F5 NETWORKS INC
Form 10-Q
February 08, 2008

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended December 31, 2007

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number 000-26041

F5 NETWORKS, INC.

(Exact name of registrant as specified in its charter)

WASHINGTON	**91-1714307**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

401 Elliott Avenue West
Seattle, Washington 98119
(Address of principal executive offices and zip code)
(206) 272-5555
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

The number of shares outstanding of the registrant s common stock as of February 6, 2008 was 85,159,557.

F5 NETWORKS, INC.
QUARTERLY REPORT ON FORM 10-Q
For the Quarter Ended December 31, 2007
Table of Contents

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

F5 NETWORKS, INC.
CONSOLIDATED BALANCE SHEETS
(unaudited, in thousands)

	December 31, 2007	September 30, 2007
ASSETS		
Current assets		
Cash and cash equivalents	$ 69,524	$ 54,296
Short-term investments	281,000	204,169
Accounts receivable, net of allowances of $3,078 and $3,161	98,764	91,774
Inventories	10,189	10,672
Deferred tax assets	5,440	5,305
Other current assets	19,363	20,434
Total current assets	484,280	386,650
Restricted cash	3,887	3,959
Property and equipment, net	37,234	36,024
Long-term investments	166,937	216,366
Deferred tax assets	37,690	38,036
Goodwill	233,997	233,997
Other assets, net	28,386	29,256
Total assets	$ 992,411	$ 944,288
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 24,973	$ 25,525
Accrued liabilities	39,688	39,990
Deferred revenue	91,335	87,895
Total current liabilities	155,996	153,410
Other long-term liabilities	7,560	7,679
Deferred revenue, long-term	18,818	12,622
Total long-term liabilities	26,378	20,301
Commitments and contingencies		
Shareholders equity		
Preferred stock, no par value; 10,000 shares authorized, no shares outstanding		
Common stock, no par value; 200,000 shares authorized, 84,943 and 84,379 shares issued and outstanding	620,632	598,436
Accumulated other comprehensive loss	(1,051)	(564)

Retained earnings		190,456		172,705
Total shareholders equity		810,037		770,577
Total liabilities and shareholders equity	$	992,411	$	944,288

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

Table of Contents

F5 NETWORKS, INC.
CONSOLIDATED INCOME STATEMENTS
(unaudited, in thousands, except per share data)

	Three months ended December 31, 2007	2006
Net revenues		
Products	$ 110,205	$ 92,062
Services	43,979	27,968
Total	154,184	120,030
Cost of net revenues		
Products	24,689	19,216
Services	10,550	7,308
Total	35,239	26,524
Gross profit	118,945	93,506
Operating expenses		
Sales and marketing	58,178	39,055
Research and development	24,332	14,539
General and administrative	13,426	12,818
Total	95,936	66,412
Income from operations	23,009	27,094
Other income, net	6,132	6,431
Income before income taxes	29,141	33,525
Provision for income taxes	11,390	11,172
Net income	$ 17,751	$ 22,353
Net income per share basic	$ 0.21	$ 0.27
Weighted average shares basic	84,854	82,062
Net income per share diluted	$ 0.21	$ 0.26
Weighted average shares diluted	86,141	84,636

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

Table of Contents

F5 NETWORKS, INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY
(unaudited, in thousands)

	Three Months Ended December 31, 2007				
	Common Stock		Accumulated Other Comprehensive	Retained	Total Shareholders
	Shares	Amount	Loss	Earnings	Equity
Balance, September 30, 2007	84,379	$ 598,436	$ (564)	$ 172,705	$ 770,577
Exercise of employee stock options	116	1,600			1,600
Issuance of stock under employee stock purchase plan	142	4,337			4,337
Issuance of restricted stock	306				
Tax benefit from employee stock transactions		923			923
Stock-based compensation		15,336			15,336
Comprehensive income:					
Net income				17,751	
Foreign currency translation adjustment			(605)		
Unrealized gain on securities			118		
Total comprehensive income					17,264
Balance, December 31, 2007	84,943	$ 620,632	$ (1,051)	$ 190,456	$ 810,037

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

Table of Contents

F5 NETWORKS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

	Three months ended December 31, 2007	2006
Operating activities		
Net income	$ 17,751	$ 22,353
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on disposition of assets		1
Loss on disposition of investments	(15)	(2)
Stock-based compensation	15,336	8,729
Provisions for doubtful accounts and sales returns	676	724
Depreciation and amortization	5,490	3,611
Deferred income taxes	206	(1,419)
Changes in operating assets and liabilities, net of amounts acquired:		
Accounts receivable	(7,666)	(5,214)
Inventories	483	32
Other current assets	1,123	1,418
Other assets	(898)	(1,209)
Accounts payable and accrued liabilities	(128)	9,466
Deferred revenue	9,636	8,348
Net cash provided by operating activities	41,994	46,838
Investing activities		
Purchases of investments	(201,857)	(180,572)
Sales of investments	174,589	120,968
Investment of restricted cash	76	(8)
Acquisition of business, net of cash acquired	(990)	
Purchases of property and equipment	(4,875)	(2,605)
Net cash used in investing activities	(33,057)	(62,217)
Financing activities		
Tax benefit from nonqualified stock options	923	1,615
Proceeds from the exercise of stock options and purchases of stock under employee stock purchase plan	5,918	7,131
Net cash provided by financing activities	6,841	8,746
Net increase (decrease) in cash and cash equivalents	15,778	(6,633)
Effect of exchange rate changes on cash and cash equivalents	(550)	(28)
Cash and cash equivalents, beginning of period	54,296	37,746
Cash and cash equivalents, end of period	$ 69,524	$ 31,085

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

6

Table of Contents

F5 NETWORKS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1. Summary of Significant Accounting Policies

Description of Business

F5 Networks, Inc. (the Company) provides products and services to help companies efficiently and securely manage their Internet Protocol (IP) traffic. The Company s products improve the performance, availability and security of applications running on Internet-based networks. Internet traffic between servers running applications and clients using these applications passes through the Company s products where the content is inspected to ensure that it is safe and modified as necessary to ensure that it is delivered securely and in a way that optimizes the performance of both the network and the applications. The Company also offers a broad range of services such as consulting, training, installation, maintenance and other technical support services.

Basis of Presentation

The year end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. In the opinion of management, the unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for their fair statement in conformity with accounting principles generally accepted in the United States of America. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted in accordance with the rules and regulations of the Securities and Exchange Commission. The information included in this Form 10-Q should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2007.

Revenue Recognition

The Company s products are integrated with software that is essential to the functionality of the equipment. Accordingly, the Company recognizes revenue in accordance with the guidance provided under Statement of Position (SOP) No. 97-2, Software Revenue Recognition, and SOP No. 98-9 Modification of SOP No. 97-2, Software Revenue Recognition, with Respect to Certain Transactions, Statement of Financial Accounting Standards (SFAS) No. 48, Revenue Recognition When Right of Return Exists, and SEC Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition.

The Company sells products through distributors, resellers and directly to end users. The Company recognizes product revenue upon shipment, net of estimated returns, provided that collection is reasonably assured and no significant performance obligations remain. In certain regions where the Company does not have the ability to reasonably estimate returns, the Company defers revenue on sales to its distributors until they have received information from the channel partner indicating that the distributor has sold the product to its customer. Payment terms to domestic customers are generally net 30 to 45 days. Payment terms to international customers range from net 30 to net 90 days based on normal and customary trade practices in the individual markets. The Company offers extended payment terms to certain customers, in which case, revenue is recognized when payments are due.

