

F5 NETWORKS INC  
Form 10-K  
November 22, 2011  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-K**

**ANNUAL REPORT PURSUANT TO SECTIONS 13 OR 15(d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

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

**For the fiscal year ended September 30, 2011**

**or**

**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)

Edgar Filing: F5 NETWORKS INC - Form 10-K

WASHINGTON  
(State or other jurisdiction of  
incorporation or organization)

91-1714307  
(I.R.S. Employer  
Identification No.)

401 Elliott Ave West

Seattle, Washington 98119

(Address of principal executive offices)

(206) 272-5555

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common stock, no par value	NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

## Edgar Filing: F5 NETWORKS INC - Form 10-K

As of March 31, 2011, the aggregate market value of the Registrant's Common Stock held by non-affiliates of the Registrant was \$8,230,608,207 based on the closing sales price of the Registrant's Common Stock on the NASDAQ Global Select Market on that date.

As of November 17, 2011, the number of shares of the Registrant's common stock outstanding was 79,484,124.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Information required in response to Part III of this Form 10-K (Items 10, 11, 12, 13 and 14) is hereby incorporated by reference to the specified portions of the Registrant's Definitive Proxy Statement for the Annual Shareholders Meeting for fiscal year 2011, which Definitive Proxy Statement shall be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days of the end of the fiscal year to which this Report relates.

**Table of Contents**

**F5 NETWORKS, INC.**

**ANNUAL REPORT ON FORM 10-K**

**For the Fiscal Year Ended September 30, 2011**

**Table of Contents**

	<b>Page</b>
<b>PART I</b>	
Item 1. <u>Business</u>	3
Item 1A. <u>Risk Factors</u>	15
Item 1B. <u>Unresolved Staff Comments</u>	21
Item 2. <u>Properties</u>	21
Item 3. <u>Legal Proceedings</u>	22
Item 4. <u>(Removed and Reserved)</u>	22
<b>PART II</b>	
Item 5. <u>Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	23
Item 6. <u>Selected Financial Data</u>	25
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	26
Item 7A. <u>Quantitative and Qualitative Disclosure About Market Risk</u>	36
Item 8. <u>Financial Statements and Supplementary Data</u>	37
Item 9. <u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	62
Item 9A. <u>Controls and Procedures</u>	62
Item 9B. <u>Other Information</u>	62
<b>PART III</b>	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	63
Item 11. <u>Executive Compensation</u>	63
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	63
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	64
Item 14. <u>Principal Accountant Fees and Services</u>	64
<b>PART IV</b>	
Item 15. <u>Exhibits and Financial Statement Schedules</u>	64
<b><u>SIGNATURES</u></b>	<b>65</b>

---

## **Table of Contents**

### **Trademarks and Tradenames**

F5, F5 Networks, F5 [DESIGN], F5 Management Pack, F5 WORLD, BIG-IP, CloudFucious, Data Manager, VIPRION, WA, WAN Optimization Manager, WOM, APM, Application Security Manager, ASM, Local Traffic Manager, LTM, Global Traffic Manager, GTM, IBR, Link Controller, Enterprise Manager, Traffic Management Operating System, TMOS, WANJet, FirePass, WebAccelerator, TrafficShield, iControl, TCP Express, Fast Application Proxy, 3DNS, iRules, iRules on Demand, Packet Velocity, ZoneRunner, OneConnect, AskF5, Intelligent Compression, Transparent Data Reduction, TDR, L7 Rate Shaping, LC, IPv6 Gateway, SSL Acceleration, Fast Cache, iHealth, Intelligent Browser Referencing, Message Security Module, PSM, MSM, Netcelera, Protocol Security Module, IT AGILITY. YOUR WAY., DEVCENTRAL, DEVCENTRAL (DESIGN), Edge Client, Edge Gateway, EM, IQUERY, Real Traffic Policy Builder, STRONGBOX, SYN Check, Access Policy Manager, Acopia, Acopia Networks, Advanced Client Authentication, Advanced Routing, ARX, Cloud Extender, CMP, DSI, DNS Express, DSC, Edge Portal, iApps, iSession, ScaleN, SuperVIP, UNITY and vCMP are trademarks or service marks of F5 Networks, Inc., or its subsidiaries in the U.S. and other countries. Any other trademarks, service marks and/or trade names appearing in this document are the property of their respective owners.

Unless the context otherwise requires, in this Annual Report on Form 10-K, the terms F5 Networks, the Company, we, us, and our refer to F5 Networks, Inc. and its subsidiaries. Our fiscal year ends on September 30, and fiscal years are referred to by the calendar year in which they end. For example, fiscal year 2011 and fiscal 2011 refer to the fiscal year ended September 30, 2011.

### **Forward-Looking Statements**

This Annual Report on Form 10-K contains 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. These forward-looking statements are based on current information and expectations and are subject to a number of risks and uncertainties. Our actual results could differ materially and adversely 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 Item 1A. Risk Factors below and in other documents we file from time to time with the Securities and Exchange Commission. We assume no obligation to revise or update any such forward-looking statements.

### **Item 1. Business**

#### **General**

F5 Networks is a leading provider of Application Delivery Networking (ADN) technology that optimizes the delivery of network-based applications and the security, performance and availability of servers, data storage devices and other network resources. As strategic points of control within a network, our products collectively function as a dynamic control plane that simplifies the management of data center operations and the delivery of services across diverse data center resources.

Founded in 1996, F5 Networks pioneered load-balancing technology that distributes internet traffic evenly across multiple servers, making them appear like a single device. Today, our BIG-IP application delivery controllers (ADCs) are generally positioned in front of web and application servers, balancing traffic and performing compute-intensive functions such as encrypting and un-encrypting transmissions, screening traffic for security threats, maintaining open connections with servers, speeding the flow of traffic, managing access to applications and data and a variety of other functions that improve the security, performance, and availability of applications.

By offloading functions from servers, BIG-IP ADCs make servers more efficient, reduce the number of servers needed to run specific applications, lower the cost of power and cooling, and drive down operating costs by simplifying the management of servers and applications. In virtual environments, this allows customers to increase the density of virtual servers running on physical servers and reduces the added complexity of managing a dynamic environment.

The core of our ADN technology is our full-proxy Traffic Management Operating System (TMOS) that enables our products to inspect and modify traffic flows to and from servers at network speed and supports a broad and growing array of functions that enhance the security, performance and availability of applications. iRules, a scripting language based on Tool Command Language (TCL), is a unique feature of TMOS that enables customers and third parties to write customized rules to inspect and modify traffic.



## **Table of Contents**

TMOS also supports a common software interface called iControl, which enables our products to communicate with one another and with third-party products, including custom and commercial enterprise applications. TMOS is designed to support the addition of new functionality as software modules and to exploit the performance-enhancing features of our purpose-built hardware platforms. Correspondingly, our hardware architecture integrates industry standard components with components we design ourselves to optimize TMOS and deliver performance that is demonstrably superior to competing products.

Just as our ADCs make many servers look like one, ARX storage virtualization products sit in front of network attached storage (NAS), making multiple storage devices from different vendors look like a single device to the individual clients, servers and applications that use them. In addition, ARX products simplify the migration of data between storage devices, the addition of new storage devices, and the distribution of files across tiers of storage, including cloud storage services, that reflect their relative immediacy or importance.

In connection with our products, we offer a broad range of services including consulting, training, installation, maintenance and other technical support services.

F5 Networks was incorporated on February 26, 1996 in the State of Washington. Our headquarters is in Seattle, Washington, and our mailing address is 401 Elliott Avenue West, Seattle, Washington 98119. The telephone number at our executive offices is (206) 272-5555. We have subsidiaries or branch offices in Australia, Belgium, Brazil, Canada, China, Denmark, France, Germany, Hong Kong, India, Indonesia, Italy, Japan, Malaysia, Mexico, Netherlands, New Zealand, Norway, the Philippines, Singapore, South Africa, South Korea, Spain, Sweden, Taiwan, Thailand, the United Arab Emirates, the United Kingdom and Vietnam. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports are available free of charge on our website, [www.f5.com](http://www.f5.com), as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission.

## **Industry Background**

### **Growth and Evolution of IP-Based Infrastructures**

Internet Protocol (IP) is a communications language used to transmit data over the Internet. For more than two decades, large business and government organizations have been gradually replacing older data center architectures with IP-based infrastructures, deploying new IP-based applications and replacing or upgrading legacy applications with new IP-enabled versions. At the same time, organizations have become more geographically dispersed, and increasingly mobile workforces depend on access to corporate applications and data from remote locations and a variety of client devices including smartphones, tablets and laptops.

Within the past three years, the information technology landscape has changed dramatically as organizations have responded to the slowdown in the global economy by using technologies such as virtualization and the growing availability and sophistication of cloud computing to reduce capital and operating costs and enhance the flexibility and efficiency of their information infrastructures. These efforts are reflected in the ongoing trend toward data center consolidation that includes a reduction in both the number and size of data centers. In addition, a growing number of organizations are turning to social networking and other online vehicles to help target customers and compete more effectively in an environment of reduced consumer spending. The rapid growth of social networks such as Facebook and Twitter, coupled with the explosion of mobile devices and applications, has challenged the abilities of content and service providers to keep up with growing demand.

Along with the growth of Internet traffic, the proliferation of unstructured data such as voice, video, images, email, spreadsheets and formatted text files continues to present an enormous and increasing challenge to IT organizations. Historically, IT organizations have responded to this challenge primarily by adding more storage. File virtualization is a relatively new technology that enables organizations to store and manage files across a heterogeneous array of storage devices and lower their overall cost of storage.

### **Emergence of the Dynamic Data Center**

From a broad perspective, the goal of IT organizations is to optimize the secure delivery of applications and data to users wherever they are and whenever they need them. In a recent survey by a leading industry research firm, global CIOs ranked developing or managing a flexible IT infrastructure as their number one priority. To achieve these goals, IT organizations are embracing virtualization technologies that enable them to group or partition data center resources to meet user demand and reconfigure these virtual resources easily and quickly as demand changes. Many are also taking advantage of the growing availability of external cloud resources as a flexible, secure and reliable alternative to owning and managing everything themselves. As a result, IT infrastructure





---

## **Table of Contents**

has become increasingly dynamic, complex and reliant on IP-based networks for the delivery of applications and data. At the same time, these changes have created new challenges to the security of IP networks and the applications and data accessible over the Internet. Within the past year, sophisticated denial of service attacks have exposed a major vulnerability in the security perimeter of corporate networks by overwhelming firewalls and effectively shutting down the networks. In addition, many network-level security threats are directly related to the improper use of the same protocols applications depend on to transmit data over the wire. Intrusion detection and prevention devices, which rely on signature databases of known threats, afford some protection against these types of attack. However, they offer no protection against many of the most common threats, including information leakage, content spoofing, cross-site request forgery or day zero attacks designed to exploit a variety of application vulnerabilities.

In addition to preventing the threat of attacks designed to disrupt, destroy or block access to network applications, organizations are faced with the equally daunting challenge of controlling access to applications and data. The proliferation of mobile devices has given users with smart phones, tablets, and laptops the ability to access corporate data centers from virtually anywhere. This, in turn, has increased the difficulty of ensuring that mobile users are able to access applications and data for which they are authorized, and that applications and data are protected from access by unauthorized users.

### *Need to Optimize the Secure Delivery of Applications and Data*

With the ongoing evolution and increasing complexity of IT infrastructures, there is a growing need to optimize the secure delivery of applications and data over IP networks. IP-based traffic passing between client devices and servers is divided into discrete packets that travel by multiple routes to their destination where they are reassembled. The disassembly, routing, and reassembly of transmissions are relatively straightforward and require little intelligence. By contrast, managing, inspecting, modifying, redirecting and securing application traffic going to and from servers requires intelligent systems capable of performing a broad array of functions. Broadly speaking, all of those functions are aspects of application delivery networking.

ADCs dynamically manage the flow of traffic between users and servers (physical or virtual), making them look like a single resource to the user. In addition they free up resources by offloading common network functions, such as encryption, IPv4/IPv6 translation, compression, authentication, rate-shaping, and a variety of specialized functions, including network and application security services, policy management, and WAN optimization, that would otherwise run on the servers or be coded into the applications. Since most large enterprises have hundreds if not thousands of servers and applications, it is not practical to replicate these functions on each server or within each virtual instance of an application. Doing so would take up valuable network resources and reduce the number of applications that could run on each server. Maintenance costs would be prohibitive and the net result would be a negative impact on the overall performance of servers and applications. Offloading specific functions onto point solutions can eliminate those problems but introduces a new set of challenges. Using point solutions from multiple vendors can create interoperability issues, and problems that do occur can be difficult to troubleshoot. From a security standpoint, it is also much more difficult to audit traffic passing through multiple devices. Providing a comprehensive set of integrated application delivery features and functions on a single, high-performance platform simplifies management of the device and the servers it sits in front of and reduces overall capital and operating costs. File virtualization delivers similar benefits by reducing the cost and complexity of file storage.

Along with other types of IP traffic, the volume of file-based information created and accessed by Internet users and network applications is growing rapidly. File virtualization allows IT organizations to map individual users and applications to a single device that can distribute files across a heterogeneous array of storage devices, keep track of their location, and retrieve them as needed. File virtualization devices maximize storage utilization and simplify the migration of data from one vendor's storage devices to another's. They can also be programmed to allocate files across tiers of storage systems, matching the cost, capacity, and performance of the storage devices to the type of information being stored, frequency of usage, and relative importance, substantially reducing both the capital and operating costs associated with file storage.

### **F5's Strategy**

Our objective is to lead the industry in delivering network architectures that integrate IP networks with applications and data, enabling the delivery of dynamic services in the data center. Those services include security, optimization and orchestration of data center operations and resources, as well as coordination of services spanning multiple data centers. Our products are designed to be strategic points of control in the IT infrastructure that allow business policies to be implemented where information is exchanged. This enables organizations to respond quickly to changing business needs, improve costly and time consuming business processes and develop new sources of revenue through highly differentiated offerings. Key components of our strategy include:

## **Table of Contents**

### ***Offering a complete, integrated application delivery product suite.***

Since the introduction of our TMOS architecture for application delivery networking, we have developed TMOS-based versions of our own legacy products, such as GTM and Link Controller, and acquired technology, including ASM, WebAccelerator, WAN Optimization Module (WOM), Edge Gateway and Application Policy Manager (APM). All of these products are currently available as integrated software modules on our BIG-IP family of ADCs. We believe this approach sharply differentiates our products from our competitors' offerings and provides customers with an expanding array of integrated application delivery networking solutions that can be customized to meet their specific needs.

### ***Investing in technology to meet evolving customer needs.***

We continue to invest in research and development to provide our customers with comprehensive, integrated solutions. In application delivery networking, our product development efforts leverage the unique attributes of our software-based platforms to deliver new features and functions that address the complex, changing needs of our customers. Although the bulk of our investment in application delivery and file virtualization technologies is software development, concurrent development of tightly integrated, high-performance hardware is a key part of our investment strategy. We also look for opportunities to acquire technologies that will enable us to broaden the scope of our offerings and expand into adjacent markets.

### ***Continuing to build and expand relationships with strategic technology partners.***

To compete successfully against Cisco Systems, Inc. and other large competitors who have an established presence in our target accounts, we have developed strategic technology partnerships with enterprise software vendors, such as Microsoft, Oracle, VMware and SAP, who often have an established or growing presence in those accounts. By taking advantage of our open application programming interface, called iControl, these vendors can equip their applications to control our products in the network, enhancing overall application performance. In return, they provide us significant leverage in the selling process by recommending our products to their customers. We have also worked closely with several of these vendors to develop configurations of our products, called iApps, that are specifically designed to simplify deployment and optimize the performance of their applications. These solutions are available as templates which allow quick and easy configuration of our products for specific applications. We plan to continue building on our existing relationships and to extend our competitive edge by developing new relationships with other strategic partners.

### ***Leveraging DevCentral, our online community of network architects and developers.***

Customization of our products using iRules enhances their "stickiness" by allowing customers to solve problems in both their applications and their networks that would be difficult if not impossible to solve by other means. To promote the use of iRules, we host an online community, DevCentral, where network architects and developers can discuss and share the ways in which they use iRules to solve problems and enhance the security, performance and availability of applications. A corollary benefit is that many of the iRules solutions posted by DevCentral participants have become standard features in new releases of TMOS. DevCentral also provides a valuable window into our customers' constantly evolving needs.

## **F5 Solutions**

We design integrated software products that run on purpose-built hardware and are also available as virtual (software only) editions. Our products function as strategic points of control in IP networks, inspecting, modifying and directing traffic to optimize the security, availability and delivery of applications and data to any user, anywhere. We believe our products offer the most intelligent architecture and advanced functionality in the marketplace along with performance and flexibility that enable organizations to simplify management of their data center operations and integrate disparate resources to reduce operating costs, enhance productivity and improve service to employees, customers and partners.

