. The amended lease expires on August 31, 2005. The future lease payments until the end of the lease are \$162,840.

7. CONTINGENT SETTLEMENT PAYABLE

In conjunction with Dr. Budimir Drakulic becoming a Vice President and Chief Technology Officer, the Company also reached an agreement-in-principle with Dr. Drakulic to offer to sell common shares to certain individuals in order to protect the Company's rights to the signal technologies. As part of that agreement, the Company agreed that should it raise more than \$2 million in certain offerings, it would pay 4% of the proceeds of those offerings greater than \$2 million to those individuals up to a maximum amount of \$480,350. There are ongoing discussions with these individuals relative to the payment of this obligation based upon certain issues the Company believes may relieve it of the liability to make such payment. The Company has entered into settlement agreements totaling \$110,000 of the maximum amount with four of those investors releasing the Company from its obligation to pay.

In October 2003, the Company raised \$5,378,750 in a Unit Offering (See Note 9, Unit Offering), and at this time has a potential obligation related to this offering of \$104,201 (included in Accounts Payable and Accrued Expenses).

8. INCOME TAXES

All prior net operating loss carryovers were restricted due to change of ownership in September 2002. The Company has provided no current income taxes due to the losses incurred in 2003 and 2002. Net operating losses for tax purposes of \$6,717,231 and \$184,203 at December 31, 2003 and December 31, 2002, respectively, are available for carryover. The net operating losses will expire from 2022 through 2023. A 100% valuation allowance has been provided for the deferred tax benefit resulting from the net operating loss carryover. The Company has recorded a valuation allowance for the full amount of the deferred tax asset resulting from the net operating loss carryover due to the reorganized Company's limited operating history. In addressing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent on the generation of future taxable income during the periods in which those temporary differences become deductible.

A reconciliation of the statutory Federal income tax rate and the effective income tax rate for the years ended December 31, 2003 and 2002 follows:

| | December 31, 2003 | December 31, 2002 |
|--------------------------------------|----------------------------------|----------------------------------|
| Statutory Federal income tax rate | (35)% | (35)% |
| Accounting Effect of: | | |
| Consultant Options/Warrants Expense | 12% | |
| Consultant Options/Warrants Exercise | (19)% | |
| Valuation Allowance | 42% | 35% |
| | — | — |
| Effective Income Tax Rate | 0% | 0% |

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The tax effects of accounting and tax differences that give rise to the deferred tax assets at December 31, 2003 and 2002, are presented below:

| | December 31, 2003 | December 31, 2002 |
|--------------------------------------|----------------------------------|----------------------------------|
| Deferred Tax Assets: | | |
| Net Operating Loss Carryforwards | \$ (5,311,377) | \$ (184,203) |
| Consultant Options/Warrants Expense | 2,284,146 | |
| Consultant Options/Warrants Exercise | (3,690,000) | □ |
| Gross Deferred Tax Assets | \$ (6,717,231) | \$ (184,203) |
| Valuation Allowance | (6,717,231) | (184,203) |
| Net Deferred Tax Assets | \$ □ | \$ □ |

9. UNIT OFFERING

During October 2003, the Company sold 53,7867 units with each unit consisting of 33,334 shares of its series A convertible preferred stock and 16,667 class C common stock purchase warrants at a price of \$100,000 per unit. The proceeds to the Company, net of expenses, was approximately \$4,806,000. Each class C warrant entitles the holder to purchase one share of common stock at an exercise price of \$3.75 per share. The class C warrants are exercisable anytime during the four year period commencing on the final closing and do not contain provisions for cashless exercise.

In accordance with EITF 00-27, the proceeds were allocated to the class C common stock purchase warrants based on their relative fair value, which totaled \$949,121 using the Black Scholes option pricing model. Further, a beneficial conversion feature of \$896,474 was attributed to the series A convertible preferred stock and was determined as the difference between the conversion price of the convertible preferred and the closing stock price of the Company on the date of issuance. The assumptions used in the Black Scholes model are as follows: (i) dividend yield of 0%, (ii) expected volatility of 81.16%, (iii) weighted average risk-free interest rate of 1.68%, and (iv) expected life of 1.5 years as the conversion feature and warrants are immediately exercisable. Both the fair value of the warrants and the beneficial conversion feature were recorded as a dividend and are included on the face of the statement of operations.