Whenever a software license, hardware, installation and post-contract customer support (PCS) elements are sold together, a portion of the sales price is allocated to each element based on their respective fair values as determined when the individual elements are sold separately. We determine fair value based on the type of customer and region in which the package is sold. Where fair value of certain elements are not available, we recognize revenue on the residual method permitted under SOP 98-9 based on the fair value of undelivered PCS. Revenues from the license of software are recognized when the software has been shipped and the customer is obligated to pay for the software. When rights of return are present and the Company cannot estimate returns, it recognizes revenue when such rights of return lapse. Revenues for PCS are recognized on a straight-line basis over the service contract term. PCS includes a limited period of telephone support updates, bug fixes and rights to upgrades, when and if available. Installation revenue is recognized when the product has been installed at the customer s site. Consulting services are customarily billed at fixed rates, plus out-of-pocket expenses, and revenues are recognized when the consulting has been completed. Training revenue is recognized when the training has been completed.

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with Financial Accounting Standards Board (FASB) Statement No. 123(R), *Share-Based Payment* (FAS 123R), using the straight-line attribution method for recognizing compensation expense. The Company recognized $15.3 million and $8.7 million of stock-based compensation expense for the three months ended December 31, 2007 and 2006, respectively. As of December 31, 2007, there was $81.9 million of total unrecognized stock-based compensation cost, the majority of which will be recognized over the next two years. Going forward, stock-based compensation expenses may increase as we issue additional equity-based awards to continue to attract and retain key employees.

The Company issues incentive awards to its employees through stock-based compensation consisting of stock options and restricted stock units (RSU s). The value of RSU s is determined using the intrinsic value method, which in this case, is based on the number of shares granted and the quoted price of the Company s common stock on the date of grant. Alternatively, in determining the fair value of stock options, the Company uses the Black-Scholes option pricing model that employs the following key assumptions. Expected volatility is based on the annualized daily historical volatility of the Company s stock price over the expected life of the option. Expected term of the option is based on historical employee stock option exercise behavior, the vesting terms of the respective option and a contractual life of ten years. The Company s stock price volatility and option lives involve management s best estimates at that time, both of which impact the fair value of the option calculated under the Black-Scholes methodology and, ultimately, the expense that will be recognized over the life of the option.

FAS 123R also requires that the Company recognize compensation expense for only the portion of stock options or RSU s that are expected to vest. Therefore, the Company applies estimated forfeiture rates that are derived from historical employee termination behavior. The Company s estimated forfeiture rate in the first quarter of fiscal 2008 is 4%. If the actual number of forfeitures differs from those estimated by management, additional adjustments to stock-based compensation expense may be required in future periods.

Compensation cost recognized for the three month period ended December 31, 2007 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of July 1, 2005, based on the grant-date fair value estimated in accordance with the original provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation* and (b) compensation cost for all share-based payments granted subsequent to July 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of FAS 123R.

In August 2007, the Company granted 276,400 RSU s to certain current executive officers. Fifty percent of the aggregate number of RSU s granted at such time vest in equal quarterly increments over two years, until such portion of the grant is fully vested on November 1, 2009. Twenty five percent of the RSU grant is subject to the Company achieving specified percentage increases in total revenue for fiscal year 2008, relative to fiscal year 2007. The remaining twenty five percent is subject to the Company meeting specified performance criteria for fiscal year 2009 to be set by the Compensation Committee of the Company s Board of Directors.

In December 2006, the Company granted 456,000 RSU s to certain current executive officers. Fifty percent of the aggregate number of RSU s granted at such time vest in equal quarterly increments over two years, until such portion of the grant is fully vested on November 1, 2008. Twenty five percent of the RSU grant was subject to the Company achieving specified percentage increases in total revenue for fiscal year 2007, relative to fiscal year 2006. This twenty five percent was fully earned in fiscal 2007. The remaining twenty five percent is subject to the Company achieving specified percentage increases in total revenue for fiscal year 2008.

Earnings Per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income by the weighted average number of common and dilutive common stock equivalent shares outstanding during the period.

The following table sets forth the computation of basic and diluted net income per share (in thousands, except per share data):

	Three months ended December 31,	
	2007	**2006**
Numerator		
Net income	$ 17,751	$ 22,353
Denominator		
Weighted average shares outstanding basic	84,854	82,062
Dilutive effect of common shares from stock options and restricted stock units	1,287	2,574
Weighted average shares outstanding diluted	86,141	84,636
Basic net income per share	$ 0.21	$ 0.27
Diluted net income per share	$ 0.21	$ 0.26

Approximately 0.6 million and 0.1 million of common shares potentially issuable from stock options for the three months ended December 31, 2007 and 2006, respectively, are excluded from the calculation of diluted earnings per share because the exercise price was greater than the average market price of commons stock for the respective period.

Comprehensive Income

Comprehensive income includes certain changes in equity that are excluded from net income. Specifically, unrealized losses on securities and foreign currency translation adjustments are included in accumulated other comprehensive loss. Comprehensive income and its components were as follows (in thousands):

	Three months ended December 31,	
	2007	**2006**
Net income	$ 17,751	$ 22,353
Unrealized gain on securities	118	424
Foreign currency translation adjustment	(605)	(120)
Total comprehensive income	$ 17,264	$ 22,657

Recent Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51* (SFAS 160), which amends Accounting Research Bulletin No. 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for the Company s fiscal years beginning October 1, 2010. The Company does not expect the adoption of SFAS 160 to have a material impact on its consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations* (SFAS 141R), which establishes principles and requirements for recognizing and measuring identifiable assets and goodwill acquired, liabilities assumed, and any noncontrolling interest in an acquisition, at their fair value as of the acquisition date. SFAS 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. This standard will change the Company s accounting treatment for business combinations on a prospective basis.

Table of Contents

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159), which allows entities to measure eligible financial instruments and certain other items at fair value. The Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for the Company s fiscal years beginning October 1, 2008. The Company is currently assessing the potential effect if any of implementing this standard.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective for the Company s fiscal years beginning October 1, 2008, and interim periods within those fiscal years. The Company is currently assessing the potential effect if any of implementing this standard.

2. Inventories

The Company outsources the manufacturing of its pre-configured hardware platforms to contract manufacturers, who assemble each product to the Company s specifications. As protection against component shortages and to provide replacement parts for its service teams, the Company also stocks limited supplies of certain key product components. The Company reduces inventory to net realizable value based on excess and obsolete inventories determined primarily by historical usage and forecasted demand. Inventories consist of hardware and related component parts and are recorded at the lower of cost or market (as determined by the first-in, first-out method).

Inventories consist of the following (in thousands):

	Three Months Ended December 31,	
	2007	**2006**
Finished goods	$ 6,081	$ 3,274
Raw materials	4,108	2,456
	$ 10,189	$ 5,730

3. Commitments and Contingencies

Guarantees and Product Warranties

In the normal course of business to facilitate sales of its products, the Company indemnifies other parties, including customers, resellers, lessors, and parties to other transactions with the Company, with respect to certain matters. The Company has agreed to hold the other party harmless against losses arising from a breach of representations or covenants, or out of intellectual property infringement or other claims made against certain parties. These agreements may limit the time within which an indemnification claim can be made and the amount of the claim. The Company has entered into indemnification agreements with its officers and directors, and the Company s bylaws contain similar indemnification obligations to the Company s agents. It is not possible to determine the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement.

The Company offers warranties of one year for hardware with the option of purchasing additional warranty coverage in yearly increments. The Company accrues for warranty costs as part of its cost of sales based on associated material product costs and technical support labor costs. The following table summarizes the activity related to product warranties for the three months ended December 31, 2007 and 2006 (in thousands):

	Three months ended December 31,	
	2007	**2006**
Balance, beginning of period	$ 1,757	$ 1,582
Provision for warranties issued	1,455	623
Payments	(1,255)	(623)

Balance, end of period	$ 1,957	$ 1,582

Table of Contents

Purchase Commitments

The Company currently has arrangements with contract manufacturers and other suppliers for the manufacture of its products. The arrangement with the primary contract manufacturer allows them to procure component inventory on their behalf based on a rolling production forecast provided by the Company. The Company is obligated to the purchase of component inventory that the contract manufacturer procures in accordance with the forecast, unless they give notice of order cancellation in advance of applicable lead times. As of December 31, 2007, the Company was committed to purchase approximately $15.4 million of such inventory during the next quarter.