### ***Application Delivery Networking***

Since 2004 we have expanded the breadth of features and functionality we offer well beyond the scope of application delivery networking as it has been traditionally defined. Today, we offer solutions that include application security, secure remote access, WAN optimization and access policy management, opening up large opportunities in several adjacent markets. Many of the features and functions that differentiate our products are built into TMOS, our full-proxy operating system. Others are available as software modules that run on TMOS.



## **Table of Contents**

### **Software**

The core of our technology is TMOS, our Traffic Management Operating System, introduced in September 2004. The full-proxy characteristics of the TMOS architecture enable our products to intercept, inspect and act on the contents of traffic from virtually every type of IP-enabled application. In addition, the modularity of the TMOS architecture allows us to deliver tightly integrated solutions that secure, optimize and ensure the availability of applications and the networks they run on.

#### *Traffic Management Operating System (TMOS)*

Since TMOS was launched, we have introduced two major upgrades, adding hundreds of new features designed to interpret and act on specific content in the traffic passing between users and applications. TMOS Version 11.0, announced in July 2011, includes enhancements to iRules, a built-in programming language, that allows customers to create or modify policies that provide direct, granular control over how our products act on traffic at any moment within the application transaction or flow. In addition, Version 11.0 includes several new features and functions that are unique to our products:

iApps is a set of portable, customizable, reusable templates that enable the rapid and predictable deployment of our products in front of more than 20 applications from vendors including Microsoft, Oracle, VMware, BEA, and SAP. iApps also allows customers and partners to create templates that simplify the deployment and provisioning of their own applications.

Scale<sup>N</sup> is a set of three unique capabilities that enhance the flexibility of our products:

Clustered Multiprocessing (CMP) allows customers to cluster and aggregate multiple processors (cores) within a BIG-IP appliance and across blades in our VIPRION chassis products.

Virtual Clustered Multiprocessing (vCMP) enables the creation of separate virtual ADCs within an appliance or chassis, each running a separate instance of TMOS with a different configuration and assigned to a different application.

Device Service Clustering (DSC) gives customers the ability to group devices and services across an array of ADCs (appliances, VIPRION chassis, or virtual editions). Devices can be added to or removed from a DSC without disrupting application services, and application services can be independently managed within the cluster.

TMOS Version 11.0 also includes a number of new security features that enhance the ability of our products to protect networks and applications against denial of service attacks and other types of security threats. Other enhancements include centralized management of multiple devices and improved visibility that allows customers to monitor and record the performance of applications and users.

#### *Feature Modules*

Many of the basic network functions our products perform are embedded as standard features in TMOS and available to our customers at no extra cost. These features include:

Advanced Client Authentication: Reduces costs and frees up server cycles by eliminating the need to manage and enforce authentication individually across applications.

Advanced Routing: Allows our products to manage the routing information used by traffic traversing networks and to share that information with other devices.

## Edgar Filing: F5 NETWORKS INC - Form 10-K

**Fast Cache:** Improves server and application performance by eliminating the need for servers to handle repeated requests for identical content.

**Intelligent Compression:** Reduces the volume of outgoing traffic as necessary to optimize transmission to individual users.

**IPv6 Gateway:** Provides complete translation and load-balancing between v4 and v6 networks, and directs traffic across mixed IPv6 and IPv4 devices.

**L7 Rate Shaping:** Reserves bandwidth for higher priority applications to ensure that low-priority traffic doesn't interfere with critical business applications.

**Protocol Security:** Prevents security attacks directed at HTTP, SMTP and FTP servers.

## **Table of Contents**

SSL Acceleration: Frees up valuable space on physical and virtual servers by offloading compute-intensive SSL encryption and decryption. Basic SSL Acceleration is included with every product. Depending on the hardware platform, customers can purchase up to 200,000 transactions per second of incremental performance.

### *Product Modules*

In addition to the features and functions embedded in TMOS, we offer a family of integrated software solutions that cover a broad range of application-aware network functions from load-balancing to application security. Depending on a number of factors, including the hardware platform they have purchased, the application they are running, and their performance and security requirements, customers may purchase one or more of these modules in addition to Local Traffic Manager (LTM), which is included with every hardware product. The following software modules are currently available on all BIG-IP and VIPRION products except BIG-IP 1600:

**Local Traffic Manager (LTM):** LTM, which provides intelligent load-balancing and traffic management, is standard on all BIG-IP appliances and VIPRION chassis-based systems. As a strategic point of control between servers and users, LTM manages the flow and distribution of all traffic passing through our products, ensuring that applications are secure, fast and available.

**Global Traffic Manager (GTM):** GTM automatically directs users to the closest or best-performing data center based on business policy, geolocation, and volume spikes, regardless of their cause. When users try to access a data center that is overloaded or unreachable, GTM automatically and seamlessly directs them to a secondary data center. It also automates the process of tracking and managing interdependencies among individual services in distributed applications. In addition, GTM enhances DNS security by automatically scaling to absorb a rapid increase in queries resulting from a denial of service attack.

**Access Policy Manager (APM):** APM provides secure, granular, context-aware control of access to applications while simplifying authentication, authorization, and accounting (AAA) management. An optional endpoint security service validates client devices to protect organizations from viruses or malware infections, accidental data loss, and rogue device access. This allows users to apply repeatable access policies across many applications and servers with centralized visibility of their authorization infrastructure. APM's Visual Policy Editor makes it easy to create individual and group access policies for many different identities, locations, and web authentication environments. APM also provides dynamic access control by creating access control lists based on user identity, IP address, and attributes such as group membership pulled from standard directory services.

**Application Security Manager (ASM):** ASM is an application firewall that provides comprehensive, proactive, application-layer protection against both generalized and targeted attacks. Combining a positive security model (deny all unless allowed) with signature-based detection, ASM can prevent day-zero attacks in addition to known security threats.

**Link Controller:** For organizations with more than one Internet Service Provider (ISP), Link Controller monitors the health and availability of each connection. In the event of a failure, traffic is dynamically directed across other available links so users and external customers stay connected. Link Controller includes an optional compression feature that reduces WAN link bandwidth for lower ISP costs and cuts down on bandwidth bottlenecks for faster application delivery.

**WAN Optimization Manager (WOM):** WOM integrates application delivery with WAN optimization technologies, enabling traditional acceleration functions, such as SSL offloading, compression, caching, and traffic prioritization, to combine with optimization technologies like symmetric adaptive compression and application quality of service. As the foundation for site-to-site communication, iSessions, a basic feature of TMOS, allows any two BIG-IP devices to be deployed symmetrically, creating a secure site-to-site connection, improving transfer rates and bandwidth usage, and offloading applications for more efficient data center to data center WAN communication.

**WebAccelerator:** WebAccelerator speeds web transactions by optimizing individual network object requests, connections, and end-to-end transactions from the browser through to databases. WebAccelerator enhances web application performance from any location, speeding up interactive performance, improving download times, utilizing bandwidth more efficiently, and dramatically reducing the cost and

## Edgar Filing: F5 NETWORKS INC - Form 10-K

response time of delivering Web-enabled applications to distributed users where it is not possible to deploy an end-point device. Devices running WebAccelerator can also be placed at key remote locations to provide acceleration to end-users above and beyond TCP optimizations and HTTP compression.

Message Security: Reputation-based, perimeter anti-spam solution that extends security for message applications to the edge of the corporate network and eliminate unwanted e-mail.

### *Virtual ADCs*

Currently, Local Traffic Manager (LTM), Global Traffic Manager (GTM), Application Security Manager (ASM), Access Policy Manager (APM), and WAN Optimization Manager (WOM) are also available as virtual editions of BIG-IP, designed to run on standard servers and to supplement our other products in hybrid environments. BIG-IP VEs also give our customers a cost-effective way to test and configure our products and help determine which systems and modules will best meet their specific needs.

---

## **Table of Contents**

### **Hardware**

All of our purpose-built hardware platforms are designed to enhance the performance of our software. Currently we offer two lines of ADN products: our BIG-IP family of ADCs; and our scalable, chassis-based VIPRION ADCs. Both BIG-IP and VIPRION run TMOS and support all of our product software modules. We also sell specialty appliances that integrate specific software services and are only available as standalone products.

Data sheets for all of our hardware platforms are available in the products section of our website.

#### *BIG-IP Application Delivery Controllers*

Products in our family of BIG-IP application delivery controllers differ primarily in their performance characteristics resulting from the hardware components and configurations that make up each system. Our current family of BIG-IP appliances includes BIG-IP 1600, BIG-IP 3600, BIG-IP 3900, BIG-IP 6900, BIG-IP 8900, BIG-IP 8950, and BIG-IP 11050.

#### *VIPRION Application Delivery Controllers*

Currently we offer two products in our line of chassis-based application delivery controllers. VIPRION 4400 and VIPRION 2400 both consist of a chassis with slots for one to four blades, each equipped with two dual-core processors. VIPRION's unique architecture distributes traffic across all available processors and allows customers to add or remove blades without disrupting traffic. It also helps customers simplify their networks by consolidating ADCs, saving management costs as well as power, space, and cooling in the datacenter.

VIPRION 4400 was introduced in January 2008 and has remained the high end of our application delivery controller product family in both performance and price. The current P200 blades, introduced in January 2010, doubled the overall performance of the platform.

VIPRION 2400, introduced in June 2011, was designed to make the VIPRION architecture available to customers who want the features and benefits of the platform but do not require the top-end performance of VIPRION 4400. A VIPRION 2400 chassis with one blade has a retail price comparable to the mid-range of our BIG-IP product family. A fully-loaded VIPRION 2400 (chassis with four blades) delivers approximately half the throughput of a fully-loaded VIPRION 4400 at roughly half the price.

Both VIPRION products support all the features, functions and capabilities of TMOS Version 11.0, including clustered multiprocessing (CMP), virtual clustered multiprocessing (vCMP), and device service clustering (DSC).

#### *Specialty Appliances*

##### **FirePass**

FirePass appliances provide SSL VPN access for remote users of IP networks and any applications connected to those networks from any standard Web browser on any device. The components of FirePass include a dynamic policy engine, which manages user authentication and authorization privileges, and special components that enable corporations to give remote users controlled access to the full array of applications and resources within the network. FirePass also supports Application Ready Access, providing full reverse-proxy services for market-leading application portals including those of SAP, Oracle, Microsoft, and others.

The FirePass appliance is available in three configurations – FirePass 1200, FirePass 4100 and FirePass 4300 – designed to support up to 2,000 concurrent users. In addition, we offer FirePass Virtual Edition, which runs in a VMware virtual environment.

##### **Edge Gateway**

BIG-IP Edge Gateway is an advanced remote access product that provides context-aware, policy controlled, secure remote access to applications at LAN speed. Edge Gateway integrates our SSL VPN remote access technology with application acceleration and optimization services at the edge of the network, giving customers remote access, access control, site-to-site security, and application acceleration on one efficient, scalable, cost-effective platform. An optional endpoint security service validates client devices with policy to protect organizations from viruses or malware infections, accidental data loss, and rogue device access.





## **Table of Contents**

Edge Gateway is available as a standalone solution on the BIG-IP 1600, 3600, 3900, 6900 and 8900 platforms.

### **Enterprise Manager**

Enterprise Manager provides a single, centralized management console for our application delivery controllers. Enterprise Manager allows customers with dozens or hundreds of our products to discover and view those products in a single window, and to upgrade or modify the software on those products simultaneously. This lowers the cost and simplifies the task of deploying, managing and maintaining our products and reduces the likelihood of error when blanket changes are implemented.

Enterprise Manager is available on three hardware platforms – Enterprise Manager 4000, Enterprise Manager 3000, and Enterprise Manager 500 and as a virtual edition.

### ***Data Solutions***

F5's data solutions products address many of the problems associated with managing today's rapidly expanding file storage infrastructure. The ARX product family is a series of high performance, enterprise-class, intelligent file virtualization devices that simplify the management of file storage environments and lower total storage costs by automating data management tasks and eliminating the disruption associated with storage management operations. Unique capabilities of our ARX products include:

**Non-disruptive Data Migration.** Automated movement of files between heterogeneous storage devices without affecting access or requiring client reconfiguration.

**Automated Storage Tiering.** Automated storage of data on tiers of heterogeneous storage devices.

**Dynamic Load-balancing.** Dynamic distribution of files across multiple file storage devices, eliminating hotspots or bottlenecks.

**Efficient Data Replication.** Replication of files between heterogeneous storage platforms for efficient and cost effective disaster recovery and centralized backup applications.

**Centralized Data Management.** Data Manager, a Windows-based reporting tool, simplifies file virtualization deployments and helps organizations monitor multiple file storage resources through a centralized and extensible storage management platform. Currently, the ARX series includes three products. ARX 500 and ARX 2000 are stand-alone devices that can support up to 600 and 6,000 users, respectively. ARX 4000 is a fixed form-factor device supporting 10 gigabit Ethernet, capable of managing more than 2 billion files, and able to support up to 12,000 users. ARX is also available in a virtual edition.

To enable our customers to take advantage of inexpensive cloud storage alternatives, we offer ARX Cloud Extender, a software solution that works in concert with the automated storage tiering capabilities of ARX to extend the file storage infrastructure seamlessly from the data center to the cloud.

### **Product Development**

We believe our future success depends on our ability to maintain technology leadership by continuing to improve our products and by developing new products to meet the changing needs of our customers. Our product development organization employs a standard process for the development, documentation and quality control of software and systems that is designed to meet these goals. This process includes working with our business development and marketing teams, product managers, customers and partners to identify new or improved solutions that meet the evolving needs of our addressable markets.

## Edgar Filing: F5 NETWORKS INC - Form 10-K

Our principal software engineering team is located in our headquarters in Seattle, Washington. Product development for FirePass, APM, WOM and WebAccelerator is located in San Jose, California. ASM product development is located in Tel Aviv, Israel. ARX product development is located in Lowell, Massachusetts. Our hardware engineering team is located in Spokane, Washington. In addition, we maintain a dedicated facility for product testing and quality control in Tomsk, Russia. Members of all our product development teams collaborate closely with one another to ensure the interoperability and performance of our hardware and software systems.

## **Table of Contents**

During the fiscal years ended September 30, 2011, 2010 and 2009, we had research and product development expenses of \$138.9 million, \$118.3 million, and \$103.7 million, respectively.

### **Customers**

Our customers include a wide variety of enterprise customers and service providers among Fortune 1000 and Business Week Global 1000 companies, including those in technology, telecommunications, financial services, transportation, education, manufacturing and healthcare, along with government customers. In fiscal year 2011, international sales represented 41.2% of our net revenues. Refer to Note 10 of our consolidated financial statements included in this Annual Report on Form 10-K for additional information regarding our revenues by geographic area.

### **Sales and Marketing**

#### ***Sales***

We sell our products and services to large enterprise customers and service providers through a variety of channels, including distributors, value-added resellers (VARs) and systems integrators. A substantial amount of our revenue for fiscal year 2011 was derived from these channel sales. Our sales teams work closely with our channel partners and also sell our products and services directly to major accounts.

*F5 sales teams.* Our inside sales team generates and qualifies leads for regional sales managers and helps manage accounts by serving as a liaison between the field and internal corporate resources. Our field sales personnel are located in major cities in four sales regions: the Americas (primarily the United States); Europe, the Middle East, and Africa (EMEA); Japan; and the Asia Pacific region (APAC). Field sales personnel work closely with our channel partners to assist them, as necessary, in the sale of our products and services to their customers. We also sell our products and services directly to customers, primarily large enterprises, whose accounts are managed by our major account services team. Field systems engineers support our regional sales managers and channel partners by participating in joint sales calls and providing pre-sale technical resources as needed.

*Distributors and VARs.* As a key component of our sales strategy, we have established relationships with a number of large national and international distributors, local and specialized distributors and VARs. We derive a majority of our product sales from these distributors and VARs.

Our agreements with these channel partners are not exclusive and do not prevent them from selling competitive products. These agreements typically have terms of one year with no obligation to renew, and typically do not provide for exclusive sales territories or minimum purchase requirements.

For fiscal year 2011, sales to two of our worldwide distributors, Avnet Technology Solutions and Ingram Micro, represented 18.1% and 10.7% of our total revenues, respectively. Our agreements with these distributors are standard, non-exclusive distribution agreements that renew automatically on an annual basis and can be terminated by either party with 30 days prior written notice. The agreements grant Avnet Technology Solutions and Ingram Micro the right to distribute our products to resellers in North America and certain other territories internationally, with no minimum purchase requirements.