The series A convertible preferred stock will pay dividends of 8% annually (\$107,575, accrued and included in accounts payable and accrued expenses as of December 31, 2003), to be paid quarterly either in cash or in the form of convertible preferred stock at the Company's discretion. The series A convertible preferred stock will be valued at \$3 per share when it is issued as a dividend. Each holder of the series A convertible preferred stock will have the option at any time to convert all or any portion of the series A convertible preferred stock held by such holder into common stock. The series A convertible preferred stock shall have a liquidation value equal to \$3 per share and shall be convertible into common stock on a one-for-one basis (the Conversion Price). The series A convertible preferred stock shall be senior to all other shares of capital stock now existing or hereinafter created of the Company as to dividend and liquidation rights and shall have voting rights as if converted into common stock.

The Company can force conversion of the series A convertible preferred stock into common stock upon 45 days written notice to the holders of the series A convertible preferred stock, if (1) the common stock is listed on a qualified exchange (NASDAQ, AMEX or NYSE); (2) the closing price of the common stock is at least \$7.50 for 30 consecutive trading days; and (3) the common stock underlying the conversion is subject to an effective registration statement filed with the SEC pursuant to the Securities Act of 1933.

The Company issued the Placement Agent a warrant exercisable into 179,292 units, each unit comprising one share of Series A convertible preferred stock and a common stock purchase warrant exercisable into one-half share of common stock at \$3.75 per share and valued at \$238,430 using the Black Scholes model. The Placement Agent's warrant is

exercisable at \$3.60 per share and will expire five years following the date of issuance.

10. OTHER EQUITY TRANSACTIONS

The Company issued 150,000 shares (post-split) of its common stock during the year ended December 31, 2001 to various consultants and service providers as partial compensation for services rendered to the Company. The shares were issued pursuant to the private placement exemption provided by Section 4(2) of the 1933 Act.

During the years ended December 31, 2002, 2001 and 2000, the Company's former President and former majority shareholder contributed capital totaling \$56,400, \$45,000 and \$35,000. These contributions were made for working capital purposes.

At September 19, 2002, the former President purchased a warrant for \$125,000. The warrant is to purchase 600,000 (200,000 pre-split) shares of common stock at an exercise price of \$0.667 per share, which was above the current market price at the date of issuance. The warrant may not be exercised before September 1, 2003, expires in September 2006, and contains cashless exercise options and certain anti-dilution and other provisions.

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On October 12, 2002, the Company agreed to issue a total of 2,100,000 (700,000 pre-split) shares of its common stock to Marvin H. Fink pursuant to a four-year employment agreement whereby Mr. Fink will serve as the Company's Chief Executive Officer and Chairman of the Board of Directors (see Note 12). The shares were valued at \$15,190 the current market value for the Company's common stock on the measurement date and vest at the rate of 8.33% or 174,999 (58,333 pre-split) shares per quarter with the first vesting on January 12, 2003. The value is being expensed over the life of the agreement of which \$ 5,063 and \$906 was expensed during the years ended December 31, 2003 and 2002, respectively and the remainder is presented as deferred compensation in Stockholders' Equity. Also, per Mr. Fink's employment agreement, he is to be paid \$1.00 each year of his agreement. The Company has estimated that the values of his services are approximately \$80,000 per year. The Company has determined that an additional annual expense of \$80,000 should be recorded to fairly present the value of the services rendered and which has been recorded for the year ended December 31, 2003. For the year ended December 31, 2002, the Company has recorded additional compensation expense of \$20,000, which was classified as contributed capital.

On October 15, 2002, the Company agreed to issue a total of 600,000 (200,000 pre-split) shares of its common stock to B World Technologies, Inc. (a company owned by Dr. Budimir Drakulic) pursuant to a Loanout Agreement with Budimir Drakulic and B World Technologies, Inc. whereby Dr. Drakulic will work as an independent contractor for the Company and serve as Vice President and Chief Technology Officer for a term of ten years (see Note 12). The shares were valued at \$4,140, the current market value for the Company's common stock on the measurement date and vest at the rate of 5% or 30,000 (10,000 pre-split) shares per quarter with the first shares vesting on January 15, 2003. The value is being expensed over the life of the agreement of which \$828 and \$153 was expensed during the years ended December 31, 2003 and 2002, respectively, and the remainder is presented as deferred compensation in Stockholders' Equity.