Legal Proceedings

Derivative Suits. Beginning on or about May 24, 2006, several derivative actions were filed against certain current and former directors and officers of the Company. These derivative lawsuits were filed in: (1) the Superior Court of King County, Washington, as In re F5 Networks, Inc. State Court Derivative Litigation (Case No. 06-2-17195-1 SEA), which consolidates Adams v. Amdahl, et al. (Case No. 06-2-17195-1 SEA), Wright v. Amdahl, et al. (Case No. 06-2-19159-5 SEA), and Sommer v. McAdam, et al. (Case No. 06-2-26248-4 SEA) (the State Court Derivative Litigation); and (2) in the U.S. District Court for the Western District of Washington, as In re F5 Networks, Inc. Derivative Litigation, Master File No. C06-0794RSL, which consolidates Hutton v. McAdam, et al. (Case No. 06-794RSL), Locals 302 and 612 of the International Union of Operating Engineers-Employers Construction Industry Retirement Trust v. McAdam et al. (Case No. C06-1057RSL), and Easton v. McAdam et al. (Case No. C06-1145RSL). On August 2, 2007, another derivative lawsuit, Barone v. McAdam et al. (Case No. C07-1200P), was filed in the U.S. District Court for the Western District of Washington. It is expected that this lawsuit will be consolidated with the other lawsuits pending in the U.S. District Court for the Western District of Washington. The complaints generally allege that certain of the Company s current and former directors and officers, including, in general, each of the Company s current outside directors (other than Deborah L. Bevier and Scott Thompson who joined the Company s Board of Directors in July 2006 and January 2008, respectively) breached their fiduciary duties to the Company by engaging in alleged wrongful conduct concerning the manipulation of certain stock option grant dates. The Company is named solely as a nominal defendant against whom the plaintiffs seek no recovery. The Company s combined motion to consolidate and stay the State Court Derivative Litigation was granted in a court order dated April 3, 2007. The Company s motion to dismiss the consolidated federal derivative actions based on plaintiffs failure to make demand on the Company s Board of Directors prior to filing suit was granted in a court order dated August 6, 2007 with leave to amend the allegations in plaintiffs complaint. Plaintiffs filed an amended consolidated federal derivative action complaint on September 14, 2007. The Company intends to vigorously pursue dismissal of the amended complaint and has filed a motion to dismiss based on plaintiffs failure to make demand on the Company s Board of Directors prior to filing suit.

The Company is not aware of any additional pending legal proceedings that, individually or in the aggregate, would have a material adverse effect on the Company s business, operating results, or financial condition. The Company may in the future be party to litigation arising in the ordinary course of business, including claims that allegedly infringe upon third-party trademarks or other intellectual property rights. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

4. Income Taxes

The effective tax rate was 39.1% and 33.3% for the three months ended December 31, 2007 and 2006 respectively. At December 31, 2007 the federal tax credit for increasing research activities expired. While this credit has a history of expiration and then subsequent reinstatement, we cannot pass judgment on what we think might occur in the future based upon this history when calculating an interim period tax expense. Therefore, the expiration of this credit has significantly impacted our effective tax rate for the quarter ending December 31, 2007.

In June 2006, FASB issued FASB Interpretation No. 48, or FIN 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109*, effective for fiscal years beginning after December 15, 2006. FIN 48 prescribes the minimum recognition threshold a tax position must meet before being recognized in the financial statements and provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted the provisions of FASB Interpretation 48, Accounting for Uncertainty in Income Taxes, on October 1, 2007. Previously, the Company had accounted for tax

11

Table of Contents

contingencies in accordance with Statement of Financial Accounting Standards 5, Accounting for Contingencies. As required by Interpretation 48, which clarifies Statement 109, Accounting for Income Taxes, the Company recognizes the financial statement impact of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest impact that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. At the adoption date, the Company applied Interpretation 48 to all tax positions where the statute of limitations remained open for all of the Company s tax years. As a result of the implementation of Interpretation 48, the Company did not incur any change in the liability for unrecognized tax benefits which at adoption of FIN 48 had a balance of $3.9 million. In the next twelve months we do not anticipate a significant increase or decrease in unrecognized tax benefits.

The company will accrue interest and, if applicable, penalties for any uncertain tax positions. This interest and penalty expense will be a component of income tax expense. At the adoption of FIN 48 the company had not accrued any interest or penalties on unrecognized tax benefits.

The Company and its subsidiaries are subject to U.S. federal income tax as well as the income tax of multiple state and foreign jurisdictions. The Company has concluded all U.S. federal income tax matters for fiscal years through September 30, 2004. Within the next four fiscal quarters, the statute of limitations will begin to close on the fiscal year end 2003 and 2004 tax returns filed in various states and the fiscal year end 2005 federal income tax return.

5. Geographic Sales and Significant Customers

Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company is organized as, and operates in, one reportable segment: the development, marketing and sale of application delivery networking products that optimize the security, performance & availability of network applications, servers and storage systems. The Company manages its business based on four geographic regions: the Americas (primarily the United States); Europe, the Middle East and Africa (EMEA); Japan; and the Asia Pacific region. The Company s chief operating decision-making group reviews financial information presented on a consolidated basis accompanied by information about revenues by geographic region. The Company s foreign offices conduct sales, marketing and support activities. The Company s management evaluates performance based primarily on revenues in the geographic locations in which it operates. Revenues are attributed by geographic location based on the location of the customer. The Company s assets are primarily located in the United States and not allocated to any specific region. Therefore, geographic information is presented only for net product revenue.

The following presents revenues by geographic region (in thousands):

	Three months ended December 31,	
	2007	**2006**
Americas	$ 87,850	$ 72,439
EMEA	33,117	20,014
Japan	16,649	14,701
Asia Pacific	16,568	12,876
	$ 154,184	$ 120,030

Net revenues from international customers are primarily denominated in U.S. dollars and totaled $66.3 million and $47.6 million for the three months ended December 31, 2007 and 2006, respectively. Two domestic distributors accounted for 25.3% of total net revenue for the three month period ended December 31, 2007. Two domestic distributors accounted for 26.0% of total net revenue for the three month period ended December 31, 2006.

6. Subsequent Events

On January 23, 2008, the Company announced that its board of directors approved a new program to repurchase up to $200 million of the Company s outstanding common stock. Acquisitions for the share repurchase program will

Table of Contents

be made from time to time in private transactions or open market purchases as permitted by securities laws and other legal requirements. The program may be discontinued at any time. As of February 7, 2008, The Company has repurchased approximately 2.5 million shares at an average price of $23.05 per share.

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

The statements contained below that are not purely historical are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933. These statements include, but are not limited to, statements about our plans, objectives, expectations, strategies, intentions or other characterizations of future events or circumstances and are generally identified by the words expects, anticipates, intends, plans, believes, seeks, estimates, and similar expressions. Because these forward-looking statements are subject to a number of risks and uncertainties, our actual results could differ materially from those expressed or implied by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed under the heading Risk Factors herein and in other documents we file from time to time with the Securities and Exchange Commission. All forward-looking statements set forth below are based on information available to us on the date hereof. Our business and the associated risks may have changed since the date this report was originally filed with the SEC. We assume no obligation to update any such forward-looking statements.