*Systems integrators.* We also market our products through strategic relationships with systems integrators, including Dell Services, HP Enterprise Services and IBM Global Services, who include our products as core components of application or network-based solutions they deploy for their customers. In most cases, systems integrators do not directly purchase our products for resale to their customers. Instead they typically recommend our products as part of broader solutions, such as enterprise resource planning (ERP) or customer relationship management (CRM) solutions that incorporate our products for high availability and enhanced performance.

#### ***Marketing***

Our marketing strategy is driven by the belief that our continued success depends on our ability to understand and anticipate the dynamic needs of our addressable markets and to develop valuable solutions that meet those needs. In line with this belief, our marketing organization works directly with customers, partners and our product development teams to identify and create innovative solutions to further enhance our leadership position. In addition, our business development team, which is a component of our marketing organization, closely monitors technology companies in adjacent and complementary markets for opportunities to acquire or partner with those whose solutions are complementary to ours and could enable us to expand our addressable market.



## **Table of Contents**

Another key component of our marketing strategy is to develop and expand our iControl partnerships. Working closely with our partners, we have developed customizable solutions templates called iApps that help ensure the successful deployment and delivery of their applications over the network. These solution templates have been integrated into TMOS Version 11.0 and allow customers to configure our products quickly and easily to optimize the performance of specific applications from major software vendors such as Microsoft, Oracle, SAP and VMware.

To support the growing number of developers using our products, including network and application architects, we continue to promote and expand DevCentral, our on-line community website that provides technical resources to customers, prospects and partners wanting to extend and optimize F5 solutions using iRules. A key aspect of DevCentral is an on-line forum where developers as well as application and network architects discuss and share solutions they have written with iRules. At the end of fiscal year 2011, DevCentral had more than 87,500 registered members.

We also engage in a number of marketing programs and initiatives aimed at promoting our brand and creating market awareness of our technology and products. These include actively participating in industry trade shows and joint marketing events with channel and technology partners, and briefing industry analysts and members of the trade press on our latest products, business relationships and technology partnerships. In addition, we market our products to chief information officers and other information technology professionals through targeted advertising, direct mail and high-profile Web events.

## **Backlog**

At the end of fiscal years 2011 and 2010, we had product backlog of approximately \$40.9 million and \$50.3 million, respectively. Backlog represents orders confirmed with a purchase order for products to be shipped generally within 90 days to customers with approved credit status. Orders are subject to cancellation, rescheduling by customers or product specification changes by customers. Although we believe that the backlog orders are firm, purchase orders may be cancelled by the customer prior to shipment without significant penalty. For this reason, we believe that our product backlog at any given date is not a reliable indicator of future revenues.

## **Customer Service and Technical Support**

We believe that our ability to provide consistent, high-quality customer service and technical support is a key factor in attracting and retaining large enterprise customers. Accordingly, we offer a broad range of support services that include installation, phone support, hardware repair and replacement, software updates, online tools, consulting and training services.

We provide these services directly to end users and also utilize a multi-tiered support model, leveraging the capabilities of our channel partners when applicable. Our technical support staff is strategically located in regional service centers to support our global customer base.

Prior to the installation of our products, our services personnel work with customers to analyze their network needs and determine the best way to deploy our products and configure product features and functions to meet those needs. Our services personnel also provide on-site installation and training services to help customers make optimal use of product features and functions.

Our customers typically purchase a one-year maintenance contract which entitles them to an array of services provided by our technical support team. Maintenance services provided under the contract include online updates, software error correction releases, hardware repair and replacement, and, in the majority of cases, round-the-clock call center support. Free updates of our software are available to customers with a current maintenance contract. Our technical support team also offers seminars and training classes for customers on the configuration and use of products, including local and wide area network system administration and management. In addition, we have a professional services team able to provide a full range of fee-based consulting services, including comprehensive network management, documentation and performance analysis, and capacity planning to assist in predicting future network requirements.

As part of our maintenance service, we offer an online, automated, self-help customer support function called **Ask F5** that provides answers to many commonly asked questions, allowing customers to get information and solve problems quickly while significantly reducing the number of calls to our support desk. This enables us to provide comprehensive customer support while keeping our support-related expenses at a manageable, consistent level. We also offer an online service called **iHealth**, which allows

---

## **Table of Contents**

customers to diagnose up-to-the-minute snapshots of their BIG-IP systems. Diagnoses include tailored feedback about configuration issues or code defects, a description of the issue, recommendations for resolution, and a link to further information in the AskF5 Knowledge Base.

### **Manufacturing**

We outsource the manufacturing of our pre-configured hardware platforms to third party contract manufacturers for assembly according to our specifications.

Flextronics manufactures our ADC product line, and Sanmina-SCI manufactures our ARX product line. The subcontracting activity at Flextronics and Sanmina-SCI encompasses prototype builds, full production and direct fulfillment. Our contract manufacturers perform the following activities on our behalf; material procurement, PCB assembly and test, final assembly, system test, quality control, direct shipment and warranty repairs. We provide a rolling forecast that allows our contract manufacturers to stock component parts and other materials, plan capacity and build finished goods inventory in anticipation of end user demand. Each of the contract manufacturers procures components in volumes consistent with our forecast, necessary to assemble the products and tests the products according to our specifications. Products are then shipped to our distributors, value-added resellers, or end users. Generally, we do not own the components. Title to the products transfers from the contract manufacturers to us and then to our customers upon delivery at a designated shipment location. If the components are unused or the products are not sold within specified periods of time, we may incur carrying charges or obsolete material charges for components that our contract manufacturers purchased to build products to meet our forecast or customer orders.

Hardware platforms for our products consist primarily of commodity parts and certain custom components designed and approved by our hardware engineering group. Most of our components are purchased from sources which we believe are readily available from other suppliers. However, several components used in the assembly of our products are purchased from a single or limited source.

During fiscal year 2010, we transitioned certain sub-assembly and testing processes of our BIG-IP products from Flextronics's facilities in Milpitas, California, to the Flextronics facility in ZhuHai, China. All sub-assemblies are configured and final tested at Flextronics's Milpitas, California for distribution to our end users.

### **Competition**

The expanding capabilities of our product offerings have enabled us to address a growing array of market opportunities, many of which are outside the bounds of the application delivery networking market as defined and measured by industry analysts such as Gartner Group, Dell Oro and others. In addition to server load-balancing and other functions normally associated with application delivery, our suite of integrated product modules has expanded our addressable market into security, WAN optimization, and policy management, where we compete with a growing number of companies not included among traditional ADC vendors. The ability to create custom network services using iRules has also enabled us, our customers, and our partners to design solutions to problems for which there is no off-the-shelf solution. As a result, we believe the traditional definitions of our market do not encompass all of the features, functions and capabilities of our products or accurately represent the addressable market for those products.

Within the more narrowly defined traditional ADC market, several companies sell server load-balancing products. These include Brocade Communications Systems, Inc., Cisco Systems, Inc., Citrix Systems, Inc., Radware Ltd., and a number of smaller competitors: A10 Networks, Array Networks, Inc., Barracuda Networks, Inc., and Riverbed Technology, which recently acquired Zeus Technology Ltd.

While file virtualization remains an early-stage market, we believe our ARX products are unique in terms of technology and functionality and are well positioned within this emerging market.

The principal competitive factors in the markets in which we compete include product features and performance, customer support, brand recognition, the scope of distribution and sales channels and pricing. Certain of our competitors have and may in the future adopt aggressive pricing policies to gain market share. However, because of the superior performance, broad functionality and unique capabilities of our products, which have resulted in high levels of customer satisfaction and growing brand awareness, we believe that we can and will compete effectively against such pricing policies.

## Table of Contents

### **Intellectual Property**

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We have obtained 95 patents in the United States, 10 foreign patents and have applications pending for various aspects of our technology. Our future success depends in part on our ability to protect our proprietary rights to the technologies used in our principal products. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use trade secrets or other information that we regard as proprietary. In addition, the laws of some foreign countries do not protect our proprietary rights as fully as do the laws of the United States. Any issued patent may not preserve our proprietary position, and competitors or others may develop technologies similar to or superior to our technology. Our failure to enforce and protect our intellectual property rights could harm our business, operating results and financial condition.

In addition to our own proprietary software, we incorporate software licensed from several third-party sources into our products. These licenses generally renew automatically on an annual basis. We believe that alternative technologies for these licenses are available both domestically and internationally.

### **Employees**

As of September 30, 2011, we had 2,488 full-time employees, including 610 in product development, 1,080 in sales and marketing, 528 in professional services and technical support and 270 in finance, administration and operations. None of our employees is represented by a labor union. We have experienced no work stoppages and believe that our employee relations are good.

### **Executive Officers of the Registrant**

The following table sets forth certain information with respect to our executive officers as of November 22, 2011:

<b>Name</b>	<b>Age</b>	<b>Position</b>
John McAdam	60	President, Chief Executive Officer and Director
Mark Anderson	49	Senior Vice President of Worldwide Sales
Jeffrey A. Christianson	54	Senior Vice President and General Counsel
Edward J. Eames	53	Senior Vice President of Business Operations
Dan Matte	45	Senior Vice President of Marketing and Business Development
Andy Reinland	47	Senior Vice President and Chief Finance Officer
Manuel F. Rivelto	47	Senior Vice President of Security and Strategic Solutions
John Rodriguez	51	Senior Vice President and Chief Accounting Officer
Karl Triebes	44	Senior Vice President of Product Development and Chief Technical Officer

*John McAdam* has served as our President, Chief Executive Officer and a director since July 2000. Prior to joining us, Mr. McAdam served as General Manager of the Web server sales business at International Business Machines Corporation from September 1999 to July 2000. From January 1995 until August 1999, Mr. McAdam served as the President and Chief Operating Officer of Sequent Computer Systems, Inc., a manufacturer of high-end open systems, which was sold to International Business Machines Corporation in September 1999. Mr. McAdam holds a B.S. in Computer Science from the University of Glasgow, Scotland.

*Mark Anderson* has served as our Senior Vice President of Worldwide Sales since October 2007. He joined F5 Networks in October 2004 as Vice President of North American Sales. Prior to joining F5, Mr. Anderson served as Executive Vice President of North American Sales at Lucent Technologies from 2003 to 2004. From 2002 through 2003, Mr. Anderson was Vice President of Business Development at RadioFrame Networks. From 1997 to 2001, he served as a Sales Director at Cisco Systems, Inc. From 1986 to 1996, he was Vice President of Western U.S. Sales at Comdisco. Mr. Anderson holds a B.A. in Business and Economics from York University in Toronto.

*Jeffrey A. Christianson* has served as our Senior Vice President and General Counsel of the Company since December 2006. From February 2000 to July 2006, Mr. Christianson was Sr. Vice President and General Counsel of Western Wireless Corporation, a wireless service provider. From March 1996 to January 2000, Mr. Christianson served as Sr. Vice President of Business Development, General Counsel and Corporate Secretary at Wizards of the Coast, Inc., a game and software company. From September 1992 to March 1996, he served as General Counsel and Secretary of Heart Technology, Inc., a medical device company. From September 1990 to September 1992, he was Vice-President and General Counsel of Spider Staging Corporation and Vice President of Administration and Corporate Counsel for Flow International Corporation after its acquisition of Spider Staging Corporation. Mr. Christianson holds a B.A. from Whitman College and a J.D. from the University of Washington,



Edgar Filing: F5 NETWORKS INC - Form 10-K

and serves on the Board of Overseers of Whitman College and the Board of Directors of the Humane Society for Seattle/King County.

---

## **Table of Contents**

*Edward J. Eames* has served as our Senior Vice President of Business Operations since January 2001 and as our Vice President of Professional Services from October 2000 to January 2001. From September 1999 to October 2000, Mr. Eames served as Vice President of e-Business Services for International Business Machines Corporation. From June 1992 to September 1999, Mr. Eames served as the European Services Director and the Worldwide Vice President of Customer Service for Sequent Computer Systems, Inc., a manufacturer of high-end open systems. Mr. Eames holds a Higher National Diploma in Business Studies from Bristol Polytechnic and in 1994 completed the Senior Executive Program at the London Business School.

*Dan Matte* has served as our Senior Vice President of Marketing since June 2004, and as Vice President of Product Marketing and Management from March 2002 through May 2004. He served as our Senior Director of Product Marketing and Management from February 2001 through February 2002. From March 1999 to February 2001, Mr. Matte served as our Director of Product Management. Mr. Matte joined F5 in February 1997. He holds a Bachelor of Commerce from Queens's University and an MBA from the University of British Columbia.

*Andy Reinland* has served as our Senior Vice President and Chief Finance Officer since October 2005. Mr. Reinland joined F5 in 1998, serving as a senior financial analyst and, most recently, Vice President of Finance. Prior to joining F5, Mr. Reinland was Chief Financial Officer for RTIME, Inc., a developer of real-time 3D software for Internet applications, which was acquired by Sony. Mr. Reinland started his career in public accounting. Mr. Reinland holds a B.A. in Business from Washington State University.

*Manuel F. Rivelo* has served as Senior Vice President of Security and Strategic Solutions at F5 Networks since October 2011. Prior to joining F5, Mr. Rivelo served as Senior Vice President – Engineering Operations and Systems for Cisco Systems, Inc. During his 19-year career at Cisco, Rivelo was a member of the Cisco Development Counsel, the senior leadership team of the Cisco Development Organization. While at Cisco, he also served as head of the worldwide systems engineering organization. His managerial career spans over 25 years in product engineering, strategic planning, business operations, field engineering sales and IT. Rivelo serves on the board of directors of Apollo Group, Inc., one of the world's largest private education providers. He holds a bachelor's and master's degree in Electrical Engineering from the Stevens Institute of Technology.

*John Rodriguez* has served as our Senior Vice President and Chief Accounting Officer since October 2005. For SEC reporting purposes, Mr. Rodriguez is the principal financial officer. Rodriguez joined F5 in 2001 as Corporate Controller. His most recent position held was Vice President and Corporate Controller. Prior to F5, Mr. Rodriguez was Vice President and Chief Financial Officer of CyberSafe, a security solutions company, and Senior Director of Finance and Operations at Mosaix, which was acquired by Lucent Technologies. Mr. Rodriguez started his career in public accounting. Mr. Rodriguez holds a B.A. in Business from the University of Washington.

*Karl Triebes* has served as our Senior Vice President of Product Development and Chief Technical Officer since August 2004. Prior to joining us, Mr. Triebes served as Chief Technology Officer and Vice President of Engineering of Foundry Networks, Inc. from January 2003 to August 2004. From June 2001 to January 2003, he served as Foundry's Vice President of Hardware Engineering. From May 2000 to June 2001, Mr. Triebes was Vice President of Engineering at Alcatel U.S.A., a telecommunications company. From December 1999 to May 2000, he was Assistant Vice President of Newbridge Networks Corp., a networking company subsequently acquired by Alcatel. Mr. Triebes holds a B.S. in Electrical Engineering from San Diego State University.

### **Item 1A. Risk Factors**

In addition to the other information in this report, the following risk factors should be carefully considered in evaluating our company and its business.

#### ***Our quarterly and annual operating results may fluctuate in future periods, which may cause our stock price to fluctuate***

Our quarterly and annual operating results have varied significantly in the past and could vary significantly in the future, which makes it difficult for us to predict our future operating results. Our operating results may fluctuate due to a variety of factors, many of which are outside of our control, including the changing and recently volatile U.S. and global economic environment, which may cause our stock price to fluctuate. 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 fiscal year. Additionally, we have exposure to the credit risks of some of our customers and sub-tenants.



**Table of Contents**

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 a major customer's creditworthiness or actual defaults are higher than expected, future 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.

*In addition to other risks listed in this Risk Factors section, factors that may affect our operating results include, but are not limited to:*

fluctuations in demand for our products and services due to changing market conditions, pricing conditions, technology evolution, seasonality, or other changes in the global economic environment;

changes or fluctuations in sales and implementation cycles for our products and services;

reduced visibility into our customers' spending and implementation plans;

reductions in customers' budgets for data center and other IT purchases or delays in these purchases;

fluctuations in our gross margins, including the factors described herein, which may contribute to such fluctuations;

our ability to control costs, including operating expenses, the costs of hardware and software components, and other manufacturing costs;

our ability to develop, introduce and gain market acceptance of new products, technologies and services, and our success in new and evolving markets;

any significant changes in the competitive environment, including the entry of new competitors or the substantial discounting of products or services;

the timing and execution of product transitions or new product introductions, and related inventory costs;

variations in sales channels, product costs, or mix of products sold;

our ability to establish and manage our distribution channels, and the effectiveness of any changes we make to our distribution model;

the ability of our contract manufacturers and suppliers to provide component parts, hardware platforms and other products in a timely manner;

## Edgar Filing: F5 NETWORKS INC - Form 10-K

benefits anticipated from our investments in sales, marketing, product development, manufacturing or other activities; and

changes in tax laws or regulations, or other accounting rules.