Effective October 15, 2002, the Company agreed to issue a total of 225,000 (75,000 pre-split) shares of its common stock to Ellsworth Roston pursuant to a two-year consulting agreement whereby Mr. Roston will consult with the Company with respect to the engineering, development and refining of the Company's technologies (see Note 12). Mr. Roston also agreed to join the Company's Board of Directors. The shares were valued at \$1,553, the current market value for the Company's common stock on the measurement date and vest at the rate of 28,125 (9,375 pre-split) shares per quarter with the first shares vesting on February 1, 2003. The value is being expensed over the life of the agreement of which \$777 and \$146 was expensed during the years ended December 31, 2003 and 2002, respectively, and the remainder is presented as deferred compensation in Stockholders' Equity.

On October 30, 2002, Mr. Roston became a Director on the Company's Board and for \$190,000 purchased 71,250 (23,750 pre-split) shares of the Company's common stock and a five-year warrant to purchase 450,000 (150,000 pre-split) shares of the Company's common stock at an exercise price of \$1.667 per share.

On October 22, 2002, the Company issued a total of 564,810 (188,270 pre split) shares of common stock to eleven individuals for total cash consideration of \$17,786, which was entered into in conjunction with Dr. Budimir Drakulic becoming a Vice President and Chief Technology Officer of the Company and also in order to protect the Company's

rights to the acquired patented signal technologies.

On October 11, 2002 the Company issued a five year warrant to purchase 375,000 (125,000 pre split) shares of common stock for \$0.007 per share exercisable immediately to one of the individuals mentioned above who also received shares of common stock. The fair value of warrants was estimated at \$5,324, which was expensed as of December 30, 2002, using the Black Scholes option pricing model computed as of the date of grant using the following assumptions: (i) dividend yield of 0%, (ii) expected volatility of 120.25%, (iii) weighed average risk free interest rate of approximately 3.01, and (iv) expected life of 1.25 years.

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In February 2003, the Company issued 216,000 options, in two tranches, to Lowell Harmison for consulting work related to helping the Company with the FDA review process for its heart monitoring device currently in development. The first tranche of options allow Mr. Harmison to purchase 108,000 shares of common stock (36,000 shares pre split) at \$0.97 per share, exercisable over five years and immediate vesting. A second tranche of 108,000 options vest over three years on a quarterly basis as certain services are provided. The fair value of the first tranche of 108,000 options was \$80,456 estimated using the Black Scholes option pricing model computed as of the grant date with the following assumptions: (i) dividend yield of 0%, (ii) expected volatility of 158.48%, (iii) weighted average risk free interest rate of approximately 1.65, and (iv) expected life of 1.5 years. The second tranche of 108,000 options are measured on the vesting dates which are the dates that the services are completed. As of December 31, 2003 there have been three quarterly vestings which were fair valued with the Black Scholes model at \$74,643. The following assumptions were used in the model: (i) dividend yield of 0%, (ii) expected volatility range between 53.84% and 114.24%, (iii) weighted average risk free rate range of between 1.42% and 1.86%, and (iv) expected life of 1.5 years.

In March 2003, the Company issued 21,000 warrants at an exercise price of \$0.81 per shares, for which the Company recognized a total of \$13,927 in expense in connection with the issuance of warrants for services rendered. These warrants expire March 2008. The fair value of warrants was recorded using the Black Scholes option pricing model computed as of the date of grant using the following assumptions: (i) dividend yield of 0%, (ii) expected volatility of 158.48%, (iii) weighed average risk free interest rate of approximately 3.13, and (iv) expected life of 1.5 years.

In March 2003, the Company entered into a consulting agreement with its then CFO for certain financial and accounting services, and issued him options to purchase 900,000 (300,000 pre-split) shares of the Company's common stock at \$0.95 per share. The options were issued as compensation for services. The options vest quarterly over a 3-year period. The agreement was terminated in November 2003 with 150,000 options having vested over two quarters. The options have been valued using the Black-Scholes value option method; with a measurement date as the date the services are rendered. The fair value of the options was estimated at \$574,196 under the Black-Scholes option-pricing model computed as of the date the services were rendered using the following assumptions: (i) dividend yield of 0%, (ii) expected volatility range of 81.16% to 114.24%, (iii) weighted-average risk-free interest rate range of 1.42% to 1.68%, and (iv) expected life of 1.5 years.