Overview

We are a global provider of software and hardware products and services that help companies efficiently and securely manage their Internet traffic. Our products enhance the delivery, optimization and security of application traffic on Internet-based networks. We market and sell our products primarily through indirect sales channels in the Americas (primarily the United States); Europe, the Middle East, and Africa (EMEA); Japan; and the Asia Pacific region. Enterprise customers (Fortune 1000 or Business Week Global 1000 companies) in financial services, transportation, government and telecommunications industries continue to make up the largest percentage of our customer base.

Our management monitors and analyzes a number of key performance indicators in order to manage our business and evaluate our financial and operating performance. Those indicators include:

Revenues. The majority of our revenues are derived from sales of our core products; BIG-IP Local Traffic Manager; BIG-IP Global Traffic Manager; BIG-IP ISP Traffic Manager; TrafficShield Application Firewall, WANJet, WebAccelerator; FirePass SSL VPN servers; and ARX. We also derive revenues from the sales of services including annual maintenance contracts, installation, training and consulting services. We carefully monitor the sales mix of our revenues within each reporting period. We believe customer acceptance rates of our new products and feature enhancements are key indicators of future trends. We also consider overall revenue concentration by customer and by geographic region as additional indicators of current and future trends.

Cost of revenues and gross margins. We strive to control our cost of revenues and thereby maintain our gross margins. Significant items impacting cost of revenues are hardware costs paid to our contract manufacturers, third-party software license fees, amortization of developed technology, and personnel and overhead expenses. Our margins have remained relatively stable over the past two years; however factors such as sales price, product mix, inventory obsolescence, returns, component price increases, and warranty costs could significantly impact our gross margins from quarter to quarter and represent the significant indicators we monitor on a regular basis.

Operating expenses. Operating expenses are substantially driven by personnel and related overhead expenses. Existing headcount and future hiring plans are the predominant factors in analyzing and forecasting future operating expense trends. Other significant operating expenses that we monitor include marketing and promotions, travel, professional fees, computer costs related to the development of new products, facilities and depreciation expenses.

Liquidity and cash flows. Our financial condition remains strong with significant cash and investments and no long term debt. The increase in cash and investments for the first three months of fiscal year 2008 was primarily

Table of Contents

due to net income from operations, with operating activities providing cash of $42.0 million. Going forward, we believe the primary driver of cash flows will be net income from operations. Capital expenditures for the first three months of fiscal year 2008 were comprised primarily of tenant improvements and information technology infrastructure and equipment to support the growth of our core business activities.

Balance sheet. We view cash, short-term and long-term investments, deferred revenue, accounts receivable balances and day s sales outstanding as important indicators of our financial health. Deferred revenues continued to increase due to the growth in the amount of annual maintenance contracts purchased on new products and maintenance renewal contracts related to our existing product installation base. Our day s sales outstanding for the first quarter of fiscal year 2008 was 58. We expect to maintain this metric in the mid-to-upper 50-day range going forward.

Summary of Critical Accounting Policies and Estimates

The preparation of our financial condition and results of operations requires us to make judgments and estimates that may have a significant impact upon our financial results. We believe that, of our significant accounting policies, the following require estimates and assumptions that require complex, subjective judgments by management, which can materially impact reported results: revenue recognition; reserve for doubtful accounts; reserve for product returns; reserve for warranties; accounting for income taxes; stock-based compensation; and goodwill impairment. Each of these accounting policies and estimates, which have not significantly changed since our annual report on Form 10-K for the year ended September 30, 2007 (the Form 10-K), are more fully described in Management s Discussion and Analysis of Financial Condition and Results of Operations in the Form 10-K. Actual results may differ from these estimates under different assumptions or conditions.

Results of Operations

The following discussion and analysis should be read in conjunction with our consolidated financial statements, related notes and risk factors included elsewhere in this Quarterly Report on Form 10-Q.

	Three months ended December 31, 2007	2006
	(in thousands, except percentages)	
Net Revenues		
Products	$ 110,205	$ 92,062
Services	43,979	27,968
Total	$ 154,184	$ 120,030
Percentage of net revenues		
Products	71.5%	76.7%
Services	28.5	23.3
Total	100.0%	100.0%

Net revenues. Total net revenues increased 28.5%, to $154.2 million for the three months ended December 31, 2007 from $120.0 million for the same period in the prior year. The improvement was due to increased demand for our application delivery networking products and higher services revenues resulting from our increased installed base of products. In addition, the current quarter includes the first full quarter of revenue from our ARX product line as a result of our acquisition of Acopia in September 2007. International revenues were 43.0% of total net revenues for the three months ended December 31, 2007 compared to 39.6% for the same period in the prior year. We expect international sales will continue to represent a significant portion of net revenues, although we cannot provide assurance that international revenues as a percentage of net revenues will remain at current levels.

Net product revenues increased 19.7%, to $110.2 million for the three months ended December 31, 2007 from $92.1 million for the same period in the prior year. The increase in the three months ended December 31, 2007, was primarily due to growth in the volume of product sales of our BIG-IP and ARX product lines. Total product revenue for the quarter ended December 31, 2007 includes $5.8 million of revenue from our ARX product line. Sales of our BIG-IP family of application delivery networking products represented 86.3% and 89.6% of product revenues for the three months ended December 31, 2007 and 2006, respectively.

Table of Contents

Net service revenues increased 57.2%, to $44.0 million for the three months ended December 31, 2007 from $28.0 million for the same period in the prior year. The increase in services revenue was primarily due to increases in the purchase or renewal of maintenance contracts as our installed base of products increased.

Avnet Technology Solutions and Ingram Micro Inc., two of our domestic distributors, accounted for 13.8% and 11.5% of our total net revenue for the three months ended December 31, 2007, respectively. Avnet Technology Solutions and Ingram Micro Inc. accounted for 14.1% and 11.8% of our total net revenue for the three months ended December 31, 2006, respectively. No other distributors accounted for more than 10% of total net revenue.

	Three months ended December 31,	
	2007	**2006**
	(in thousands, except percentages)	
Cost of net revenues and gross profit		
Products	$ 24,689	$ 19,216
Services	10,550	7,308
Total	35,239	26,524
Gross profit	$ 118,945	$ 93,506
Cost of net revenues and gross profit (as a percentage of related net revenue)		
Products	22.4%	20.9%
Services	24.0	26.1
Total	22.9	22.1
Gross profit	77.1%	77.9%

Cost of Net Product Revenues. Cost of net product revenues consist of finished products purchased from our contract manufacturers, manufacturing overhead, freight, warranty, provisions for excess and obsolete inventory and amortization expenses in connection with developed technology from acquisitions. Our product margins remained stable for all periods presented at approximately 78%. Cost of net product revenues increased to $24.7 million for the three months ended December 31, 2007 from $19.2 million for the same period in the prior year. The increases were primarily due to the higher volume of units shipped along with higher warranty expense and indirect manufacturing costs.

Cost of Net Service Revenues. Cost of net service revenues consist of the salaries and related benefits of our professional services staff, travel, facilities and depreciation expenses. For the three months ended December 31, 2007, cost of net services revenues as a percentage of net service revenues decreased to 24.0% compared to 26.1% for the same period in the prior year. Cost of net service revenues increased primarily as a result of recent growth in professional services headcount. Professional services headcount at the end of December 2007 increased to 297 from 223 at the end of December 2006. In addition, stock compensation expense increased to $1.0 million for the three months ended December 31, 2007 from $0.6 million for the same period in the prior year. Going forward, we expect to continue to increase our cost of service revenues to support our expanded product lines and growing customer base.