***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***

The application delivery networking and file virtualization markets are 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 the acceptance of those products and features 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.

---

## **Table of Contents**

The current development cycle for our products is on average 12-24 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 results of operations.

### ***Our success depends on sales and continued innovation of our Application Delivery Networking product lines***

For the fiscal year ended September 30, 2011, we derived approximately 97.4% of our net product revenues, or approximately 61.0% of our total net revenues, from sales of our Application Delivery Networking (ADN) product lines. We expect to continue to derive a significant portion of our net revenues from sales of our ADN products in the future. Implementation of our strategy depends upon these products being able to solve critical network availability and performance problems for our customers. If our ADN products are unable to solve these problems for our customers or if we are unable to sustain the high levels of innovation in our ADN 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 Brocade Communications Systems, Inc., Cisco Systems, Inc., Citrix Systems, Inc. and Radware Ltd. In the adjacent WAN Optimization Controller market, we compete with Blue Coat Systems, Inc., Cisco, Citrix, Juniper Networks, Inc. and Riverbed Technology, Inc. In the file virtualization market, we compete with EMC Corporation. 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 from other companies 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. Any of these circumstances may limit our opportunities for growth and negatively impact our financial performance.

### ***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.



---

**Table of Contents**

***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 outsource the manufacturing of our hardware platforms to third party 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 one or more of our contract manufacturers 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, we currently subcontract manufacturing of our application delivery networking products to a single contract manufacturer with whom we do not have a long-term contract. If our arrangement with this single source of hardware assembly was terminated or otherwise impaired, and we were not able to engage another contract manufacturer in a timely manner, our business, financial condition and results of operation could be adversely affected.

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 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.



---

**Table of Contents**

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. We expect that infringement claims may increase as the number of products and competitors in our market increases and overlaps occur. Also, as we have gained greater visibility, market exposure and competitive success, we face a higher risk of being the subject of intellectual property infringement 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, or 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 significant distribution partners could hurt our business***

We sell our products and services through multiple distribution channels in the United States and internationally, including leading industry distributors, value-added resellers, systems integrators, 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 worldwide distributors of our products accounted for 28.8% of our total net revenue for fiscal year 2011. Two worldwide distributors of our products accounted for 24.7% of our total net revenue for fiscal year 2010. A substantial reduction or delay in sales of our products to these distribution partners, if not replaced by sales to other indirect channel partners and distributors, 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. 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.

---

**Table of Contents**

***Adverse general 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. International, national, regional and local economic conditions, such as recessionary economic cycles, protracted economic slowdown or further deterioration of the economy could adversely impact demand for our products. The purchase of our products is often discretionary and may involve a significant commitment of capital and other resources. Continued weak economic conditions or a reduction in information technology spending even if economic conditions improve would likely result in longer sales cycles and reduced product sales, each of which would adversely impact our business, results of operations and financial condition.

***Our investments in auction rate securities are subject to risks that may cause losses and affect the liquidity of these investments***

At September 30, 2011, the fair value of our AAA/A- (or equivalent) rated municipal auction rate securities (ARS) was approximately \$13.0 million. We may not be able to liquidate these ARS and realize their full carrying value unless the issuer calls the security, a successful auction occurs, a buyer is found outside of the auction process, or the security otherwise matures. While we do not believe the decline in the carrying values of these municipal ARS is permanent, if the issuers of these securities are unable to successfully close future auctions and their credit ratings are lowered, we may be required to record future impairment charges related to these investments, which would harm our results of operations. We believe certain of these available-for-sale investments may remain illiquid for longer than twelve months and as a result, we have classified these investments as long-term as of September 30, 2011.

***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 recessionary economic cycles or protracted slowdowns 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 41.2% and 41.4% of our net revenues for the fiscal years ended September 30, 2011 and 2010, respectively.

***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.

***Changes in financial accounting standards may cause adverse unexpected revenue fluctuations and affect our reported results of operations***

A change in accounting policies can have a significant effect on our reported results and may even affect our reporting of transactions completed before the change is effective. New pronouncements and varying interpretations of existing pronouncements have occurred with frequency and may occur in the future. Changes to existing rules, or changes to the interpretations of existing rules, could lead to changes in our accounting practices, and such changes could adversely affect our reported financial results or the way we conduct our business.

***Acquisitions 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 integrating the acquired technologies or products with our existing product lines. Our ongoing business and management's attention

---

## **Table of Contents**

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 product quality, technology and other matters.

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. 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 these lawsuits 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 shareholders 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 shareholders 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 1B. Unresolved Staff Comments***

Not applicable.

### ***Item 2. Properties***

We lease our principal administrative, sales, marketing, research and development facilities, which are located in Seattle, Washington and consist of approximately 300,000 square feet. In April 2010, we amended and restated the lease agreement for the three buildings that serve as our corporate headquarters. The lease commenced in April, July and August of 2010 for various sections of the first building; and August 2010 for the second and third buildings. The lease for all three buildings will expire in 2022 with an option for renewal. In October 2006, we entered into an agreement to lease a building adjacent to the three buildings that serve as our corporate headquarters. This lease will expire in 2018. During 2008, we entered into two separate sublease agreements to sublease approximately 112,500 square feet of this building. One sublease will expire in 2013. In March 2010, we amended the second sublease, which expanded the subleased space by approximately 11,700 square feet and extended the term of the sublease to 2018.



**Table of Contents**

We believe that our existing properties are in good condition and suitable for the conduct of our business. We also lease office space for our product development personnel in Spokane, Washington, San Jose, California, Lowell, Massachusetts, Israel, and Russia and for our sales and support personnel in Georgia, Illinois, New York, Washington D.C., Australia, Belgium, Brazil, Canada, China, Denmark, France, Germany, Hong Kong, India, Indonesia, Italy, Japan, Malaysia, Mexico, Netherlands, New Zealand, Norway, the Philippines, Singapore, South Africa, South Korea, Spain, Sweden, Taiwan, Thailand, the United Arab Emirates, the United Kingdom and Vietnam. We believe that our future growth can be accommodated by our current facilities or by leasing additional space if necessary.

**Item 3. *Legal Proceedings***

We are not aware of any pending legal proceedings that, individually or in the aggregate, are reasonably possible to 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 we allegedly infringe upon third-party intellectual property rights. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

**Item 4. *(Removed and Reserved)***

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities****Market Prices of Common Stock**

Our common stock is traded on the Nasdaq Global Select Market under the symbol FFIV. The following table sets forth the high and low sales prices of our common stock as reported on the Nasdaq Global Select Market.

	Fiscal Year 2011		Fiscal Year 2010	
	High	Low	High	Low
First Quarter	\$ 143.75	\$ 89.05	\$ 53.59	\$ 37.93
Second Quarter	\$ 145.76	\$ 91.10	\$ 65.10	\$ 47.11
Third Quarter	\$ 114.90	\$ 92.03	\$ 77.10	\$ 60.50
Fourth Quarter	\$ 119.69	\$ 69.01	\$ 107.30	\$ 66.79

The last reported sales price of our common stock on the Nasdaq Global Select Market on November 17, 2011 was \$107.10.

As of November 17, 2011, there were approximately 70 holders of record of our common stock. As many of our shares of common stock are held by brokers and other institutions on behalf of shareholders, we are unable to estimate the total number of beneficial holders of our common stock represented by these record holders.

**Dividend Policy**

Our policy has been to retain cash to fund future growth. Accordingly, we have not paid dividends and do not anticipate declaring dividends on our common stock in the foreseeable future.

**Unregistered Securities Sold in 2011**

We did not sell any unregistered shares of our common stock during the fiscal year 2011.

**Issuer Purchases of Equity Securities**

On October 26, 2010, we announced that our Board of Directors approved a new program to repurchase up to an additional \$200 million of our outstanding common stock. On August 15, 2011, we announced that our Board of Directors authorized an additional \$200 million for our common stock share repurchase program. This new authorization is incremental to the existing \$200 million program, approved in October 2010. Acquisitions for the share repurchase programs will be made from time to time in private transactions or open market purchases as permitted by securities laws and other legal requirements. The programs may be discontinued at any time. As of November 17, 2011, we had repurchased and retired 7,601,631 shares at an average price of \$58.21 per share under the programs.

Shares repurchased and retired as of November 17, 2011 are as follows (in thousands, except shares and per share data):

		Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased per the Publicly Announced Plan	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plan
October 1, 2010	October 31, 2010		\$		\$ 237,564
November 1, 2010	November 30, 2010	126,125	\$ 120.30	126,125	\$ 222,384

Edgar Filing: F5 NETWORKS INC - Form 10-K

December 1, 2010	December 31, 2010	71,519	\$ 137.24	71,519	\$ 212,565
January 1, 2011	January 31, 2011	43,200	\$ 106.71	43,200	\$ 207,953
February 1, 2011	February 28, 2011	203,785	\$ 118.36	203,785	\$ 183,823
March 1, 2011	March 31, 2011	157,948	\$ 112.55	157,948	\$ 166,038
April 1, 2011	April 30, 2011		\$		\$ 166,038
May 1, 2011	May 31, 2011	265,720	\$ 103.66	265,720	\$ 138,481
June 1, 2011	June 30, 2011	205,913	\$ 108.94	205,913	\$ 116,038

**Table of Contents**

July 1, 2011	July 31, 2011	26,657	\$ 99.45	26,657	\$ 113,386
August 1, 2011	August 31, 2011	1,091,868	\$ 77.61	1,091,868	\$ 228,595
September 1, 2011	September 30, 2011	794,244	\$ 78.71	794,244	\$ 166,038
October 1, 2011	October 31, 2011		\$		\$ 366,038
November 1, 2011	November 17, 2011	82,300	\$ 108.03	82,300	\$ 157,144

On October 25, 2011, we announced that our Board of Directors authorized an additional \$200 million for our common stock share repurchase program. This new authorization is incremental to the existing \$400 million program, initially approved in October 2010 and expanded in August 2011.

**Performance Measurement Comparison of Shareholder Return**

The following graph compares the annual percentage change in the cumulative total return on shares of our common stock, the Nasdaq Composite Index and the Nasdaq Computer Index for the period commencing September 30, 2006, and ending September 30, 2011.

**Comparison of Cumulative Total Return**

**On Investment Since September 30, 2006\***

The Company's closing stock price on September 30, 2011, the last trading day of the Company's 2011 fiscal year, was \$71.05 per share.

\* Assumes that \$100 was invested September 30, 2006 in shares of Common Stock and in each index, and that all dividends were reinvested. Shareholder returns over the indicated period should not be considered indicative of future shareholder returns.



**Table of Contents****Item 6. Selected Financial Data**

The following selected consolidated historical financial data are derived from our audited financial statements. The consolidated balance sheet data as of September 30, 2011 and 2010 and the consolidated statement of operations data for the years ended September 30, 2011, 2010 and 2009 are derived from our audited consolidated financial statements and related notes that are included elsewhere in this report. The consolidated balance sheet data as of September 30, 2009, 2008 and 2007 and the consolidated statement of operations for the years ended September 30, 2008 and 2007 are derived from our audited consolidated financial statements and related notes which are not included in this report. The information set forth below should be read in conjunction with our historical financial statements, including the notes thereto, and Management's Discussion and Analysis of Financial Condition and Results of Operations, included elsewhere in this report.

	2011	Years Ended September 30,			2007
		2010	2009	2008	
	(In thousands, except per share data)				
<b>Consolidated Statement of Operations Data</b>					
Net revenues					
Products	\$ 721,975	\$ 561,142	\$ 406,529	\$ 452,929	\$ 392,921
Services	429,859	320,830	246,550	197,244	132,746
<b>Total</b>	<b>1,151,834</b>	<b>881,972</b>	<b>653,079</b>	<b>650,173</b>	<b>525,667</b>
Cost of net revenues					
Products	129,325	113,834	95,209	102,400	84,094
Services	78,679	58,118	47,517	46,618	34,230
<b>Total</b>	<b>208,004</b>	<b>171,952</b>	<b>142,726</b>	<b>149,018</b>	<b>118,324</b>
<b>Gross profit</b>	<b>943,830</b>	<b>710,020</b>	<b>510,353</b>	<b>501,155</b>	<b>407,343</b>
Operating expenses					
Sales and marketing	370,735	293,201	225,193	237,175	175,555
Research and development	138,910	118,314	103,664	103,394	69,030
General and administrative	83,523	68,503	55,243	56,001	49,256
In-process research and development(1)					14,000
Loss on facility exit and sublease(2)				5,271	
Restructuring charges(3)			4,329		
<b>Total</b>	<b>593,168</b>	<b>480,018</b>	<b>388,429</b>	<b>401,841</b>	<b>307,841</b>
<b>Income from operations</b>	<b>350,662</b>	<b>230,002</b>	<b>121,924</b>	<b>99,314</b>	<b>99,502</b>
Other income, net	10,089	7,625	9,724	18,950	28,191
<b>Income before income taxes</b>	<b>360,751</b>	<b>237,627</b>	<b>131,648</b>	<b>118,264</b>	<b>127,693</b>
Provision for income taxes	119,354	86,474	40,113	43,933	50,693
<b>Net income</b>	<b>\$ 241,397</b>	<b>\$ 151,153</b>	<b>\$ 91,535</b>	<b>\$ 74,331</b>	<b>\$ 77,000</b>
Net income per share basic(4)	\$ 2.99	\$ 1.90	\$ 1.16	\$ 0.90	\$ 0.93
Weighted average shares basic(4)	80,658	79,609	78,842	82,290	83,205
Net income per share diluted(4)	\$ 2.96	\$ 1.86	\$ 1.14	\$ 0.89	\$ 0.90
Weighted average shares diluted(4)	81,482	81,049	80,073	83,428	85,137

**Consolidated Balance Sheet Data**

Cash, cash equivalents, and short-term investments	\$ 542,550	\$ 428,496	\$ 317,128	\$ 190,186	\$ 258,465
Restricted cash(5)	162	195	2,729	2,748	3,959
Long-term investments	470,203	433,570	257,294	261,086	216,366
Total assets	1,568,549	1,362,192	1,068,645	939,223	944,288
Long-term liabilities	90,806	71,409	46,611	34,143	20,301
Total shareholders' equity	1,105,436	1,003,698	799,020	718,259	770,577

- (1) In-process research and development (IPR&D) expense represents the amount of IPR&D that we acquired in the Acopia Networks, Inc. ( Acopia ) acquisition.
- (2) Loss on facility exit and sublease expense represents a charge related to the closure of our office space in Bellevue, Washington and the consolidation of our corporate headquarters in Seattle, Washington.
- (3) Restructuring charges represent the expense related to the consolidation of facilities, accelerated depreciation on tenant improvements, and a reduction in workforce that took place in the second quarter of fiscal 2009 as part of a comprehensive restructuring program.

---

**Table of Contents**

- (4) Share and per share amounts have been adjusted as appropriate to reflect a two-for-one stock-split effective August 2007.
- (5) Restricted cash represents escrow accounts established in connection with lease agreements for our facilities.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion of our financial condition and results of operations contains 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. These forward-looking statements are based on current information and expectations and 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 Item 1A. Risk Factors herein and in other documents we file from time to time with the Securities and Exchange Commission. We assume no obligation to revise or update any such forward-looking statements.

**Overview**

We are a global provider of appliances consisting of software and hardware and services that help companies efficiently and securely manage the delivery, optimization and security of application and data traffic on Internet-based networks, and to optimize the performance and utilization of data storage infrastructure and other network resources. We market and sell our products primarily through multiple indirect sales channels in the Americas (primarily the United States); Europe, the Middle East, and Africa (EMEA); Japan; and the Asia Pacific region (APAC). Enterprise customers (Fortune 1000 or Business Week Global 1000 companies) in the technology, telecommunications, financial services, transportation, education, manufacturing and health care industries, along with government customers, continue to make up the largest percentage of our customer base.

Our management team 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 Application Delivery Networking (ADN) products including our high end VIPRION chassis and related software modules; BIG-IP Local Traffic Manager, BIG-IP Global Traffic Manager, BIG-IP Link Controller, BIG-IP Application Security Manager, BIG-IP Edge Gateway, BIG-IP WAN Optimization module, BIG-IP Access Policy Manager, and WebAccelerator; FirePass SSL VPN appliance; and our ARX file virtualization products. We also derive revenues from the sales of services including annual maintenance contracts, 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 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; 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 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.