In March 2003, the Company's Board of Directors approved the issuance of five-year warrants to purchase 900,000 shares (300,000 pre-split) of the Company's common stock at \$.50 per share to a firm which was retained to perform various services including: the introduction of the Company to investment banking firms; assistance in the advisory services; and assistance in developing strategic relationships. The fair value of these fully vested warrants (containing cashless exercise option) was estimated at \$657,779 under the Black-Scholes option-pricing model computed as of the date of grant using the following assumptions: (i) dividend yield of 0%, (ii) expected volatility of 158.48%, (iii) weighted-average risk-free interest rate of approximately 1.65, and (iv) expected life of 1.5 years.

On April 1, 2003, the Company completed the private placement of 112,792 (37,604 pre-split) shares of its common stock for a total consideration of \$250,000. The consideration included \$100,000 in cash and the cancellation of \$150,000 of debt previously advanced for \$33,208 in expenses and \$116,792 of furniture and fixtures and leasehold improvements from a related party.

On April 15, 2003, the Company committed to issue to Brookstreet Securities Corporation warrants to purchase 200,000 shares of the Company's common stock pursuant to an investment banking agreement. The warrants were issuable in four tranches of 50,000 each, with the first tranche of 50,000 fully vested and exercisable at \$1.25 per share. The second tranche will vest in 90 days after the date of the agreement and will have an exercise price of \$2.25 per share. The third tranche will vest in 180 days and will have an exercise price of \$3.25 per share. The fourth tranche will vest in 270 days

and will have an exercise price of \$4.25 per share. The fair value of warrants was estimated at \$418,187 under the Black Scholes option pricing model computed as of the measurement dates, which are the dates the services were performed (vesting date). The following assumptions were used: (i) dividend yield of 0%, (ii) expected volatility range of 53.84% to 114.24%, (iii) weighed average risk free interest rate range of 1.42% to 2.57%, and (iv) expected life of 1.5 years.

In May 2003, the Company completed the first tranche of a private placement pursuant to which it sold 82,667 units to three accredited investors at \$3.00 per unit for cash amounting to \$248,000. Each unit consisted of one share of common stock and one warrant. Each warrant is exercisable at \$3.00 until May 14, 2004. Upon exercise of the warrants each investor will receive one share of common stock and an additional warrant to purchase one share of common stock at \$6.00 per share until November 15, 2004.

On June 20, 2003, the Board of Directors amended the Company's articles of incorporation to increase the number of authorized shares to 110,000,000 shares, designating 100,000,000 to common stock and 10,000,000 to preferred stock. The Board of Directors is authorized to provide from time to time for the issuance of shares of preferred stock in series and to fix and determine from time to time, before issuance, the designation and relative rights and preferences of the shares of each series of preferred stock and the restrictions or qualifications. See Note 9, Unit Offering .

On June 2, 2003, the Company committed to issue to a consultant options to purchase 108,000 shares of the Company's common stock at \$2.40 pursuant to a consulting agreement. The warrants are issuable on demand. The fair value of warrants was estimated at \$199,226 under the Black-Scholes option-pricing model computed as of the date of grant using the following assumptions: (i) dividend yield of 0%, (ii) expected volatility of 114.24%, (iii) weighed-average risk-free interest rate of approximately 1.42%, and (iv) expected life of 1.5 years.

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On July 17, 2003 the Company retained Maxim Group, LLC (Maxim) a New York based investment banking firm to act as its lead investment bank. Under that agreement Maxim provides, among other services, assistance with the Company's financing efforts as it attempts to secure additional capital for product development as well as to fund the process of gaining approval for the Company's cardiac monitoring device by the FDA. Maxim will also assist the Company with general business strategy and with seeking a listing on a national exchange. Maxim was paid \$50,000 at the inception of the agreement and will be paid \$7,500 per month through June 30, 2004. In addition, Maxim received a total of 100,000 warrants to purchase shares of restricted common stock at \$4.92 per share. The fair value of warrants was estimated at \$133,349 under the Black-Scholes option-pricing model computed as of the date of grant using the following assumptions: (i) dividend yield of 0%, (ii) expected volatility of 81.16%, (iii) weighed-average risk-free interest rate of approximately 1.68, and (iv) expected life of 1.5 years.

In July 2003, the Company closed the second tranche of a private placement by selling 75,075 units to four accredited investors for total cash of \$250,000, under terms consistent with the first tranche.