	Three months ended December 31,	
	2007	**2006**

	(in thousands, except percentages)			
Operating expenses				
Sales and marketing	$	58,178	$	39,055
Research and development		24,332		14,539
General and administrative		13,426		12,818
Total	$	95,936	$	66,412
Operating expenses (as a percentage of net revenue)				
Sales and marketing		37.7%		32.5%
Research and development		15.8		12.1
General and administrative		8.7		10.7
Total		62.2%		55.3%

Table of Contents

Sales and marketing. Sales and marketing expenses consist of salaries, commissions and related benefits of our sales and marketing staff, the costs of our marketing programs, including public relations, advertising and trade shows, facilities and depreciation expenses. Sales and marketing expenses increased 49.0% for the three months ended December 31, 2007 from the comparable period in the prior year. The increase in sales and marketing expense was primarily due to increased commissions and personnel costs of $12.6 million for the three months ended December 31, 2007. The increased commissions and personnel costs were driven by growth in sales and marketing employee headcount, the addition of Acopia personnel and increased revenue for the respective periods. Sales and marketing headcount at the end of December 2007 increased to 687 from 489 at the end of December 2006. In addition, sales and marketing expense included stock-based compensation expense of $6.4 million for the three months ended December 31, 2007, compared to $3.4 million for the same period in the prior year. We expect to continue to increase sales and marketing expenses in order to grow revenues and increase our market share.

Research and development. Research and development expenses consist of the salaries and related benefits for our product development personnel, prototype materials and expenses related to the development of new and improved products, facilities and depreciation expenses. Research and development expenses increased 67.4% for the three months ended December 31, 2007 from the comparable period in the prior year. The increase in research and development expense was primarily due to increased personnel costs of $6.3 million for the three months ended December 31, 2007. Research and development headcount at the end of December 2007 increased to 453 from 298 at the end of December 2006. The growth in headcount was primarily related to enhancement of our current products and our ability to develop new, technologically advanced products that meet the changing needs of our customers and the addition of Acopia personnel. In addition, research and development expense included stock-based compensation expense of $4.0 million for the three months ended December 31, 2007, compared to $2.3 million for the same period in the prior year. The increase in research and development expense also included costs associated with the integration and development of technology acquired with the Acopia acquisition. We expect to continue to increase research and development expenses as our future success is dependent on the continued development of our products.

General and administrative. General and administrative expenses consist of the salaries, benefits and related costs of our executive, finance, information technology, human resource and legal personnel, third-party professional service fees, bad debt charges, facilities and depreciation expenses. General and administrative expenses increased 4.7% for the three months ended December 31, 2007 from the comparable period in the prior year. The increase in general and administrative expenses was primarily due to increased personnel costs of $1.3 million for the three months ended December 31, 2007 partially offset by a decrease in expenses incurred by third parties for legal, accounting, tax and other professional services in connections with the Special Committee investigation of $2.6 million. In addition, general and administrative expense included stock-based compensation expense of $3.9 million for the three months ended December 31, 2007, compared to $2.4 million for the same period in the prior year. General and administrative headcount at the end of December 2007 increased to 190 from 145 at the end of December 2006. General and administrative expense is expected to remain at these increased levels as we continue to build our infrastructure to support the worldwide growth of our business.

	Three months ended December 31,	
	2007	**2006**
	(in thousands, except percentages)	
Other Income and Income Taxes		
Income from operations	$ 23,009	$ 27,094
Other income, net	6,132	6,431
Income before income taxes	29,141	33,525
Provision for income taxes	11,390	11,172

Net income	$ 17,751	$ 22,353
Other income and income taxes (as percentage of revenue)		
Income from operations	14.9%	22.6%
Other income, net	4.0	5.4
Income before income taxes	18.9	27.9
Provision for income taxes	7.4	9.3
Net income	11.5%	18.6%

Other income, net. Other income, net, consists of interest income and foreign currency transaction gains and losses. Other income, net, decreased 4.7% compared to the same period in the prior year. The decrease was due to reduced investment balances as additional cash was required for the acquisition of Acopia in September, 2007.

Provision for Income taxes. We recorded a 39.1% provision for income taxes for the three month period ended December 31, 2007. As of December 31, 2007 we do not have a valuation allowance on any of our deferred tax assets in any of the jurisdictions in which we operate because we believe that these assets are more likely than not to be realized. In making this determination we have considered projected future taxable income and ongoing prudent and feasible tax planning strategies in assessing the appropriateness of a valuation allowance. Our net deferred tax assets at December 31, 2007 and December 31, 2006 were $43.1 million and $25.1 million, respectively. Our worldwide effective tax rate may fluctuate based on a number of factors including variations in projected taxable income in our various geographic locations in which we operate, changes in the valuation of our net deferred tax assets, resolution of potential exposures, tax positions taken on tax returns filed in the various geographic locations in which we operate, introduction of new accounting standards or changes in tax laws or interpretations thereof in the various geographic locations in which we operate. We have recorded liabilities to address potential tax exposures related to business and income tax positions we have taken that could be challenged by taxing authorities. The ultimate resolution of these potential exposures may be greater or less than the liabilities recorded which could result in an adjustment to our future tax expense.

Liquidity and Capital Resources

Cash and cash equivalents, short-term investments and long-term investments were $517.5 million as of December 31, 2007 compared to $474.8 million as of September 30, 2007, representing an increase of $42.7 million. The increase was primarily due to cash provided by operating activities of $42.0 million for the three months ended December 31, 2007 compared to $46.8 million for the same period in the prior year. The decrease in cash flow from operations for the first three months of fiscal year 2008 resulted from decreased net income combined with changes in operating assets and liabilities, as adjusted for various non-cash items including stock-based compensation, depreciation and amortization charges. Based on our current operating and capital expenditure forecasts, we believe that our existing cash and investment balances together with cash generated from operations should be sufficient to meet our operating requirements for the foreseeable future.

Cash used in investing activities was $33.1 million for the three months ended December 31, 2007 compared to $62.2 million for the same period in the prior year. Investing activities include purchases, sales and maturities of available-for-sale securities, capital expenditures and changes in restricted cash requirements. The amount of cash used in investing activities for the first three months of fiscal year 2008 was primarily due to the purchase of investments partially offset by the sale of investments.

Cash provided by financing activities for the three months ended December 31, 2007 was $6.8 million compared to $8.7 million for the same period in the prior year. Our financing activities for the three months ended December 31, 2007 and 2006 consisted primarily of cash received from the exercise of employee stock options and purchases under our employee stock purchase plan.

As of December 31, 2007, our principal commitments consisted of obligations outstanding under operating leases. We lease our facilities under operating leases that expire at various dates through 2014. There have been no material changes in our principal lease commitments compared to those discussed in the Form 10-K. In connection with the lease agreement for our corporate headquarters we established a restricted escrow account collateralized by a certificate of deposit that has been included on our balance sheet as a component of restricted cash. The total amount required in escrow reduces at various dates as set forth by the lease agreement. The amount required in escrow at December 31, 2007 was $3.6 million as set forth by the lease agreement.

We outsource the manufacturing of our pre-configured hardware platforms to contract manufacturers who assemble each product to our specifications. Our agreement with our largest contract manufacturer allows them to procure component inventory on our behalf based upon a rolling production forecast. We are contractually obligated to purchase the component inventory in accordance with the forecast, unless we give notice of order cancellation in advance of applicable lead times. As of December 31, 2007, we were committed to purchase approximately $15.4 million of such inventory during the next quarter.

17

Recent Accounting Pronouncements

The anticipated impact of recent accounting pronouncements is discussed in Note 1 to the accompanying Notes to Consolidated Financial Statements.

Risk Factors that May Affect Future Results

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. Our business, operating results, financial performance and share price may be materially adversely affected by a number of factors, including but not limited to the following risk factors, any one of which could cause actual results to vary materially from anticipated results or from those expressed in any forward-looking statements made by us in this Quarterly Report on Form 10-Q or in other reports, press releases or other statements issued from time to time. Additional factors that may cause such a difference are set forth elsewhere in this Quarterly Report on Form 10-Q.