---

**Table of Contents**

*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 fiscal year 2011 was primarily due to cash provided by operating activities of \$416.9 million. This increase was partially offset by \$271.5 million of cash used to repurchase outstanding common stock under our share repurchase program in fiscal year 2011. Going forward, we believe the primary driver of cash flows will be net income from operations. Capital expenditures for fiscal year 2011 were comprised primarily of information technology infrastructure and equipment to support the growth of our core business activities. We will continue to evaluate possible acquisitions of, or investments in businesses, products, or technologies that we believe are strategic, which may require the use of cash.

*Balance sheet.* We view cash, short-term and long-term investments, deferred revenue, accounts receivable balances and days sales outstanding as important indicators of our financial health. Deferred revenues continued to increase in fiscal 2011 due to growth in the amount of annual maintenance contracts purchased on new products and maintenance renewal contracts related to our existing product installation base. Our days sales outstanding for the fourth quarter of fiscal year 2011 was 47.

**Critical Accounting Policies**

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect the more significant estimates and judgments used in the preparation of our financial statements.

*Revenue Recognition.* We sell products through distributors, resellers, and directly to end users. Revenue is recognized provided that all of the following criteria have been met:

Persuasive evidence of an arrangement exists. Evidence of an arrangement generally consists of a purchase order issued pursuant to the terms and conditions of a distributor, reseller or end user agreement.

Delivery has occurred. We use shipping or related documents, or written evidence of customer acceptance, when applicable, to verify delivery or completion of any performance terms.

The sales price is fixed or determinable. We assess whether the sales price is fixed or determinable based on payment terms associated with the transaction and whether the sales price is subject to refund or adjustment.

Collectability is reasonably assured. We assess collectability primarily based on the creditworthiness of the customer as determined by credit checks and related analysis, as well as the Customer's payment history.

In certain regions where we do not have the ability to reasonably estimate returns, we defer revenue on sales to our distributors until they have received information from the channel partner indicating that the product has been sold to the end-user customer. Payment terms to domestic customers are generally net 30 days to net 45 days. Payment terms to international customers range from net 30 days to net 120 days based on normal and customary trade practices in the individual markets. We offer extended payment terms to certain customers, in which case, revenue is recognized when payments are due.

Whenever product, training services 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. Revenue from the sale of products is recognized when the product has been shipped and the customer is obligated to pay for the product. When rights of return are present and we cannot estimate returns, we recognize 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, repair or replacement of any failed product or component that fails during the term of the agreement, bug fixes and rights to upgrades, when and if available. Consulting services are

## Edgar Filing: F5 NETWORKS INC - Form 10-K

customarily billed at fixed hourly 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.

---

## **Table of Contents**

In October 2009, the Financial Accounting Standards Board (FASB) amended the accounting standards for revenue recognition to remove from the scope of industry-specific software revenue recognition guidance any tangible products containing software components and non-software components that operate together to deliver the products essential functionality. In addition, the FASB amended the accounting standards for certain multiple element revenue arrangements to:

Provide updated guidance on whether multiple elements exist, how the elements in an arrangement should be separated, and how the arrangement consideration should be allocated to the separate elements;

Require an entity to allocate arrangement consideration to each element based on a selling price hierarchy, where the selling price for an element is based on vendor-specific objective evidence (VSOE), if available, third-party evidence (TPE), if available and VSOE is not available; or the best estimate of selling price (BESP), if neither VSOE or TPE is available; and

Eliminate the use of the residual method and require an entity to allocate arrangement consideration using the selling price hierarchy. We adopted this guidance in the first quarter of fiscal year 2011 on a prospective basis for applicable arrangements originating or materially modified after October 1, 2010. The impact of this adoption was not material to our financial position and results of operations for the fiscal year ended September 30, 2011.

The majority of our products are hardware appliances that contain software essential to the overall functionality of the products. Accordingly, we no longer recognize revenue on sales of these products in accordance with the industry-specific software revenue recognition guidance.

For all transactions entered into prior to the first quarter of fiscal year 2011 and for sales of nonessential and stand-alone software after October 1, 2010, we allocate revenue for arrangements with multiple elements based on the software revenue recognition guidance. Software revenue recognition guidance requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair values of those elements. The fair value of an element must be based on VSOE. Where fair value of certain elements is not available, revenue is recognized on the residual method based on the fair value of undelivered elements. If evidence of the fair value of one or more undelivered elements does not exist, all revenue is deferred and recognized at the earlier of the delivery of those elements or the establishment of fair value of the remaining undelivered elements.

For transactions entered into subsequent to the adoption of the amended revenue recognition standards that are multiple-element arrangements, the arrangement consideration is allocated to each element based on the relative selling prices of all of the elements in the arrangement using the fair value hierarchy in the amended revenue recognition guidance.

Consistent with the methodology used under the previous accounting guidance, we establish VSOE for our products, training services, PCS and consulting services based on the sales price charged for each element when sold separately. The sales price is discounted from the applicable list price based on various factors including the type of customer, volume of sales, geographic region and program level. Our list prices are generally not fair value as discounts may be given based on the factors enumerated above. We believe that the fair value of our consulting services is represented by the billable consulting rate per hour, based on the rates we charge customers when they purchase standalone consulting services. The price of consulting services is not based on the type of customer, volume of sales, geographic region or program level.

We use historical sales transactions to determine whether VSOE can be established for each of the elements. In most instances, VSOE is the sales price of actual standalone (unbundled) transactions within the past 12 month period that are priced within a reasonable range, which we have determined to be plus or minus 15% of the median sales price of each respective price list.

VSOE of PCS is based on standalone sales since we do not provide stated renewal rates to our customers. In accordance with our PCS pricing practice (supported by standalone renewal sales), renewal contracts are priced as a percentage of the undiscounted product list price. The PCS renewal percentages may vary, depending on the type and length of PCS purchased. We offer standard and premium PCS, and the term generally ranges from one to three years. We employ a bell-shaped-curve approach in evaluating VSOE of fair value of PCS. Under this approach, we consider VSOE of the fair value of PCS to exist when a substantial majority of our standalone PCS sales fall within a narrow range of pricing.



---

**Table of Contents**

We are typically not able to determine TPE for our products or services. TPE is based on competitor prices for similar elements when sold separately. Generally, our go-to-market strategy differs from that of other competitive products or services in our markets and our offerings contain a significant level of differentiation such that the comparable pricing of products with similar functionality cannot be obtained. Furthermore, we are unable to reliably determine the selling prices on a stand-alone basis of similar products offered by our competitors.

When we are unable to establish the selling price of our non-software elements using VSOE or TPE, we use BESP in our allocation of arrangement consideration. The objective of BESP is to determine the price at which we would transact a sale if the product or service were sold on a stand-alone basis. We are generally not able to establish VSOE for non-software product sales. Under software revenue recognition guidance, these product sales were accounted for utilizing the residual method. With the adoption of the new revenue recognition guidance, we have been able to establish BESP for non-software product sales through the list price, less a discount deemed appropriate to maintain a reasonable gross margin. Management regularly reviews the gross margin information. Non-software product BESP is determined through our review of historical sales transactions within the past 12 month period. Additional factors considered in determining an appropriate BESP include, but are not limited to, cost of products, pricing practices, geographies, customer classes, and distribution channels.

We have established and regularly validate the VSOE of fair value and BESP for elements in our multiple element arrangements. We account for taxes collected from customers and remitted to governmental authorities on a net basis and excluded from revenues.

*Reserve for Doubtful Accounts.* Estimates are used in determining our allowance for doubtful accounts and are based upon an assessment of selected accounts and as a percentage of our remaining accounts receivable by aging category. In determining these percentages, we evaluate historical write-offs, current trends in the credit quality of our customer base, as well as changes in the credit policies. We perform ongoing credit evaluations of our customers' financial condition and do not require any collateral. If there is deterioration of a major customer's credit worthiness or actual defaults are higher than our historical experience, our allowance for doubtful accounts may not be sufficient.

*Reserve for Product Returns.* In some instances, product revenue from distributors is subject to agreements allowing rights of return. Product returns are estimated based on historical experience and are recorded at the time revenues are recognized. Accordingly, we reduce recognized revenue for estimated future returns at the time revenue is recorded. When rights of return are present and we cannot estimate returns, revenue is recognized when such rights lapse. The estimates for returns are adjusted periodically based upon changes in historical rates of returns and other related factors. It is possible that these estimates will change in the future or that the actual amounts could vary from our estimates.

*Accounting for Income Taxes.* We are required to estimate our income taxes in each of the jurisdictions in which we operate as part of the process of preparing our consolidated financial statements. This process involves estimating our actual current tax exposure, including assessing the risks associated with tax audits, together with assessing temporary differences resulting from the different treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities. Due to the evolving nature and complexity of tax rules combined with the large number of jurisdictions in which we operate, it is possible that our estimates of our tax liability could change in the future, which may result in additional tax liabilities and adversely affect our results of operations, financial condition and cash flows.

*Stock-Based Compensation.* We account for stock-based compensation using the straight-line attribution method for recognizing compensation expense over the requisite service period of the related award. We recognized \$89.7 million and \$70.8 million of stock-based compensation expense for the years ended September 30, 2011 and 2010, respectively. As of September 30, 2011, there was \$105.5 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.

We issue incentive awards to our employees through stock-based compensation consisting of restricted stock units (RSUs). The value of RSUs is determined using the fair value method, which in this case, is based on the number of shares granted and the quoted price of our common stock on the date of grant. No stock options were granted in fiscal years 2011, 2010 and 2009.

We recognize compensation expense for only the portion of RSUs that are expected to vest. Therefore, we apply estimated forfeiture rates that are derived from historical employee termination behavior. Based on historical differences with forfeitures of stock-based awards granted to our executive officers and Board of Directors versus grants awarded to all other employees, we developed separate forfeiture expectations for these two groups. In fiscal year 2011, the estimated forfeiture rate for grants awarded to our executive officers and Board of Directors was approximately 3% and the estimated forfeiture rate for grants awarded to all other employees was approximately 9%. 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.





## Table of Contents

We recognize compensation costs for awards with performance conditions when we conclude it is probable that the performance condition will be achieved. We reassess the probability of vesting at each balance sheet date and adjust compensation costs based on our probability assessment.

*Common stock repurchase.* On October 26, 2010, we announced that our Board of Directors approved a new program to repurchase up to an additional \$200 million of our outstanding common stock. Our Board of Directors authorized an additional \$200 million on August 15, 2011 and an additional \$200 million on October 25, 2011, for our common stock share repurchase program. These new authorizations are incremental to the existing \$200 million program, previously announced as authorized in October 2010. As of November 17, 2011, we had repurchased and retired 7,601,631 shares at an average price of \$58.21 per share.

*Goodwill and intangible assets.* We have goodwill and intangible assets on our balance sheet related to acquisitions. Intangible assets are carried and reported at acquisition cost, net of accumulated amortization subsequent to acquisition. Intangible assets are amortized over the estimated useful lives, which generally range from three to five years. Intangible assets are reviewed for impairment whenever events or circumstances indicate impairment might exist. Projected undiscounted net cash flows expected to be derived from the use of those assets are compared to the respective net carrying amounts to determine whether any impairment exists. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets.

The determination of the net carrying value of goodwill and intangible assets and the extent to which, if any, there is impairment are dependent on material estimates and judgments on our part, including the useful life over which the intangible assets are to be amortized, and the estimates of the value of future net cash flows, which are based upon further estimates of future revenues, expenses and operating margins. We review our goodwill annually for impairment in the second fiscal quarter, or whenever events or changes in circumstances indicate that the carrying amount of goodwill may not be recoverable. The first step of the test identifies whether potential impairment may have occurred, while the second step of the test measures the amount of the impairment, if any. Impairment is recognized when the carrying amount of goodwill exceeds its fair value. In March 2011, we completed our annual impairment test and concluded that there was no impairment of goodwill. We have considered the assumptions used in the test and noted that no reasonably possible changes would reduce the fair value of the reporting unit to such a level that would cause an impairment charge. Additionally, we considered potential impairment indicators at September 30, 2011 and noted no indicators of impairment.

*Investments.* Our investments are diversified among high-credit quality debt securities in accordance with our investment policy. We classify our investments as available-for-sale, which are reported at fair market value with the related unrealized gains and losses included in accumulated other comprehensive income or loss in stockholders' equity. Realized gains and losses and declines in value of these investments judged to be other than temporary are included in other income (expense). To date, we have not deemed it necessary to record any charges related to other-than-temporary declines in the estimated fair values of our marketable debt securities. However, the fair value of our investments is subject to volatility. Declines in the fair value of our investments judged to be other than temporary could adversely affect our future operating results.

Our investments also include auction rate securities (ARS) that are classified as available-for-sale. ARS are reported at fair market value with the related unrealized gains and losses included in accumulated other comprehensive income or loss in stockholders' equity. We believe these investments may remain illiquid for longer than twelve months and as a result, we have classified these investments as long-term as of September 30, 2011. We used the income approach to determine the fair value of our ARS using a discounted cash flow analysis. The assumptions we used in preparing the discounted cash flow model include estimates for interest rates; estimates for discount rates using yields of comparable traded instruments adjusted for illiquidity and other risk factors, amount of cash flows and expected holding periods for the ARS.

## **Results of Operations**

The following discussion and analysis should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K.

	<b>Years Ended September 30,</b>		
	<b>2011</b>	<b>2010</b>	<b>2009</b>
	<b>(In thousands, except for percentages)</b>		
<b>Net Revenues</b>			
Products	\$ 721,975	\$ 561,142	\$ 406,529
Services	429,859	320,830	246,550

Edgar Filing: F5 NETWORKS INC - Form 10-K

Total	\$ 1,151,834	\$ 881,972	\$ 653,079
<b>Percentage of net revenues</b>			
Products	62.7%	63.6%	62.2%
Services	37.3	36.4	37.8
Total	100.0%	100.0%	100.0%

**Table of Contents**

*Net Revenues.* Total net revenues increased 30.6% in fiscal year 2011 from fiscal year 2010, compared to an increase of 35.0% in fiscal year 2010 from the prior year. Overall revenue growth for the year ended September 30, 2011 was primarily due to increased service and product revenues as a result of our increased installed base of products and increased demand for our core ADN products, including application security and WAN optimization products. International revenues represented 41.2%, 41.4% and 44.7% of net revenues in fiscal years 2011, 2010 and 2009, respectively. 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 28.7% in fiscal year 2011 from fiscal year 2010, compared to an increase of 38.0% in fiscal year 2010 from the prior year. The increase of \$160.8 million in net product sales for fiscal year 2011 was primarily due to growth in the volume of product sales of our ADN products of \$157.6 million. In addition, net product revenue from our ARX file virtualization products increased \$3.2 million in fiscal year 2011. The increase of \$154.6 million in net product sales for fiscal year 2010 was primarily due to growth in the volume of product sales of our ADN products of \$152.2 million. In addition, net product revenue from our ARX file virtualization products increased \$2.3 million in fiscal year 2010. Sales of our ADN products represented 97.4%, 97.2% and 96.7% of total product revenues in fiscal years 2011, 2010 and 2009, respectively. We are now including our FirePass SSL VPN product as a component of ADN revenue.

Net service revenues increased 34.0% in fiscal year 2011 from fiscal year 2010, compared to an increase of 30.1% in fiscal year 2010 from the prior year. The increases in service revenue were the result of increased purchases or renewals of maintenance contracts driven by additions to our installed base of products.

Avnet Technology Solutions, one of our worldwide distributors, accounted for 18.1%, 14.5% and 15.4% of our total net revenues in fiscal years 2011, 2010 and 2009, respectively. Ingram Micro, Inc., another worldwide distributor, accounted for 10.7% of our total net revenues in fiscal year 2011. Tech Data, another worldwide distributor, accounted for 10.2% of our total net revenues in fiscal year 2010. Avnet Technology Solutions and Ingram Micro, Inc. accounted for 15.0% and 14.5% of our accounts receivable as of September 30, 2011, respectively. Avnet Technology Solutions, Tech Data and Ingram Micro, Inc. accounted for 13.2%, 11.8% and 13.2% of our accounts receivable as of September 30, 2010, respectively. Avnet Technology Solutions and Ingram Micro, Inc. accounted for 11.6% and 10.7% of our accounts receivable as of September 30, 2009, respectively. No other distributors accounted for more than 10% of total net revenue or receivables for fiscal years 2011, 2010 and 2009.