In August 2003, the Company entered into voluntary trading restriction agreements with three shareholders in exchange for warrants to purchase a total of 23,501 shares of the Company's common stock at a price of \$3.29 per share. In September 2003, the Company entered into a voluntary trading restriction agreement with a shareholder in exchange for warrants to purchase 18,000 shares of the Company's common stock at 85% of the closing price of the common stock on the date of the agreement (\$5.29 at September 23, 2003). The fair value of the warrants was estimated at \$74,088 under the Black-Scholes option-pricing model computed as of the date of grant using the following assumptions: (i) dividend yield of 0%, (ii) expected volatility of 81.16%, (iii) weighed-average risk-free interest rate of approximately 1.68, and (iv) expected life of 1.5 years.

In September 2003, the Company issued a consultant warrants to purchase 25,000 shares of the Company's common stock at an exercise price of \$3.29 per share. The fair value of warrants was estimated at \$41,202 under the Black-Scholes option-pricing model computed as of the measurement date, which is the date that the services were performed, using the following assumptions: (i) dividend yield of 0%, (ii) expected volatility of 81.16%, (iii) weighed-average risk-free interest rate of approximately 1.68, and (iv) expected life of 1.5 years

In September 2003, the Company issued 305,000 shares of restricted common stock to three persons pursuant to the cashless exercise provisions of 305,000 common stock purchase warrants held by such persons.

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In November 2003, the Company issued 800,000 shares of restricted common stock to an investment banking company pursuant to the exercise of 900,000 common stock purchase warrants held by such company. The warrants were exercised with the cashless exercise provisions of the common stock purchase warrant agreement.

During the year ended December 31, 2003, the Company issued in the aggregate 367,514 shares of common stock, for marketing and business services rendered during the period. These services were valued at \$1,236,905 based upon the fair market value of the shares determined as the closing stock price as reported by the NASDAQ system, at the date of issuance.

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The number and weighted average exercise prices of common stock options and warrants issued to consultants and others are as follows: (excluding warrants referred to in note 9)

| | December 31, 2003 | | December 31, 2002 | |
|---|-------------------|---------------------------------|-------------------|---------------------------------|
| | Number | Weighted Average Exercise Price | Number | Weighted Average Exercise Price |
| Outstanding at beginning of the period | 975,000 | \$ 0.21 | | \$ |
| Granted during the period | 2,780,439 | 1.46 | 975,000 | 0.21 |
| Exercised during the period | 1,205,000 | 0.54 | | |
| Terminated during the period | 750,000 | 0.95 | | |
| Outstanding at end of the period | 1,800,439 | 1.72 | 975,000 | 0.20 |
| Exercisable at end of the period | 1,583,932 | \$ 1.64 | 375,000 | \$ 0.01 |

The following table summarizes information on common stock purchase options and warrants outstanding issued to consultants and others at December 31, 2003: (excluding warrants referred to in note 9)

| Range of Exercise Prices | Remaining Number Outstanding | Weighted Average Contractual Life (Years) | Weighted Average Fair Value | Weighted Average Exercise Price |
|--------------------------|------------------------------|---|-----------------------------|---------------------------------|
| \$0 to 1 | 682,000 | 3.6 | \$ 1.16 | \$ 0.83 |
| 1 to 2 | 50,000 | 4.3 | \$ 2.01 | \$ 1.25 |
| 2 to 3 | 158,000 | 4.4 | \$ 2.11 | \$ 2.35 |
| 3 to 4 | 367,439 | 4.7 | \$ 1.28 | \$ 3.55 |
| 4 to 5 | 150,000 | 4.5 | \$ 1.19 | \$ 4.70 |
| 5 to 6 | 18,000 | 4.7 | 2.09 | \$ 5.29 |

| Range of Exercise Prices | Remaining Number Outstanding | Weighted Average Contractual Life (Years) | Weighted Average Fair Value | Weighted Average Exercise Price |
|--------------------------|------------------------------|---|-----------------------------|---------------------------------|
|--------------------------|------------------------------|---|-----------------------------|---------------------------------|

| | | | | |
|----------|---------|-----|---------|---------|
| \$0 to 1 | 375,000 | 3.8 | \$ 0.02 | \$ 0.01 |
|----------|---------|-----|---------|---------|

11. STOCK OPTIONS

Stock Plans

On November 1, 2002, the Company's Board of Directors approved the establishment of the 2002 Stock Plan (the "2002 Stock Plan"). The Company's shareholders approved the plan on June 5, 2003. The total number of shares of common stock available for grant and issuance under the plan may not exceed 6,000,000 (2,000,000 pre-split) shares, subject to adjustment in the event of certain recapitalizations, reorganizations and similar transactions. Common stock purchase options may be exercisable by the payment of cash or by other means as authorized by the committee or the Board of Directors. At December 31, 2003, the Company had issued 3,090,000 common share purchase options under the plan.