Our success depends on our timely development of new products and features, market acceptance of new product offerings and proper management of the timing of the life cycle of our products

We expect the application delivery networking and file virtualization markets to be characterized by rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards. Our continued success depends on our ability to identify and develop new products and new features for our existing products to meet the demands of these changes, and for those products and features to be accepted by our existing and target customers. If we are unable to identify, develop and deploy new products and new product features on a timely basis, our business and results of operations may be harmed.

The current life cycle of our products is typically 12 to 24 months. The introduction of new products or product enhancements may shorten the life cycle of our existing products, or replace sales of some of our current products, thereby offsetting the benefit of even a successful product introduction, and may cause customers to defer purchasing our existing products in anticipation of the new products. This could harm our operating results by decreasing sales, increasing our inventory levels of older products and exposing us to greater risk of product obsolescence. We have also experienced, and may in the future experience, delays in developing and releasing new products and product enhancements. This has led to, and may in the future lead to, delayed sales, increased expenses and lower quarterly revenue than anticipated. Also, in the development of our products, we have experienced delays in the prototyping of our products, which in turn has led to delays in product introductions. In addition, complexity and difficulties in managing product transitions at the end-of-life stage of a product can create excess inventory of components associated with the outgoing product that can lead to increased expenses. Any or all of the above problems could materially harm our business and operating results.

Our success depends on sales and continued innovation of our BIG-IP product lines

For the fiscal year ended September 30, 2007, and the three months ended December 31, 2007, we derived 91.0% and 86.3%, respectively of our product revenues from sales of our BIG-IP family of application delivery networking product lines. We continue to expect to derive a significant portion of our net revenues from sales of our BIG-IP products in the future. Implementation of our strategy depends upon BIG-IP products being able to solve critical network availability and performance problems of our customers. If BIG-IP products are unable to solve these problems for our customers or if we are unable to sustain the high levels of innovation in BIG-IP s product feature set needed to maintain leadership in what will continue to be a competitive market environment, our business and results of operations will be harmed.

We may not be able to compete effectively in the emerging application delivery networking and file virtualization markets

The markets we serve are new, rapidly evolving and highly competitive, and we expect competition to persist and intensify in the future. Our principal competitors in the application delivery networking market include Cisco Systems, Inc., Nortel Networks Corporation, Foundry Networks, Inc., Citrix Systems, Inc., Radware Ltd. and Juniper Networks, Inc. In the adjacent WAN Optimization market, we compete with Riverbed Technology, Inc.,

Table of Contents

Juniper Networks, Inc., Packeteer, Inc., Cisco Systems, Inc. and Citrix systems, Inc. In the file virtualization market, we compete with EMC, Network Appliance, Brocade and Cisco. We expect to continue to face additional competition as new participants enter our markets. As we continue to expand globally, we may see new competitors in different geographic regions. In addition, larger companies with significant resources, brand recognition, and sales channels may form alliances with or acquire competing application delivery networking solutions and emerge as significant competitors. Potential competitors may bundle their products or incorporate an Internet traffic management or security component into existing products in a manner that discourages users from purchasing our products.

Our quarterly and annual operating results are inherently unpredictable and may cause our stock price to fluctuate

Our quarterly and annual operating results have varied significantly in the past and will vary significantly in the future, which makes it difficult for us to predict our future operating results. In particular, we anticipate that the size of customer orders may increase as we continue to focus on larger business accounts. A delay in the recognition of revenue, even from just one account, may have a significant negative impact on our results of operations for a given period. In the past, a majority of our sales have been realized near the end of a quarter. Accordingly, a delay in an anticipated sale past the end of a particular quarter may negatively impact our results of operations for that quarter, or in some cases, that year. Additionally, we have exposure to the credit risks of some of our customers and sub-tenants. Although we have programs in place that are designed to monitor and mitigate the associated risk, there can be no assurance that such programs will be effective in reducing our credit risks adequately. We monitor individual payment capability in granting credit arrangements, seek to limit the total credit to amounts we believe our customers can pay and maintain reserves we believe are adequate to cover exposure for potential losses. If there is a deterioration of a sub-tenant s or major customer s creditworthiness or actual defaults are higher than expected future resulting losses, if incurred, could harm our business and have a material adverse effect on our operating results.

Further, our operating results may be below the expectations of securities analysts and investors in future quarters or years. Our failure to meet these expectations will likely harm the market price of our common stock. Such a decline could occur, and has occurred in the past, even when we have met our publicly stated revenue and/or earnings guidance.

The average selling price of our products may decrease and our costs may increase, which may negatively impact gross profits

It is possible that the average selling prices of our products will decrease in the future in response to competitive pricing pressures, increased sales discounts, new product introductions by us or our competitors or other factors. Therefore, in order to maintain our gross profits, we must develop and introduce new products and product enhancements on a timely basis and continually reduce our product costs. Our failure to do so will cause our net revenue and gross profits to decline, which will harm our business and results of operations. In addition, we may experience substantial period-to-period fluctuations in future operating results due to the erosion of our average selling prices.

It is difficult to predict our future operating results because we have an unpredictable sales cycle

Our products have a lengthy sales cycle and the timing of our revenue is difficult to predict. Historically, our sales cycle has ranged from approximately two to three months and has tended to lengthen as we have increasingly focused our sales efforts on the enterprise market. Also, as our distribution strategy has evolved into more of a channel model, utilizing value-added resellers, distributors and systems integrators, the level of variability in the length of sales cycle across transactions has increased and made it more difficult to predict the timing of many of our sales transactions. Sales of our products require us to educate potential customers in their use and benefits. Sales of our products are subject to delays from the lengthy internal budgeting, approval and competitive evaluation processes that large corporations and governmental entities may require. For example, customers frequently begin by evaluating our products on a limited basis and devote time and resources to testing our products before they decide whether or not to purchase. Customers may also defer orders as a result of anticipated releases of new products or enhancements by our competitors or us. As a result, our products have an unpredictable sales cycle that contributes to the uncertainty of our future operating results.

Our business may be harmed if our contract manufacturers are not able to provide us with adequate supplies of our products or if a single source of hardware assembly is lost or impaired

We rely on third party contract manufacturers to assemble our products. We outsource the manufacturing of our hardware platforms to contract manufacturers who assemble these hardware platforms to our specifications. We have experienced minor delays in shipments from contract manufacturers in the past. However, if we experience major delays in the future or other problems, such as inferior quality and insufficient quantity of product, any one or a combination of these factors may harm our business and results of operations. The inability of our contract manufacturers to provide us with adequate supplies of our products or the loss of our contract manufacturer may cause a delay in our ability to fulfill orders while we obtain a replacement manufacturer and may harm our business and results of operations. In particular, because we subcontract substantially all of our manufacturing to a single contract manufacturer, with whom we do not have a long-term contract, any termination, loss or impairment in our arrangement with this single source of hardware assembly, or any impairment of their facilities or operations, would harm our business, financial condition and results of operation.

If the demand for our products grows, we will need to increase our raw material and component purchases, contract manufacturing capacity and internal test and quality control functions. Any disruptions in product flow may limit our revenue, may harm our competitive position and may result in additional costs or cancellation of orders by our customers.

Our business could suffer if there are any interruptions or delays in the supply of hardware components from our third-party sources

We currently purchase several hardware components used in the assembly of our products from a number of single or limited sources. Lead times for these components vary significantly. The unavailability of suitable components, any interruption or delay in the supply of any of these hardware components or the inability to procure a similar component from alternate sources at acceptable prices within a reasonable time, may delay assembly and sales of our products and, hence, our revenues, and may harm our business and results of operations.

We are subject to governmental export and import controls that could subject us to liability or impair our ability to compete in international markets.