	Years Ended September 30,		
	2011	2010	2009
(In thousands, except for percentages)			
<b>Cost of net revenues and Gross margin</b>			
Products	\$ 129,325	\$ 113,834	\$ 95,209
Services	78,679	58,118	47,517
Total	208,004	171,952	142,726
Gross margin	\$ 943,830	\$ 710,020	\$ 510,353
<b>Cost of net revenues and Gross margin (as a percentage of related net revenue)</b>			
Products	17.9%	20.3%	23.4%
Services	18.3	18.1	19.3
Total	18.1	19.5	21.9
Gross margin	81.9%	80.5%	78.1%

*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. Cost of net product revenues increased 13.6% in fiscal year 2011 from the prior year, primarily due to a higher volume of units shipped along with an increase in warranty expense. Cost of net product revenues increased to \$113.8 million in fiscal year 2010 from \$95.2 million in fiscal year 2009. The year over year increase was primarily due to the higher volume of units shipped and an increase in warranty expense, partially offset by a decrease in expense related to obsolete inventory. Product cost as a percentage of related net revenue decreased to 20.3% in fiscal year 2010 from 23.4% in fiscal year 2009 primarily due to reduced manufacturing costs and decreased

indirect product 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. Cost of net service revenues as a percentage of net service revenues remained relatively consistent with the prior year at 18.3%. Cost of net service revenues as a percentage of net service revenues decreased to 18.1% in fiscal year 2010 from 19.3% in fiscal year 2009 primarily due to the scalability of our existing customer support infrastructure and increased revenue from maintenance contracts. Professional services headcount at the end of fiscal year 2011

**Table of Contents**

increased to 528 from 421 at the end of fiscal year 2010 and 330 at the end of fiscal year 2009. In addition, cost of net service revenues included stock-based compensation expense of \$7.8 million, \$6.0 million and \$4.8 million for fiscal years 2011, 2010 and 2009, respectively.

	Years Ended September 30,		
	2011	2010	2009
(In thousands, except for percentages)			
<b>Operating expenses</b>			
Sales and marketing	\$ 370,735	\$ 293,201	\$ 225,193
Research and development	138,910	118,314	103,664
General and administrative	83,523	68,503	55,243
Restructuring charges			4,329
<b>Total</b>	<b>\$ 593,168</b>	<b>\$ 480,018</b>	<b>\$ 388,429</b>
<b>Operating expenses (as a percentage of net revenue)</b>			
Sales and marketing	32.2%	33.2%	34.5%
Research and development	12.1	13.4	15.9
General and administrative	7.2	7.8	8.4
Restructuring charges			0.7
<b>Total</b>	<b>51.5%</b>	<b>54.4%</b>	<b>59.5%</b>

*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, travel, facilities, and depreciation expenses. Sales and marketing expense increased 26.4% in fiscal year 2011 as compared to a year over year increase of 30.2% in fiscal year 2010 and a year over year decrease of 5.1% in fiscal year 2009. The increase in sales and marketing expense for fiscal year 2011 was primarily due to an increase in commissions and personnel costs of \$45.4 million, compared to the prior year. The increased commissions and personnel costs were driven by growth in sales and marketing employee headcount and increased sales volume for fiscal year 2011 over the previous year. The increase in sales and marketing expense for fiscal year 2011 was also due to an increase of \$14.5 million in marketing promotions and initiatives aimed at promoting our brand and creating market awareness of our technology and our products. The increase in sales and marketing expense for fiscal year 2010 was primarily due to an increase in commissions and personnel costs of \$43.9 million as well as an increase of \$9.2 million in marketing promotions and initiatives aimed at promoting our brand and creating market awareness of our technology and our products. Sales and marketing headcount at the end of fiscal 2011 increased to 1,080 from 856 at the end of fiscal 2010 and 696 at the end of fiscal 2009. Sales and marketing expense included stock-based compensation charges of \$34.7 million, \$27.3 million and \$22.6 million for fiscal years 2011, 2010 and 2009, respectively.

*Research and Development.* Research and development expenses consist of the salaries and related benefits for our product development personnel, prototype materials and other expenses related to the development of new and improved products, facilities and depreciation expenses. Research and development expense increased 17.4% in fiscal year 2011, compared to the prior year. The increase in research and development expense for fiscal year 2011 was primarily due to increased personnel costs of \$14.0 million, which is consistent with the increase in revenue for the corresponding period. In addition, research and development expense included a year over year increase in computer equipment and software costs of \$1.5 million to support the development of new and improved products. In fiscal year 2010, research and development expense increased 14.1%, compared to the prior year. The increase in research and development expense for fiscal year 2010 was primarily due to increased personnel costs of \$7.1 million, which is consistent with the increase in revenue for the corresponding period. In addition, research and development expense included a year over year increase in computer equipment and software costs of \$3.8 million to support the development of new and improved products. Research and development headcount at the end of fiscal 2011 increased to 610 from 509 at the end of fiscal 2010 and 430 at the end of fiscal 2009. Research and development expense included stock-based compensation charges of \$23.3 million, \$19.4 million and \$16.7 million for fiscal years 2011, 2010 and 2009, respectively. We expect research and development expenses to remain consistent as a percentage of net revenue in the foreseeable future.

*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 expense increased 21.9% in fiscal year 2011, compared to the prior year. The increase in general and administrative expense for fiscal year 2011 was primarily due to an increase in personnel costs of \$5.3 million, compared to the prior year. In addition, fees paid to outside consultants for legal, accounting and information technology services increased \$4.2 million for fiscal year 2011

## Edgar Filing: F5 NETWORKS INC - Form 10-K

compared to the prior year. In fiscal year 2010, general and administrative expense increased 24.0%, compared to the prior year. The increase in general and administrative expense was primarily due to an increase of \$4.1 million in personnel costs for the year ended September 30, 2010, compared to the prior year. General and

**Table of Contents**

administrative headcount at the end of fiscal 2011 increased to 270 from 226 at the end of fiscal 2010 and 190 at the end of fiscal 2009. General and administrative expense included stock-based compensation charges of \$22.4 million, \$17.0 million and \$11.6 million for fiscal years 2011, 2010 and 2009, respectively.

*Restructuring.* Beginning in the second quarter of fiscal 2009 we implemented a comprehensive restructuring program as part of an overall initiative to reduce certain operating expenses. Restructuring actions included the consolidation of facilities, accelerated depreciation on tenant improvements and a reduction in workforce. In the second quarter of fiscal 2009, we recorded restructuring expenses of \$4.3 million, which included a \$2.1 million charge for severance and related costs and a \$2.2 million charge for the exit of certain offices worldwide. All accrued restructuring costs had been incurred as of September 30, 2011.

	Years Ended September 30,		
	2011	2010	2009
(In thousands, except for percentages)			
<b>Other Income and Income Taxes</b>			
Income from operations	\$ 350,662	\$ 230,002	\$ 121,924
Other income, net	10,089	7,625	9,724
Income before income taxes	360,751	237,627	131,648
Provision for income taxes	119,354	86,474	40,113
Net income	\$ 241,397	\$ 151,153	\$ 91,535
<b>Other Income and Income Taxes (as percentage of net revenue)</b>			
Income from operations	30.4%	26.1%	18.7%
Other income, net	0.9	0.8	1.5
Income before income taxes	31.3	26.9	20.2
Provision for income taxes	10.4	9.8	6.2
Net income	20.9%	17.1%	14.0%

*Other Income, Net.* Other income, net, consists primarily of interest income and foreign currency transaction gains and losses. Other income, net increased 32.3% in fiscal year 2011, as compared to fiscal year 2010 and decreased 21.6% in fiscal year 2010 as compared to fiscal year 2009. Interest income was \$8.1 million, \$8.1 million and \$9.9 million for fiscal years 2011, 2010 and 2009, respectively. The increase in other income, net for fiscal year 2011 as compared to fiscal year 2010 was primarily due to a one-time charge of \$1.5 million related to a legal settlement in fiscal year 2010 that was not incurred in fiscal year 2011. In addition, foreign currency transaction gains increased \$1.0 million, compared to the prior year. The decrease in other income, net for fiscal year 2010 as compared to fiscal year 2009 was primarily due to decreased interest income of \$1.8 million, partially offset by increased foreign currency transaction gains of \$1.0 million. The decrease in interest income for fiscal year 2010 was primarily due to a decline in interest rates for the year.

*Provision for Income Taxes.* We recorded a 33.1% provision for income taxes for fiscal year 2011 compared to 36.4% in fiscal year 2010 and 30.5% in fiscal year 2009. The decrease in the effective tax rate from fiscal year 2010 to fiscal year 2011 was primarily due to an increased benefit resulting from the United States Domestic Production Activities Deduction, the reinstatement of the federal research and development credit on December 17, 2010 and a change in our uncertain tax positions as a result of the settlement of audits and expiration of statutes of limitation in various jurisdictions.

At September 30, 2011, we did 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 the 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 as of fiscal year end 2011, 2010 and 2009 were \$43.2 million, \$46.6 million and \$57.0 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, and the 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



## Edgar Filing: F5 NETWORKS INC - Form 10-K

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**

We have funded our operations with our cash balances, cash generated from operations and proceeds from public offerings of our securities.

**Table of Contents**

	Years Ended September 30,		
	2011	2010	2009
	(In thousands)		
<b>Liquidity and Capital Resources</b>			
Cash and cash equivalents and investments	\$ 1,012,753	\$ 862,066	\$ 574,422
Cash provided by operating activities	416,938	313,612	201,981
Cash used in investing activities	(139,719)	(238,223)	(99,109)
Cash used in financing activities	(226,664)	(16,798)	(70,706)

Cash and cash equivalents, short-term investments and long-term investments totaled \$1,012.8 million as of September 30, 2011 compared to \$862.1 million as of September 30, 2010, representing an increase of \$150.7 million. The increase was primarily due to cash provided by operating activities of \$416.9 million for fiscal year 2011, compared to \$313.6 million for fiscal year 2010, which was partially offset by \$271.5 million of additional cash required for the repurchase of outstanding common stock under our share repurchase program in fiscal 2011. In fiscal year 2010, the increase was primarily due to cash provided by operating activities of \$313.6 million, compared to \$202.0 million for fiscal year 2009, which was partially offset by \$75.0 million of additional cash required for the repurchase of outstanding common stock under our share repurchase program in fiscal 2010.

At September 30, 2011, we held \$13.0 million in fair value of tax-exempt ARS, which are variable-rate debt securities and have a long-term maturity with the interest rates being reset through Dutch auctions that are typically held every 7, 28 or 35 days. The securities have historically traded at par and are callable at par at the option of the issuer. Interest is typically paid at the end of each auction period or semi-annually. We limit our investments in ARS to securities that carry a AAA/A- (or equivalent) rating from recognized rating agencies and limit the amount of credit exposure to any one issuer. At the time of initial investment and at the date of this Annual Report on Form 10-K, all of our ARS were in compliance with our investment policy.

Beginning in February 2008, auctions failed for approximately \$53.4 million in par value of municipal ARS we held because sell orders exceeded buy orders. When these auctions failed to clear, higher interest rates for those securities went into effect. However, the funds associated with these failed auctions will not be accessible until the issuer calls the security, a successful auction occurs, a buyer is found outside of the auction process or the security matures.

We have no reason to believe that any of the underlying issuers of our ARS are presently at risk of default. The underlying assets of the municipal ARS we hold, including the securities for which auctions have failed, are generally student loans that are guaranteed by the U.S. government. During fiscal years 2011 and 2010, we liquidated \$4.0 million and \$26.1 million of ARS that we held at par value, respectively. Through September 30, 2011, we have continued to receive interest payments on the ARS in accordance with their terms. We believe we will be able to liquidate our investments without significant loss primarily due to the government guarantee of the underlying securities. However, due to uncertainty in the ARS market, we believe certain of these available-for-sale investments may remain illiquid for longer than twelve months and as a result, we have classified \$15.0 million (par value) of our ARS as long-term as of September 30, 2011.

Cash provided by operating activities during fiscal year 2011 was \$416.9 million compared to \$313.6 million in fiscal year 2010 and \$202.0 million in fiscal year 2009. Cash provided by operating activities resulted primarily from cash generated from net income, after adjusting for non-cash charges such as stock-based compensation, depreciation and amortization charges and changes in operating assets and liabilities.

Cash used in investing activities during fiscal year 2011 was \$139.7 million compared to cash used in investing activities of \$238.2 million in fiscal year 2010 and cash used in investing activities of \$99.1 million in fiscal year 2009. Cash used in investing activities for fiscal year 2011 was primarily the result of the purchase of investments and capital expenditures related to maintaining our operations worldwide partially offset by the sale and maturity of investments. Cash used in investing activities for fiscal year 2010 was primarily the result of the purchase of investments and capital expenditures related to maintaining our operations worldwide partially offset by the sale and maturity of investments. Cash used in investing activities for fiscal year 2009 was primarily the result of the purchase of investments and capital expenditures related to maintaining our operations worldwide partially offset by the sale and maturity of investments.

Cash used in financing activities was \$226.7 million for fiscal year 2011, compared to cash used in financing activities of \$16.8 million for fiscal year 2010 and cash used in financing activities of \$70.7 million for fiscal year 2009. Cash used in financing activities for fiscal year 2011 included \$271.5 million to repurchase common stock under our share repurchase program, which was partially offset by cash received from the exercise of employee stock options and stock purchases under our employee stock purchase plan of \$21.2 million and excess tax benefits related to share-based compensation of \$23.6 million. Cash used in financing activities for fiscal 2010 included \$75.0 million to repurchase common stock under our share repurchase program, which was partially offset by



**Table of Contents**

cash received from the exercise of employee stock options and stock purchases under our employee stock purchase plan of \$31.7 million and excess tax benefits related to share-based compensation of \$26.5 million. Cash used in financing activities for fiscal 2009 included \$87.4 million to repurchase common stock under our share repurchase program, which was partially offset by the exercise of employee stock options and purchases under our employee stock purchase plan.

Based on our current operating and capital expenditure forecasts, we believe that our existing cash and investment balances, excluding ARS, together with cash generated from operations should be sufficient to meet our operating requirements for the next twelve months. Our future capital requirements will depend on many factors, including our rate of revenue growth, the expansion of our sales and marketing activities, the timing and extent of expansion into new territories, the timing of introductions of new products and enhancements of existing products, and the continuing market acceptance of our products.

**Obligations and Commitments**

The following table summarizes our contractual payment obligations and commitments as of September 30, 2011:

	2012	2013	Payment Obligations by Year			Thereafter	Total
			2014	2015	2016		
				(In thousands)			
Operating leases	\$ 42,317	\$ 17,673	\$ 16,185	\$ 15,786	\$ 15,072	\$ 65,370	\$ 172,403
Purchase obligations	13,572						13,572
<b>Total</b>	<b>\$ 55,889</b>	<b>\$ 17,673</b>	<b>\$ 16,185</b>	<b>\$ 15,786</b>	<b>\$ 15,072</b>	<b>\$ 65,370</b>	<b>\$ 185,975</b>

We lease our facilities under operating leases that expire at various dates through 2022.

We adopted the provisions of FASB Interpretation No. 48, *Accounting for Income Taxes* on October 1, 2007. As of September 30, 2011, we had approximately \$6.0 million of tax liabilities, including interest and penalties, related to uncertain tax positions (See Note 5 to our Consolidated Financial Statements). Because of the high degree of uncertainty regarding the settlement of these liabilities, we are unable to estimate the years in which future cash outflows may occur.

Purchase obligations are comprised of purchase commitments with our contract manufacturers. The agreement with our primary contract manufacturer allows it to procure component inventory on our behalf based on our production forecast. We are obligated to purchase component inventory that the contract manufacturer procures in accordance with the forecast, unless cancellation is given within applicable lead times.

**Recent Accounting Pronouncements**

In May 2011, the FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS* (ASU 2011-04), which amends current fair value measurement and disclosure guidance to converge with International Financial Reporting Standards (IFRS) and provides increased transparency around valuation inputs and investment categorization. The amendments in this standard are effective for fiscal years, and interim periods within those years beginning after December 15, 2011. We will adopt ASU 2011-04 in the first quarter of fiscal 2013 and do not expect the adoption of this standard to have an impact on our consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income, Presentation of Comprehensive Income* (ASU 2011-05), which eliminates the option of presenting other comprehensive income as part of the statement of changes in stockholders' equity and instead requires the entity to present other comprehensive income as either a single statement of comprehensive income combined with net income or as two separate but continuous statements. The amendments in this standard are to be applied retrospectively and are effective for fiscal years, and interim periods within those years beginning after December 15, 2011. We will adopt ASU 2011-05 in the first quarter of fiscal 2013 and do not expect the adoption of this standard to have an impact on our consolidated financial statements.

In September 2011, the FASB issued ASU 2011-08, *Intangibles - Goodwill and Other, Testing Goodwill for Impairment* (ASU 2011-08), which simplifies how an entity tests goodwill for impairment by allowing the entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If an entity determines, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required.

## Edgar Filing: F5 NETWORKS INC - Form 10-K

Otherwise, no further testing is required. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. We are likely to early adopt this standard for the goodwill impairment test to be performed in fiscal 2012. This standard will impact how we assess goodwill for impairment but will not change the measurement or recognition of a potential goodwill impairment charge.