On March 31, 2003, the Company's Board of Directors approved the establishment of the 2003 Nonqualified Stock Option and Stock Plan (the "2003 Stock Plan"). The 2003 Stock Plan allows the Board to grant common stock purchase options or issue free-trading or restricted common stock from time to time to the Company's employees, officers, directors and consultants. The total number of shares of common stock available for grant and issuance under the plan may not exceed 1,500,000 (500,000 pre-split) shares, subject to adjustment in the event of certain recapitalizations, reorganizations and similar transactions. Options may be exercisable by the payment of cash or by other means as authorized by the Board of Directors. Options granted under the 2003 Stock Plan will not qualify under Section 422 of the Internal Revenue Code as incentive stock options. At December 31, 2003, the Company had issued 367,514 shares of common stock under the plan, and no options.

Information On Options And Warrants Issued To Employees

The number and weighted average exercise prices of common stock purchase options and warrants issued to employees are as follows:

| | December 31, 2003 | | December 31, 2002 | |
|--|-------------------|---------------------------------|-------------------|---------------------------------|
| | Number | Weighted Average Exercise Price | Number | Weighted Average Exercise Price |
| Outstanding at beginning of the period | | \$ | | \$ |
| Granted during the period | 1,866,000 | 1.14 | | |
| Exercised during the period | | | | |
| Terminated during the period | | | | |
| Outstanding at end of the period | 1,866,000 | 1.14 | | |
| Exercisable at end of the period | 1,002,750 | \$ 1.03 | | \$ |

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| Range of Exercise Prices | Remaining Number Outstanding | Weighted Average Contractual Life (Years) | Weighted Average Fair Value | Exercise Price |
|--------------------------|------------------------------|---|-----------------------------|----------------|
| \$0 to 1 | 1,740,000 | 4.2 | \$ 0.62 | \$ 0.92 |
| 1 to 2 | | | \$ | \$ |

| | | | | |
|--------|---------|-----|---------|---------|
| 2 to 3 | 10,000 | 4.3 | \$ 1.48 | \$ 2.85 |
| 3 to 4 | 10,000 | 4.6 | \$ 1.46 | \$ 3.75 |
| 4 to 5 | 106,000 | 4.6 | \$ 0.82 | \$ 4.31 |

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Table of Contents**12. COMMITMENTS AND CONTINGENCIES**

The Company employs Mr. Marvin H. Fink as its Chief Executive Officer and Chairman of the Board currently under a four-year employment agreement entered into effective as of October 12, 2002. The essential terms of the employment agreement are as follows:

- Mr. Fink's initial base salary under the agreement is \$1 per year. Following the one-year anniversary of the agreement, the Board of Directors may review and adjust the base salary in light of the Company's performance.
- Mr. Fink is entitled to a cash bonus for his second through fourth years of employment. The amount of the bonus is 10% of the after tax income exclusive of extraordinary expenses for the second year, and 15% of that amount for the third and fourth years.
- Mr. Fink is granted 2,100,000 restricted shares of common stock (700,000 shares pre-split), to be earned over three years of continuous employment. These shares, which are held in escrow by the company pursuant

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to the terms of a restricted stock agreement until they are earned, vest in tranches of 174,999 each at the end of the first eleven quarters of Mr. Fink's employment, with the balance vesting at the end of the twelfth quarter. Mr. Fink is entitled to all dividends, which may be declared with respect to these shares, even if not vested. See Note 10