Our products are subject to U.S. export controls and may be exported outside the U.S. only with the required level of export license or through an export license exception, because we incorporate encryption technology into our products. In addition, various countries regulate the import of certain encryption technology and have enacted laws that could limit our ability to distribute our products or could limit our customers ability to implement our products in those countries. Changes in our products or changes in export and import regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products throughout their global systems or, in some cases, prevent the export or import of our products to certain countries altogether. Any change in export or import regulations or related legislation, shift in approach to the enforcement or scope of existing regulations or change in the countries, persons or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers with international operations. For example, we will need to comply with Waste Electrical and Electronic Equipment Directive laws, which are being adopted by certain European Economic Area countries on a country-by-country basis. Failure to comply with these and similar laws on a timely basis, or at all, could have a material adverse effect on our business, operating results and financial condition. Any decreased use of our products or limitation on our ability to export or sell our products would likely adversely affect our business, operating results and financial condition.

We may not be able to adequately protect our intellectual property and our products may infringe on the intellectual property rights of third parties

We rely on a combination of patent, copyright, trademark and trade secret laws, and restrictions on disclosure of confidential and proprietary information to protect our intellectual property rights. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. Monitoring unauthorized use of our products is difficult, and we cannot be certain that the steps we have taken will prevent misappropriation of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States.

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. In the ordinary course of our business, we are involved in disputes and licensing discussions with others regarding their claimed proprietary rights and cannot assure you that we will always successfully defend ourselves against such claims. If we are found to infringe the proprietary rights of others, or if we otherwise settle such claims, we could be compelled to pay damages or royalties and either obtain a license to those intellectual property rights or alter our products so that they no longer infringe upon such proprietary rights. Any license could be very expensive to obtain or may not be available at all. Similarly, changing our products or processes to avoid infringing upon the rights of others may be costly or impractical. In addition, we have initiated, and may in the future initiate, claims or litigation against third parties for infringement of our proprietary rights, to determine the scope and validity of our proprietary rights or those of our competitors. Any of these claims, whether claims that we are infringing the proprietary rights of others, or vice versa, with or without merit, may be time-consuming, result in costly litigation and diversion of technical and management personnel or require us to cease using infringing technology, develop non-infringing technology or enter into royalty or licensing agreements. Further, our license agreements typically require us to indemnify our customers, distributors and resellers for infringement actions related to our technology, which could cause us to become involved in infringement claims made against our customers, distributors or resellers. Any of the above-described circumstances relating to intellectual property rights disputes could result in our business and results of operations being harmed.

Many of our products include intellectual property licensed from third parties. In the future, it may be necessary to renew licenses for third party intellectual property or obtain new licenses for other technology. These third party licenses may not be available to us on acceptable terms, if at all. The inability to obtain certain licenses, or litigation regarding the interpretation or enforcement of license rights and related intellectual property issues, could have a material adverse effect on our business, operating results and financial condition. Furthermore, we license some third party intellectual property on a non-exclusive basis and this may limit our ability to protect our intellectual property rights in our products.

We may not be able to sustain or develop new distribution relationships and a reduction or delay in sales to a significant distribution partner could hurt our business

Our sales strategy requires that we establish and maintain multiple distribution channels in the United States and internationally through leading industry resellers, systems integrators, Internet service providers and other indirect channel partners. We have a limited number of agreements with companies in these channels, and we may not be able to increase our number of distribution relationships or maintain our existing relationships. Recruiting and retaining qualified channel partners and training them in our technologies requires significant time and resources. If we are unable to establish or maintain our indirect sales channels, our business and results of operations will be harmed. In addition, two domestic distributors of our products together accounted for 24.8% and 25.2% of our total net revenue for the fiscal years 2007 and 2006, respectively. Two domestic distributors of our products accounted for 25.3% of our total net revenue for the three months ended December 31, 2007. A substantial reduction or delay in sales of our products to this or any other key distribution partner could harm our business, operating results and financial condition.

Undetected software or hardware errors may harm our business and results of operations

Our products may contain undetected errors or defects when first introduced or as new versions are released. We have experienced these errors or defects in the past in connection with new products and product upgrades. We expect that these errors or defects will be found from time to time in new or enhanced products after commencement of commercial shipments. These problems may cause us to incur significant warranty and repair costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relations problems. We may also be subject to liability claims for damages related to product errors or defects.

Table of Contents

While we carry insurance policies covering this type of liability, these policies may not provide sufficient protection should a claim be asserted. A material product liability claim may harm our business and results of operations.

Our products must successfully operate with products from other vendors. As a result, when problems occur in a network, it may be difficult to identify the source of the problem. The occurrence of software or hardware problems, whether caused by our products or another vendor s products, may result in the delay or loss of market acceptance of our products. The occurrence of any of these problems may harm our business and results of operations.

Adverse economic conditions or reduced information technology spending may adversely impact our business.

A substantial portion of our business depends on the demand for information technology by large enterprise customers and service providers, the overall economic health of our current and prospective customers and the continued growth and evolution of the Internet. The purchase of our products is often discretionary and may involve a significant commitment of capital and other resources. Weak economic conditions, or a reduction in information technology spending even if economic conditions improve, would likely adversely impact our business, operating results and financial condition in a number of ways, including longer sales cycles, lower prices for our products and services and reduced unit sales.

Our operating results are exposed to risks associated with international commerce

As our international sales increase, our operating results become more exposed to international operating risks. These risks include risks related to potential recessions in economies outside the United States, foreign currency exchange rates, managing foreign sales offices, regulatory, political or economic conditions in specific countries, military conflict or terrorist activities, changes in laws and tariffs, inadequate protection of intellectual property rights in foreign countries, foreign regulatory requirements and natural disasters. All of these factors could have a material adverse effect on our business. We intend to continue expanding into international markets. International sales represented 41.6% and 42.6% of our net revenues for the fiscal years ended September 30, 2007 and 2006, respectively and 43.0% for the three months ended December 31, 2007. In particular, in fiscal year 2007, we derived 12.2% of our total revenue from the Japanese market. This revenue is dependent on a number of factors outside our control, including the viability and success of our resellers and the strength of the Japanese economy.

Changes in governmental regulations could negatively affect our revenues

Our products are subject to various regulations promulgated by the United States and various foreign governments including, but not limited to, environmental regulations and regulations implementing export license requirements and restrictions on the import or export of some technologies, especially encryption technology. Changes in governmental regulation and our inability or failure to obtain required approvals, permits or registrations could harm our international and domestic sales and adversely affect our revenues, business and operations.

Acquisitions, including our recent acquisition of Acopia Networks, Inc., present many risks and we may not realize the financial and strategic goals that are contemplated at the time of the transaction

With respect to our past acquisitions, as well as any other future acquisitions we may undertake, we may find that the acquired businesses, products or technologies do not further our business strategy as expected, that we paid more than what the assets are later worth or that economic conditions change, all of which may generate future impairment charges. Our acquisitions may be viewed negatively by customers, financial markets or investors. There may be difficulty integrating the operations and personnel of the acquired business, and we may have difficulty retaining the key personnel of the acquired business. We may have difficulty in incorporating the acquired technologies or products with our existing product lines. Our ongoing business and management s attention may be disrupted or diverted by transition or integration issues and the complexity of managing geographically and culturally diverse locations. We may have difficulty maintaining uniform standards, controls, procedures and policies across locations. We may experience significant problems or liabilities associated with the product quality, technology and other matters.

Table of Contents

Our inability to successfully operate and integrate newly-acquired businesses appropriately, effectively and in a timely manner, or to retain key personnel of any acquired business, could have a material adverse effect on our ability to take advantage of further growth in demand for integrated traffic management and security solutions and other advances in technology, as well as on our revenues, gross margins and expenses.