**Table of Contents****Item 7A. Quantitative and Qualitative Disclosure About Market Risk**

*Interest Rate Risk.* Our cash equivalents consist of high-quality securities, as specified in our investment policy guidelines. The policy limits the amount of credit exposure to any one issue or issuer to a maximum of 5% of the total portfolio with the exception of U.S. treasury and agency securities, commercial paper and money market funds, which are exempt from size limitation. The policy requires investments in securities that mature in three years or less, with the average maturity being no greater than one and a half years. These securities are subject to interest rate risk and will decrease in value if interest rates increase. A decrease of one percent in the average interest rate would have resulted in a decrease of approximately \$7.9 million in our interest income for the fiscal year 2011.

	Three Months or Less	Three Months to One Year	Maturing in Greater Than One Year	Total	Fair Value
(In thousands, except for percentages)					
<b>September 30, 2011</b>					
Included in cash and cash equivalents	\$ 33,740	\$	\$	\$ 33,740	\$ 33,740
Weighted average interest rate	0.1%				
Included in short-term investments	\$ 133,713	\$ 192,053	\$	\$ 325,766	\$ 325,766
Weighted average interest rates	0.9%	0.9%			
Included in long-term investments	\$	\$	\$ 470,203	\$ 470,203	\$ 470,203
Weighted average interest rates			0.9%		
<b>September 30, 2010</b>					
Included in cash and cash equivalents	\$ 26,987	\$	\$	\$ 26,987	\$ 26,987
Weighted average interest rate	0.1%				
Included in short-term investments	\$ 43,970	\$ 215,772	\$	\$ 259,742	\$ 259,742
Weighted average interest rates	1.4%	1.6%			
Included in long-term investments	\$	\$	\$ 433,570	\$ 433,570	\$ 433,570
Weighted average interest rates			1.4%		
<b>September 30, 2009</b>					
Included in cash and cash equivalents	\$ 19,790	\$	\$	\$ 19,790	\$ 19,790
Weighted average interest rate	1.0%				
Included in short-term investments	\$ 59,981	\$ 146,310	\$	\$ 206,291	\$ 206,291
Weighted average interest rates	3.1%	3.0%			
Included in long-term investments	\$	\$	\$ 257,294	\$ 257,294	\$ 257,294
Weighted average interest rates			2.8%		

At September 30, 2011, the fair value of our AAA/A- (or equivalent) rated municipal ARS was approximately \$13.0 million. ARS are collateralized long-term debt instruments that provide liquidity through a Dutch auction process that resets the applicable interest rate at pre-determined intervals, typically every 7, 28 or 35 days. Beginning in February 2008, auctions failed for approximately \$53.4 million in par value of municipal ARS we held because sell orders exceeded buy orders. When these auctions failed to clear, higher interest rates for those securities went into effect. However, the funds associated with these failed auctions will not be accessible until the issuer calls the security, a successful auction occurs, a buyer is found outside of the auction process, or the security matures. The underlying assets of the municipal ARS we hold, including the securities for which auctions have failed, are generally student loans that are guaranteed by the U.S. government. Based on our expected operating cash flows and our other sources of cash, we do not believe that any reduction in liquidity of our municipal ARS will have a material impact on our overall ability to meet our liquidity needs. We have no intent to sell, won't be required to sell, and believe we will hold these securities until recovery. We believe certain of these available-for-sale investments may remain illiquid for longer than twelve months and as a result, we have classified \$15.0 million (par value) of securities as long-term as of September 30, 2011.

*Foreign Currency Risk.* The majority of our sales and expenses are denominated in U.S. dollars and as a result, we have not experienced significant foreign currency transaction gains and losses to date. While we have conducted some transactions in foreign currencies during the fiscal year ended September 30, 2011 and expect to continue to do so, we do not anticipate that foreign currency transaction gains or losses will be significant at our current level of operations. However, as we continue to expand our operations internationally, transaction gains or losses may become significant in the future. We have not engaged in foreign currency hedging to date. However, we may do so in the future.

**Table of Contents**

**Item 8. *Financial Statements and Supplementary Data***

**F5 NETWORKS, INC.**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

	<b>Page</b>
<b>Consolidated Financial Statements</b>	
<u>Report of Independent Registered Public Accounting Firm</u>	38
<u>Consolidated Balance Sheets</u>	39
<u>Consolidated Income Statements</u>	40
<u>Consolidated Statements of Shareholders' Equity and Comprehensive Income</u>	41
<u>Consolidated Statements of Cash Flows</u>	42
<u>Notes to Consolidated Financial Statements</u>	43

---

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders

of F5 Networks, Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of F5 Networks, Inc. and its subsidiaries at September 30, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2011 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company’s management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company’s internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

**PricewaterhouseCoopers LLP**

Seattle, WA

November 22, 2011



**Table of Contents****F5 NETWORKS, INC.****CONSOLIDATED BALANCE SHEETS**

	September 30, 2011      2010 (In thousands)	
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 216,784	\$ 168,754
Short-term investments	325,766	259,742
Accounts receivable, net of allowances of \$2,898 and \$4,319	165,676	112,132
Inventories	17,149	18,815
Deferred tax assets	8,391	8,767
Other current assets	29,907	37,745
<b>Total current assets</b>	<b>763,673</b>	<b>605,955</b>
Property and equipment, net	47,998	34,157
Long-term investments	470,203	433,570
Deferred tax assets	34,762	37,864
Goodwill	234,691	234,700
Other assets, net	17,222	15,946
<b>Total assets</b>	<b>\$ 1,568,549</b>	<b>\$ 1,362,192</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable	\$ 33,525	\$ 21,180
Accrued liabilities	67,902	61,768
Deferred revenue	270,880	204,137
<b>Total current liabilities</b>	<b>372,307</b>	<b>287,085</b>
Other long-term liabilities	18,388	16,153
Deferred revenue, long-term	72,418	55,256
<b>Total long-term liabilities</b>	<b>90,806</b>	<b>71,409</b>
Commitments and contingencies (Note 7)		
Shareholders' equity		
Preferred stock, no par value; 10,000 shares authorized, no shares outstanding		
Common stock, no par value; 200,000 shares authorized, 79,145 and 80,355 shares issued and outstanding	380,737	517,215
Accumulated other comprehensive loss	(6,422)	(3,241)
Retained earnings	731,121	489,724
<b>Total shareholders' equity</b>	<b>1,105,436</b>	<b>1,003,698</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,568,549</b>	<b>\$ 1,362,192</b>

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



**Table of Contents****F5 NETWORKS, INC.****CONSOLIDATED INCOME STATEMENTS**

	Years Ended September 30,		
	2011	2010	2009
	(In thousands, except per share data)		
Net revenues			
Products	\$ 721,975	\$ 561,142	\$ 406,529
Services	429,859	320,830	246,550
Total	1,151,834	881,972	653,079
Cost of net revenues			
Products	129,325	113,834	95,209
Services	78,679	58,118	47,517
Total	208,004	171,952	142,726
Gross profit	943,830	710,020	510,353
Operating expenses			
Sales and marketing	370,735	293,201	225,193
Research and development	138,910	118,314	103,664
General and administrative	83,523	68,503	55,243
Restructuring charges			4,329
Total	593,168	480,018	388,429
Income from operations	350,662	230,002	121,924
Other income, net	10,089	7,625	9,724
Income before income taxes	360,751	237,627	131,648
Provision for income taxes	119,354	86,474	40,113
Net income	\$ 241,397	\$ 151,153	\$ 91,535
Net income per share basic	\$ 2.99	\$ 1.90	\$ 1.16
Weighted average shares basic	80,658	79,609	78,842
Net income per share diluted	\$ 2.96	\$ 1.86	\$ 1.14
Weighted average shares diluted	81,482	81,049	80,073

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

Table of Contents

## F5 NETWORKS, INC.

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY AND  
COMPREHENSIVE INCOME**

	Common Stock		Accumulated Other Comprehensive Income/(Loss) (In thousands)	Retained Earnings	Total Shareholders Equity
	Shares	Amount			
<b>Balance, September 30, 2008</b>	79,094	\$ 477,299	\$ (6,076)	\$ 247,036	\$ 718,259
Exercise of employee stock options	498	7,243			7,243
Issuance of stock under employee stock purchase plan	561	11,574			11,574
Issuance of restricted stock	1,516				
Repurchase of common stock	(3,344)	(87,436)			(87,436)
Tax loss from employee stock transactions		(1,958)			(1,958)
Stock-based compensation		56,064			56,064
Net income				91,535	
Foreign currency translation adjustment			387		
Unrealized gain on securities, net of tax			3,352		
Comprehensive income					95,274
<b>Balance, September 30, 2009</b>	78,325	\$ 462,786	\$ (2,337)	\$ 338,571	\$ 799,020
Exercise of employee stock options	911	17,618			17,618
Issuance of stock under employee stock purchase plan	458	13,936			13,936
Issuance of restricted stock	1,849				
Repurchase of common stock	(1,188)	(75,000)			(75,000)
Tax benefit from employee stock transactions		27,102			27,102
Stock-based compensation		70,773			70,773
Net income				151,153	
Foreign currency translation adjustment			(771)		
Unrealized loss on securities, net of tax			(133)		
Comprehensive income					150,249
<b>Balance, September 30, 2010</b>	80,355	\$ 517,215	\$ (3,241)	\$ 489,724	\$ 1,003,698
Exercise of employee stock options	150	2,293			2,293
Issuance of stock under employee stock purchase plan	257	18,932			18,932
Issuance of restricted stock	1,370				
Repurchase of common stock	(2,987)	(271,526)			(271,526)
Tax benefit from employee stock transactions		24,076			24,076
Stock-based compensation		89,747			89,747
Net income				241,397	
Foreign currency translation adjustment			(2,366)		
Unrealized loss on securities, net of tax			(815)		
Comprehensive income					238,216
<b>Balance, September 30, 2011</b>	79,145	\$ 380,737	\$ (6,422)	\$ 731,121	\$ 1,105,436

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



**Table of Contents****F5 NETWORKS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Years Ended September 30,		
	2011	2010	2009
	(In thousands)		
<b>Operating activities</b>			
Net income	\$ 241,397	\$ 151,153	\$ 91,535
Adjustments to reconcile net income to net cash provided by operating activities:			
Realized gain on disposition of assets and investments	(163)	(125)	(9)
Stock-based compensation	89,747	70,773	56,064
Provisions for doubtful accounts and sales returns	982	1,206	2,638
Depreciation and amortization	20,887	23,833	26,407
Deferred income taxes	4,487	8,243	(6,057)
Gain on auction rate securities put option		(1,491)	(3,901)
Loss on trading auction rate securities		1,491	3,901
Changes in operating assets and liabilities, net of amounts acquired:			
Accounts receivable	(54,526)	(6,365)	(12,555)
Inventories	1,666	(4,996)	(3,671)
Other current assets	8,000	(17,064)	(523)
Other assets	81	(1,466)	(226)
Accounts payable and accrued liabilities	20,476	12,157	10,248
Deferred revenue	83,904	76,263	38,130
Net cash provided by operating activities	416,938	313,612	201,981
<b>Investing activities</b>			
Purchases of investments	(979,597)	(877,003)	(414,857)
Maturities of investments	812,042	603,825	315,110
Sales of investments	63,977	45,050	13,000
Decrease in restricted cash	19	2,530	13
Acquisition of intangible assets	(5,715)		(706)
Purchases of property and equipment	(30,445)	(12,625)	(11,669)
Net cash used in investing activities	(139,719)	(238,223)	(99,109)
<b>Financing activities</b>			
Excess tax benefit (loss) from stock-based compensation	23,623	26,532	(1,958)
Proceeds from the exercise of stock options and purchases of stock under employee stock purchase plan	21,239	31,670	18,688
Repurchase of common stock	(271,526)	(75,000)	(87,436)
Net cash used in financing activities	(226,664)	(16,798)	(70,706)
Net increase in cash and cash equivalents	50,555	58,591	32,166
Effect of exchange rate changes on cash and cash equivalents	(2,525)	(674)	368
Cash and cash equivalents, beginning of year	168,754	110,837	78,303
Cash and cash equivalents, end of year	\$ 216,784	\$ 168,754	\$ 110,837
<b>Supplemental Information</b>			
Cash paid for taxes	\$ 84,753	\$ 67,120	\$ 48,586

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



**Table of Contents**

**F5 NETWORKS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Summary of Significant Accounting Policies**

***The Company***

F5 Networks, Inc. (the Company) provides products and services to help companies manage their Internet Protocol (IP) traffic and file storage infrastructure efficiently and securely. The Company's application delivery networking products improve the performance, availability and security of applications on Internet-based networks. Internet traffic between network-based applications and clients passes through these devices 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's storage virtualization products simplify and reduce the cost of managing files and file storage devices, and ensure fast, secure, easy access to files for users and applications. The Company also offers a broad range of services that include consulting, training, maintenance and other technical support services.

***Accounting Principles***

The Company's consolidated financial statements and accompanying notes are prepared on the accrual basis of accounting in accordance with generally accepted accounting principles in the United States of America (GAAP).

***Principles of Consolidation***

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

***Reclassifications***

Certain reclassifications have been made to prior year balances to conform to the current period presentation. Such reclassifications did not affect total revenues, operating income or net income.

***Use of Estimates***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Estimates are used in accounting for revenue recognition, reserves for doubtful accounts, product returns, obsolete and excess inventory and valuation allowances on deferred tax assets. Actual results could differ from those estimates.

***Cash and Cash Equivalents***

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. The Company invests its cash and cash equivalents in deposits with four major financial institutions, which, at times, exceed federally insured limits. The Company has not experienced any losses on its cash and cash equivalents.

***Investments***

The Company classifies its investment securities as available-for-sale. Investment securities, consisting of corporate and municipal bonds and notes and United States government and agency securities, are reported at fair value with the related unrealized gains and losses included as a component of accumulated other comprehensive income (loss) in shareholders' equity. Realized gains and losses and declines in value of securities judged to be other than temporary are included in other income (expense). The cost of investments for purposes of computing realized and unrealized gains and losses is based on the specific identification method. Investments in securities with maturities of less than one year or where management's intent is to use the investments to fund current operations are classified as short-term investments. Investments with maturities of greater than one year, as well as certain auction rate securities (ARS) that the Company believes it will not be able to liquidate in the next twelve months, are classified as long-term investments.





## **Table of Contents**

The Company has ARS that are classified as available-for-sale securities and are reported as long-term. The Company has no intent to sell, won't be required to sell, and believes it will hold these securities until recovery. The Company uses the income approach to estimate the fair value of ARS. The assumptions the Company used in preparing the discounted cash flow model include estimates for interest rates; estimates for discount rates using yields of comparable traded instruments adjusted for illiquidity and other risk factors, amount of anticipated future cash flows and expected holding periods for the ARS.

### ***Concentration of Credit Risk***

The Company extends credit to customers and is therefore subject to credit risk. The Company performs initial and ongoing credit evaluations of its customers' financial condition and does not require collateral. An allowance for doubtful accounts is recorded to account for potential bad debts. Estimates are used in determining the allowance for doubtful accounts and are based upon an assessment of selected accounts and as a percentage of remaining accounts receivable by aging category. In determining these percentages, the Company evaluates historical write-offs, and current trends in customer credit quality, as well as changes in credit policies. At September 30, 2011, Avnet Technology Solutions and Ingram Micro, Inc. accounted for 15.0% and 14.5% of the Company's accounts receivable, respectively. At September 30, 2010, Avnet Technology Solutions, Ingram Micro, Inc. and Tech Data accounted for 13.2%, 13.2% and 11.8% of the Company's accounts receivable, respectively.

The Company maintains its cash and investment balances with high credit quality financial institutions. Included within the Company's investment portfolio are investments in ARS. The Company's ARS investments are currently not liquid as a result of continued auction failures. If the issuers are not able to meet their payment obligations or if the Company sells its ARS investments before they recover, the Company may lose some or all of its principal invested or may be required to further reduce the carrying value.

### ***Fair Value of Financial Instruments***

Short-term and long-term investments are recorded at fair value as the underlying securities are classified as available-for-sale with any unrealized gain or loss being recorded to other comprehensive income. The fair value for securities held is determined using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency with the exception of ARS, which fair market value is estimated using a discounted cash flow model.

### ***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):

	<b>Years Ended</b>	
	<b>September 30,</b>	
	<b>2011</b>	<b>2010</b>
Finished goods	\$ 12,917	\$ 14,949
Raw materials	4,232	3,866
	<b>\$ 17,149</b>	<b>\$ 18,815</b>

### ***Property and Equipment***

Property and equipment is stated at cost. Depreciation of property and equipment are provided using the straight-line method over the estimated useful lives of the assets, ranging from two to five years. Leasehold improvements are amortized over the lesser of the lease term or the estimated useful life of the improvements. The cost of normal maintenance and repairs is charged to expense as incurred and expenditures for major improvements are capitalized at cost. Gains or losses on the disposition of assets are reflected in the income statements at the time of

disposal.