- The agreement contains a gross up provision obligating the Company to make a cash payment to Mr. Fink to cover any taxes he may incur by reason of receiving any payment or distribution that would constitute an excess golden parachute payment under the federal tax laws. The gross up provision also applies to the 2,100,000 restricted shares of common stock described above, however, Mr. Fink exercised his section 83(b) election under the Internal Revenue Code subjecting him to immediate taxation upon the receipt of the shares notwithstanding their future forfeitability, so the Company's liability, if any, for any taxes imposed under that grant should be nominal.
- Should the Company's shares of common stock be listed on any of the NYSE, AMEX or Nasdaq national stock exchanges or markets, Mr. Fink would be entitled, if then still employed by the Company, to an additional grant of 600,000 shares of common stock (200,000 shares pre-split).
- In the event of a change in control (as that term is defined in the employment agreement), Mr. Fink would be entitled, if then still employed by the Company, to an additional grant of common stock having a market value of \$5,000,000, but not to exceed 600,000 shares (200,000 shares pre-split) in total.
- Mr. Fink is entitled to a number of employee benefits under the agreement, including a \$1,200 per month automobile allowance, individual medical plan reimbursement of up to \$2,000 per month until the Company adopts a group plan for the Company's employees, and the right to participate in all benefit plans established for the Company's employees or executives, including medical, hospitalization, dental, long-term care and life insurance programs.
- The employment agreement provides for early termination in the case of Mr. Fink's death or disability, Mr. Fink's termination by the Company for cause as that term is defined in the agreement; Mr. Fink's termination of employment for good reason as that term is defined in the agreement, a change in ownership as that term is defined in the agreement, or sixty days prior notice by Mr. Fink. In the event of an early termination of the

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agreement for any reason, all compensation and benefits under the agreement will terminate and the unvested portion of the 2,100,000 restricted common share grant shall be deemed forfeit as of the effective termination date, with the following exceptions:

- ◆ If the agreement is terminated during years two through four due to Mr. Fink's disability, termination by Mr. Fink for good reason; the Company's termination of Mr. Fink without cause, or a change in ownership, Mr. Fink will nevertheless be entitled to a pro rata portion (based upon the actual number of days of employment) of the cash bonus based on the Company's after-tax income that he would have otherwise received for the year of termination had he remained employed until the end of that year;
- ◆ If the agreement is terminated due to Mr. Fink's death, disability, termination by Mr. Fink for good reason; The Company's termination of Mr. Fink without cause, or a change in ownership, the unvested portion of the 2,100,000 restricted common share grant to Mr. Fink will become fully vested and the shares released from escrow; and
- ◆ Mr. Fink and his family will be entitled to an additional three years' medical, hospitalization, dental, long-term care and life insurance coverage if the agreement is terminated by Mr. Fink for good reason or terminated by The Company's termination without cause, and an additional one year's coverage if the agreement is terminated due to Mr. Fink's disability.

The Company has engaged Dr. Budimir Drakulic as Vice President and Chief Technology Officer on an independent contractor basis under a loan-out agreement dated October 15, 2002 with two companies, B World

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Technologies, Inc. and B Technologies, Inc., and Dr. Drakulic individually. Dr. Drakulic is the president and owner of these companies. The essential terms of the agreement are as follows:

- The agreement provides for a ten-year initial term. After the initial term, the agreement renews automatically for successive one-year terms, unless either party delivers 90-days' written notice to the other of their intent not to renew.
- Dr. Drakulic's services are provided on a mutually-acceptable part-time basis.
- The Company is obligated to pay B Technologies a \$10,000 bonus upon execution, and a monthly service fee of \$15,000 thereafter.
- B World Technologies was granted 600,000 restricted shares of common stock (200,000 shares pre-split), to be earned over five years of continuous provision of services by Dr. Drakulic. These shares, which will be held in escrow with the company pursuant to the terms of a restricted stock agreement until they are earned, vest at the rate of 30,000 shares per quarter with the first 30,000 shares vesting on January 15, 2003. B World Technologies is entitled to all dividends, which may be declared with respect to these shares, even if not vested. See Note 13.
- The loan-out agreement provides for early termination should B World and B Technologies fail, neglect or refuse to provide Dr. Drakulic's services. In such an event, all compensation under the agreement will terminate and the unvested portion of the 600,000 restricted common share grants shall be deemed forfeit as of the effective termination date.

Concurrent with entering into the loan-out agreement, B World Technologies, B Technologies and Dr. Drakulic signed an employment, confidential information, invention assignment and arbitration agreement under which they agreed, among other things, to assign to the Company all of Dr. Drakulic's right, title and interest in and to any and all inventions, discoveries, etc. which he conceives or develops while engaged by the Company.