Our success depends on our key personnel and our ability to attract and retain qualified sales and marketing, operations, product development and professional services personnel

Our success depends to a significant degree upon the continued contributions of our key management, product development, sales, marketing and finance personnel, many of whom may be difficult to replace. The complexity of our application delivery networking products and their integration into existing networks and ongoing support, as well as the sophistication of our sales and marketing effort, requires us to retain highly trained professional services, customer support and sales personnel. Competition for qualified professional services, customer support and sales personnel in our industry is intense because of the limited number of people available with the necessary technical skills and understanding of our products. Our ability to retain and hire these personnel may be adversely affected by volatility or reductions in the price of our common stock, since these employees are generally granted restricted stock units or stock options. The loss of services of any of our key personnel, the inability to retain and attract qualified personnel in the future or delays in hiring qualified personnel, may harm our business and results of operations.

We face litigation risks

We are a party to lawsuits in the normal course of our business. Litigation in general and intellectual property and securities litigation in particular, can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. Responding to lawsuits has been, and will likely continue to be, expensive and time-consuming for us. An unfavorable resolution of the lawsuits could adversely affect our business, results of operations or financial condition.

Our historical stock option practices and the restatement of our prior financial statements have exposed us to greater risks associated with litigation. Beginning in May 2006 several derivative actions were filed against certain current and former directors and officers (as discussed further in Item 1, Note 3, Commitments and Contingencies Legal Proceedings) based on allegations relating to our historical stock option practices. We cannot assure you that this current litigation will result in the same conclusions reached by the special committee of outside directors formed by our Board of Directors to conduct a review of our stock option practices (the Special Committee).

We may in the future be subject to additional litigation arising in relation to our historical stock option practices and the restatement of our prior financial statements. Litigation may be time consuming, expensive and distracting for management from the conduct of our business. The adverse resolution of any lawsuit could have a material adverse effect on our business, financial condition and results of operations. We cannot assure you that any future litigation relating to our historical stock option practices will result in the same conclusions reached by the Special Committee. Furthermore, if we are subject to adverse findings in any of these matters, we could be required to pay damages or penalties or have other remedies imposed upon us which could adversely affect our business, results of operations or financial condition.

The matters relating to the Special Committee s review of our historical stock option practices and the restatement of our consolidated financial statements has resulted in regulatory proceedings against us and may result in future regulatory proceedings, which could have a material adverse impact on our financial condition

On November 8, 2006, we announced that the Special Committee had completed its review of our historical stock option practices. Upon completion of its review, the Special Committee found that the recorded grant dates for certain stock options granted during fiscal years 1999 to 2004 should be adjusted as the measurement date for accounting purposes and the accounting treatment used for the vesting of certain stock options was incorrect. Based on the Special Committee s review, to correct the accounting treatment, we amended our Annual Report on Form 10-K/A (as amended) for the year ended September 30, 2005 and our Quarterly Reports on Form 10-Q for the three months ended December 31, 2005 and March 31, 2006 to restate the consolidated financial statements contained in those reports.

Table of Contents

We have received notice from both the Securities and Exchange Commission (SEC) and the United States Attorney s Office for the Eastern District of New York (the Department of Justice) that they are conducting informal inquiries into our historical stock option practices, and we have fully cooperated with both agencies. Considerable legal and accounting expenses related to our historical stock option practices have already been incurred to date and significant expenditures may continue to be incurred in the future. We may in the future be subject to additional regulatory proceedings or actions arising in relation to our historical stock option practices and the restatement of our prior period financial statements. Any potential regulatory proceeding or action may be time consuming, expensive and distracting for management from the conduct of our business. The adverse resolution of any potential regulatory proceeding or action could adversely affect our business, results of operations or financial condition. We cannot assure you that the SEC and Department of Justice inquiries, or any future regulatory action relating to our historical stock option practices, will result in the same conclusions reached by the Special Committee. Furthermore, if we are subject to adverse findings in any of these matters, we could be required to pay damages or penalties or have other remedies imposed upon us, including criminal penalties, which could adversely affect our business, results of operations or financial condition.

Anti-takeover provisions could make it more difficult for a third party to acquire us

Our Board of Directors has the authority to issue up to 10,000,000 shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by the shareholders. The rights of the holders of common stock may be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock may have the effect of delaying, deferring or preventing a change of control of our company without further action by our shareholder and may adversely affect the voting and other rights of the holders of common stock. Further, certain provisions of our bylaws, including a provision limiting the ability of stockholders to raise matters at a meeting of shareholders without giving advance notice, may have the effect of delaying or preventing changes in control or management of our company, which could have an adverse effect on the market price of our common stock. In addition, our articles of incorporation provide for a staggered board, which may make it more difficult for a third party to gain control of our board of directors. Similarly, state anti-takeover laws in the State of Washington related to corporate takeovers may prevent or delay a change of control of our company.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Management believes there have been no material changes to our quantitative and qualitative disclosures about market risk during the three month period ended December 31, 2007, compared to those discussed in our Annual Report on Form 10-K for the year ended September 30, 2007.

Item 4. Controls and Procedures

Our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) are designed to ensure that required information is properly recorded, processed, summarized and reported within the required timeframe, as specified in the rules set forth by the SEC. Our disclosure controls and procedures are also designed to ensure that information required to be disclosed is accumulated and communicated to management, including our Chief Executive Officer and Chief Accounting Officer, to allow timely decisions regarding required disclosures.

Our management, with the participation of our Chief Executive Officer and Chief Accounting Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2007. Based upon that evaluation, our Chief Executive Officer and Chief Accounting Officer have concluded that our disclosure controls and procedures were effective as of December 31, 2007.

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) or 15d-15(f) of the Exchange Act) during the period covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II OTHER INFORMATION

Item 1. Legal Proceedings

We are not aware of any pending legal proceedings that, individually or in the aggregate, would have a material adverse effect on our business, operating results, or financial condition. We may in the future be party to litigation arising in the ordinary course of business, including claims that allegedly infringe upon third-party trademarks or other intellectual property rights. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

Reference is made to Item 1, Note 3, Commitments and Contingencies Legal Proceedings, of Part I of this Quarterly Report on Form 10-Q and Item 3, Legal Proceedings, in the Form 10-K, filed November 19, 2007 for descriptions of our legal proceedings. We continue to believe that the resolution of these legal proceedings will not have a material adverse effect on us and there have been no material developments since the time of the Form 10-K filing, except as noted in Item 1, Note 3 of Part I of this Quarterly Report on Form 10-Q.

Item 1A. Risk Factors

Information regarding risk factors appears in Part I Item 2 of this Quarterly Report on Form 10-Q, Management s Discussion and Analysis of Financial Condition and Results of Operations Risk Factors that May Affect Future Results and in Part I Item 1A of the Form 10-K. There have been no material changes from the risk factors previously disclosed in the Form 10-K.

Table of Contents

Item 6. Exhibits

Exhibit Number	Exhibit Description
3.1	Second Amended and Restated Articles of Incorporation of the Registrant (1)
3.2	Amended and Restated Bylaws of the Registrant (1)
4.1	Specimen Common Stock Certificate (1)
31.1*	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed herewith.

(1) Incorporated by reference from Registration Statement on Form S-1, File No. 333-75817.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 8th day of February, 2008.

F5 NETWORKS, INC.

By: /s/ JOHN RODRIGUEZ
John Rodriguez
Senior Vice President, Chief Accounting Officer (principal financial officer)

Table of Contents

EXHIBIT INDEX

Exhibit Number	Exhibit Description
3.1	Second Amended and Restated Articles of Incorporation of the Registrant (1)
3.2	Amended and Restated Bylaws of the Registrant (1)
4.1	Specimen Common Stock Certificate (1)
31.1*	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed herewith.

(1) Incorporated by reference from Registration Statement on Form S-1, File No. 333-75817.