In conjunction with Dr. Drakulic becoming our Vice President and Chief Technology Officer, the Company also reached an agreement in principle with Dr. Drakulic to offer to sell the Company's common shares to certain individuals in order to protect our rights in the Signal Technologies. Pursuant to this understanding, on October 22, 2002, the Company sold 564,810 common shares (188,270 shares pre split) to eleven of those individuals, and issued a five year warrant to purchase 375,000 common shares (125,000 shares pre split) for \$0.007 per share to one of those individuals, in consideration of their cash investment of \$17,786. See Note 10, Other Equity Offerings. The Company further agreed that should it raise more than \$2 million in certain offerings, to pay 4% of the proceeds of those offerings to those individuals up to the amount of \$480,350. The Company is currently in discussion with those individuals relative to the payment of this obligation based upon certain issues it believes may relieve it of the liability to make such payment, and has entered into settlement agreements with four of those investors releasing the Company from the obligation to pay \$110,000 of the \$480,350. See Note 7, Contingent Settlement Payable.

Since March 1, 2003, Dr. Drakulic has worked for the Company on a full-time basis even though the loan-out agreement only provides for the provision of part-time services. The Company has agreed to characterize these additional services as being provided by Dr. Drakulic as an employee, and to pay him \$7,500 annually as compensation for their provision.

On March 10, 2003, as additional incentive for the performance of Dr. Drakulic, the Company granted to B World Technologies options entitling it to purchase 750,000 shares of common stock at \$0.95 per share. These options vest quarterly over a four-year term, and lapse, if not exercised, on March 9, 2008.

Mr. Ellsworth Roston, one of the Company's Directors, provides consulting services to the Company under a two-year agreement dated November 1, 2002. Under this agreement, Mr. Roston provides advice to the Company relating to engineering, developing and refining the Company's products and technologies. Mr. Roston also agreed under the agreement to act as a member of the Company's Board of Directors during its term. Mr. Roston is a patent attorney who handles the Company's patent work. The agreement specifically provides that the consulting

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services provided by Mr. Roston will not include any legal work, for which the Company will compensate him separately. In compensation for his consulting services, the Company granted to Mr. Roston 225,000 restricted shares of common stock (75,000 shares pre-split). See Note 10, Other Equity Transactions.

Dr. Lowell T. Harmison, one of the Company's Directors, provides consulting services to the Company under a three-year agreement dated February 14, 2003. Under this agreement, Dr. Harmison provides advice to the Company in the areas of technological support and strategy, product development, medical and scientific advisory board development, and FDA regulation. The compensatory terms of the agreement are as follows:

- The Company is obligated to pay Dr. Harmison \$36,000 per year over the term of the agreement, payable quarterly. Dr. Harmison was entitled to receive upon execution of the agreement an initial grant of options entitling him to purchase 216,000 shares of common stock, in two tranches of 108,000 options, (36,000 shares pre split) at \$0.97 per share, exercisable over five years. The first tranche of 108,000 options vest immediately and the second tranche of 108,000 options vest over three years on a quarterly basis. The fair value of the first tranche of options was \$80,456 estimated using the Black Scholes option pricing model computed as of the measurement dates, which is the grant date, with the following assumptions: (i) dividend yield of 0%, (ii) expected volatility of 158.48%, (iii) weighed average risk free interest rate of approximately 1.65, and (iv) expected life of 1.5 years. The second tranche of 108,000 options are measured on the vesting dates which are the dates that the services were completed. As of December 31, 2003 there have been three quarterly vestings which were fair valued with the Black Scholes model at \$74,643. The following assumptions were used in the model: (i) dividend yield of 0%, (ii) expected volatility range between 53.84% and 114.24%, (iii) weighted average risk free rate range of between 1.42% and 1.86%, and (iv) expected life of 1.5 years.
- Dr. Harmison is entitled to receive options exercisable into shares of common stock in tranches of 20,000 shares per milestone for assisting the Company in attaining various milestones determined by the Company's Board of Directors, including the preparation and filing with the FDA of a 510K application for the Company's product, approval of that application by the FDA, and market launch of that product.

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- A grant of 20,000 shares of common stock in the event of a change in control as that term is defined in the agreement.

In the event the agreement is terminated by the Company for any reason other than negligence, misconduct, breach of its material terms by Dr. Harmison or the failure of Dr. Harmison to render services in a reasonable fashion, all compensation prospectively payable under the agreement will become due and payable in 90 days.

13. SUBSEQUENT EVENTS

On January 28, 2004, the Company received a 510K approval from the Food and Drug Administration (FDA) to proceed with the sales and marketing of its first medical device, a 12-lead, 24-hour ECG heart monitoring device. The approval provides that the Company may market the device subject to requirements of annual registration, listing of devices, good manufacturing practice, labeling, prohibitions against misbranding and adulteration as well as other legal provisions.

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