Property and equipment consist of the following (in thousands):

**Table of Contents**

	Years Ended September 30,	
	2011	2010
Computer equipment	\$ 77,899	\$ 59,557
Office furniture and equipment	11,243	9,793
Leasehold improvements	41,344	36,462
	130,486	105,812
Accumulated depreciation and amortization	(82,488)	(71,655)
	\$ 47,998	\$ 34,157

Depreciation and amortization expense totaled approximately \$16.6 million, \$17.8 million, and \$18.4 million for the fiscal years ended September 30, 2011, 2010 and 2009, respectively.

**Goodwill**

Goodwill represents the excess purchase price over the estimated fair value of net assets acquired as of the acquisition date. The Company tests goodwill for impairment on an annual basis and between annual tests when impairment indicators are identified, and goodwill is written down when impaired. Goodwill was recorded in connection with the acquisition of Acopia Networks, Inc. in fiscal year 2007, Swan Labs, Inc. in fiscal year 2006, MagniFire Websystems, Inc. in fiscal year 2004 and uRoam, Inc. in fiscal year 2003.

The Company performs its annual goodwill impairment test during the second fiscal quarter, or whenever events or changes in circumstances indicate that the carrying amount of goodwill may not be recoverable. The first step of the test identifies whether potential impairment may have occurred, while the second step of the test measures the amount of the impairment, if any. Impairment is recognized when the carrying amount of goodwill exceeds its fair value. For its annual goodwill impairment analysis, the Company operates under one reporting unit. The Company determined the fair value of its reporting unit based on the Company's enterprise value. In March 2011, the Company completed its annual impairment test and concluded there was no impairment of goodwill. The Company also considered potential impairment indicators at September 30, 2011 and noted no indicators of impairment.

**Other Assets**

Other assets primarily consist of software development costs, acquired and developed technology and customer relationships.

Software development costs are charged to research and development expense in the period incurred until technological feasibility is established. Thereafter, until the product is released for sale, software development costs are capitalized and reported at the lower of unamortized cost or net realizable value of each product. Capitalized software development costs are amortized over the remaining estimated economic life of the product. The establishment of technological feasibility and the ongoing assessment of recoverability of costs require considerable judgment by the Company with respect to certain internal and external factors, including, but not limited to, anticipated future gross product revenues, estimated economic life and changes in hardware and software technology. The Company did not capitalize any software development costs in fiscal years 2011, 2010 and 2009. Amortization expense related to capitalized software development was immaterial for fiscal years 2011, 2010, and 2009.

Acquired and developed technology and customer relationship assets are recorded at cost and amortized over their estimated useful lives of five years. The estimated useful life of these assets is assessed and evaluated for reasonableness periodically. Acquired technology of \$15.0 million in fiscal 2007 and \$8.0 million in fiscal 2006 was recorded in connection with the acquisitions of Acopia and Swan Labs, respectively. Amortization expense related to acquired technology, which is charged to cost of product revenues, totaled \$3.1 million, \$4.6 million and \$5.3 million during the fiscal years 2011, 2010 and 2009, respectively.

Amortization expense of all other intangible assets, including customer relationships, patents and trademarks was not material during the fiscal years 2011, 2010 and 2009.

**Impairment of Long-Lived Assets**

## Edgar Filing: F5 NETWORKS INC - Form 10-K

The Company assesses the impairment of long-lived assets whenever events or changes in business circumstances indicate that the carrying amount of an asset may not be recoverable. When such events occur, management determines whether there has been impairment by comparing the anticipated undiscounted net future cash flows to the related asset's carrying value. If impairment exists, the asset is written down to its estimated fair value. No impairment of long-lived assets was noted as of and for the year ended September 30, 2011.

---

**Table of Contents**

***Revenue Recognition***

The Company sells products through distributors, resellers, and directly to end users. Revenue is recognized provided that all of the following criteria have been met:

Persuasive evidence of an arrangement exists. Evidence of an arrangement generally consists of a purchase order issued pursuant to the terms and conditions of a distributor, reseller or end user agreement.

Delivery has occurred. The Company uses shipping or related documents, or written evidence of customer acceptance, when applicable, to verify delivery or completion of any performance terms.

The sales price is fixed or determinable. The Company assesses whether the sales price is fixed or determinable based on payment terms associated with the transaction and whether the sales price is subject to refund or adjustment.

Collectability is reasonably assured. The Company assesses collectability primarily based on the creditworthiness of the customer as determined by credit checks and related analysis, as well as the Customer's payment history.

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 product has been sold to the end-user customer. Payment terms to domestic customers are generally net 30 days to net 45 days. Payment terms to international customers range from net 30 days to net 120 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 product, training services 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. Revenue from the sale of products is recognized when the product has been shipped and the customer is obligated to pay for the product. 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, repair or replacement of any failed product or component that fails during the term of the agreement, bug fixes and rights to upgrades, when and if available. Consulting services are customarily billed at fixed hourly 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.

In October 2009, the Financial Accounting Standards Board (FASB) amended the accounting standards for revenue recognition to remove from the scope of industry-specific software revenue recognition guidance any tangible products containing software components and non-software components that operate together to deliver the products essential functionality. In addition, the FASB amended the accounting standards for certain multiple element revenue arrangements to:

Provide updated guidance on whether multiple elements exist, how the elements in an arrangement should be separated, and how the arrangement consideration should be allocated to the separate elements;

Require an entity to allocate arrangement consideration to each element based on a selling price hierarchy, where the selling price for an element is based on vendor-specific objective evidence (VSOE), if available, third-party evidence (TPE), if available and VSOE is not available; or the best estimate of selling price (BESP), if neither VSOE or TPE is available; and

Eliminate the use of the residual method and require an entity to allocate arrangement consideration using the selling price hierarchy.

## Edgar Filing: F5 NETWORKS INC - Form 10-K

The Company adopted this guidance in the first quarter of fiscal year 2011 on a prospective basis for applicable arrangements originating or materially modified after October 1, 2010. The impact of this adoption was not material to the Company's financial position and results of operations for the fiscal year ended September 30, 2011.

## **Table of Contents**

The majority of the Company's products are hardware appliances which contain software essential to the overall functionality of the products. Accordingly, the Company no longer recognizes revenue on sales of these products in accordance with the industry-specific software revenue recognition guidance.

For all transactions entered into prior to the first quarter of fiscal year 2011 and for sales of nonessential and stand-alone software after October 1, 2010, the Company allocates revenue for arrangements with multiple elements based on the software revenue recognition guidance. Software revenue recognition guidance requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair values of those elements. The fair value of an element must be based on VSOE. Where fair value of certain elements is not available, revenue is recognized on the residual method based on the fair value of undelivered elements. If evidence of the fair value of one or more undelivered elements does not exist, all revenue is deferred and recognized at the earlier of the delivery of those elements or the establishment of fair value of the remaining undelivered elements.

For transactions entered into subsequent to the adoption of the amended revenue recognition standards that are multiple-element arrangements, the arrangement consideration is allocated to each element based on the relative selling prices of all of the elements in the arrangement using the fair value hierarchy in the amended revenue recognition guidance.

Consistent with the methodology used under the previous accounting guidance, the Company establishes VSOE for its products, training services, PCS and consulting services based on the sales price charged for each element when sold separately. The sales price is discounted from the applicable list price based on various factors including the type of customer, volume of sales, geographic region and program level. The Company's list prices are generally not fair value as discounts may be given based on the factors enumerated above. The Company believes that the fair value of its consulting services is represented by the billable consulting rate per hour, based on the rates they charge customers when they purchase standalone consulting services. The price of consulting services is not based on the type of customer, volume of sales, geographic region or program level.

The Company uses historical sales transactions to determine whether VSOE can be established for each of the elements. In most instances, VSOE is the sales price of actual standalone (unbundled) transactions within the past 12 month period that are priced within a reasonable range, which the Company has determined to be plus or minus 15% of the median sales price of each respective price list.

VSOE of PCS is based on standalone sales since the Company does not provide stated renewal rates to its customers. In accordance with the Company's PCS pricing practice (supported by standalone renewal sales), renewal contracts are priced as a percentage of the undiscounted product list price. The PCS renewal percentages may vary, depending on the type and length of PCS purchased. The Company offers standard and premium PCS, and the term generally ranges from one to three years. The Company employs a bell-shaped-curve approach in evaluating VSOE of fair value of PCS. Under this approach, the Company considers VSOE of the fair value of PCS to exist when a substantial majority of its standalone PCS sales fall within a narrow range of pricing.

The Company is typically not able to determine TPE for its products or services. TPE is based on competitor prices for similar elements when sold separately. Generally, the Company's go-to-market strategy differs from that of other competitive products or services in its markets and the Company's offerings contain a significant level of differentiation such that the comparable pricing of products with similar functionality cannot be obtained. Furthermore, the Company is unable to reliably determine the selling prices on a stand-alone basis of similar products offered by its competitors.

When the Company is unable to establish the selling price of its non-software elements using VSOE or TPE, the Company uses BEBP in its allocation of arrangement consideration. The objective of BEBP is to determine the price at which the Company would transact a sale if the product or service were sold on a stand-alone basis. The Company is generally not able to establish VSOE for non-software product sales. Under software revenue recognition guidance, these product sales were accounted for utilizing the residual method. With the adoption of the new revenue recognition guidance, the Company has been able to establish BEBP for non-software product sales through the list price, less a discount deemed appropriate to maintain a reasonable gross margin. Management regularly reviews the gross margin information. Non-software product BEBP is determined through our review of historical sales transactions within the past 12 month period. Additional factors considered in determining an appropriate BEBP include, but are not limited to, cost of products, pricing practices, geographies, customer classes, and distribution channels.

The Company has established and regularly validates the VSOE of fair value and BEBP for elements in its multiple element arrangements. The Company accounts for taxes collected from customers and remitted to governmental authorities on a net basis and excluded from revenues.





## **Table of Contents**

### ***Shipping and Handling***

Shipping and handling fees charged to the Company's customers are recognized as product revenue in the period shipped and the related costs for providing these services are recorded as a cost of sale.

### ***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 for those customers without service contracts, 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. Accrued warranty costs as of September 30, 2011, 2010 and 2009 were not considered material.

### ***Research and Development***

Research and development expenses consist of salaries and related benefits of product development personnel, prototype materials and expenses related to the development of new and improved products, and an allocation of facilities and depreciation expense. Research and development expenses are reflected in the statements of income as incurred.

### ***Advertising***

Advertising costs are expensed as incurred. The Company incurred \$2.2 million, \$2.1 million and \$1.3 million in advertising costs during the fiscal years 2011, 2010 and 2009, respectively.

### ***Income Taxes***

Deferred income tax assets and liabilities are determined based upon differences between the financial statement and income tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The realization of deferred tax assets is based on historical tax positions and estimates of future taxable income. A valuation allowance is recorded when it is more likely than not that some of the deferred tax assets will not be realized.

The Company assesses whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. The Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The tax benefits to be recognized in the financial statements from such a position is measured as the largest amount of benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. The new guidance also provides guidance on de-recognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures.

### ***Foreign Currency***

The functional currency for the Company's foreign subsidiaries is the local currency in which the respective entity is located, with the exception of F5 Networks, Ltd., in the United Kingdom that uses the U.S. dollar as its functional currency. An entity's functional currency is determined by the currency of the economic environment in which the majority of cash is generated and expended by the entity. The financial statements of all majority-owned subsidiaries and related entities, with a functional currency other than the U.S. dollar, have been translated into U.S. dollars. All assets and liabilities of the respective entities are translated at year-end exchange rates and all revenues and expenses are translated at average rates during the respective period. Translation adjustments are reported as a separate component of accumulated other comprehensive income (loss) in shareholders' equity.



## Table of Contents

Foreign currency transaction gains and losses are a result of the effect of exchange rate changes on transactions denominated in currencies other than the functional currency, including U.S. dollars. Gains and losses on those foreign currency transactions are included in determining net income or loss for the period of exchange. The net effect of foreign currency gains and losses was not significant during the fiscal years ended September 30, 2011, 2010 and 2009.

### *Segments*

Management has determined that the Company was organized as, and operated in, one reportable operating segment for fiscal year 2011 and prior years: the development, marketing and sale of application delivery networking products that optimize the security, performance and availability of network applications, servers and storage systems.

### *Stock-Based Compensation*

The Company accounts for stock-based compensation using the straight-line attribution method for recognizing compensation expense. The Company recognized \$89.7 million, \$70.8 million and \$56.1 million of stock-based compensation expense for the fiscal years ended September 30, 2011, 2010 and 2009, respectively. As of September 30, 2011, there was \$105.5 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 the Company issues 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 restricted stock units (RSUs). On July 29, 2011, the Company's Compensation Committee approved 833,739 RSUs to employees and executive officers pursuant to the Company's annual equity awards program. The value of RSUs is determined using the fair 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. No stock options were granted in fiscal years 2011, 2010 and 2009. In determining the fair value of shares issued under the Employee Stock Purchase Plan (ESPP), the Company uses the Black-Scholes option pricing model that employs the following key assumptions.

	<b>Employee Stock Purchase Plan</b>		
	<b>Years Ended September 30,</b>		
	<b>2011</b>	<b>2010</b>	<b>2009</b>
Risk-free interest rate	0.10%	0.25%	0.31%
Expected dividend			
Expected term	0.5 years	0.5 years	0.5 years
Expected volatility	53.87%	41.04%	47.00%

The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The Company does not anticipate declaring dividends in the foreseeable future. Expected volatility is based on the annualized daily historical volatility of the Company's stock price commensurate with the expected life of the ESPP option. Expected term of the ESPP option is based on an offering period of six months. The assumptions above are based on management's best estimates at that time, which impact the fair value of the ESPP option calculated under the Black-Scholes methodology and, ultimately, the expense that will be recognized over the life of the ESPP option.

The Company recognizes compensation expense for only the portion of restricted stock units that are expected to vest. Therefore, the Company applies estimated forfeiture rates that are derived from historical employee termination behavior. Based on historical differences with forfeitures of stock-based awards granted to the Company's executive officers and Board of Directors versus grants awarded to all other employees, the Company has developed separate forfeiture expectations for these two groups. The estimated forfeiture rate for grants awarded to the Company's executive officers and Board of Directors was approximately 3% and the estimated forfeiture rate for grants awarded to all other employees was approximately 9% in fiscal 2011. If the actual number of forfeitures differs from those estimated by management, additional adjustments to compensation expense may be required in future periods.

In August 2011, the Company granted 170,390 RSUs to certain current executive officers as part of the annual equity awards program. Fifty percent of the aggregate number of RSUs granted as part of the annual equity awards program vest in equal quarterly increments over three years, until such portion of the grant is fully vested on August 1, 2014. One-sixth of the annual equity awards RSU grant, or a portion thereof, is subject to the Company achieving specified quarterly revenue and EBITDA goals during the period beginning in the fourth quarter of fiscal year 2011 through the third quarter of fiscal year 2012. In each case, 50% of the quarterly performance stock grant is based on achieving at least 80% of the quarterly revenue goal and the other 50% is based on achieving at



**Table of Contents**

least 80% of the quarterly EBITDA goal. The quarterly performance stock grant is paid linearly above 80% of the targeted goals. At least 100% of both goals must be attained in order for the quarterly performance stock grant to be awarded over 100%. Each goal is evaluated individually and subject to the 80% achievement threshold and 100% over-achievement threshold. The remaining 33.33% of this annual equity awards RSU grant shall be subject to performance based vesting for each of the four quarter periods beginning with the fourth quarters of fiscal years 2012 and 2013 (16.66% in each period). The Compensation Committee of the Board of Directors will set applicable performance targets and vesting formulas for each of these periods.

In August 2010, the Company granted 181,334 and 83,000 RSUs to certain current executive officers as part of the annual equity and retention awards programs, respectively. Fifty percent of the aggregate number of RSUs granted as part of the annual equity awards program vest in equal quarterly increments over three years, until such portion of the grant is fully vested on August 1, 2013. One-sixth of the annual equity awards RSU grant, or a portion thereof, was subject to the Company achieving specified quarterly revenue and EBITDA goals during the period beginning in the fourth quarter of fiscal year 2010 through the third quarter of fiscal year 2011. In each case, 50% of the quarterly performance stock grant is based on achieving at least 80% of the quarterly revenue goal and the other 50% is based on achieving at least 80% of the quarterly EBITDA goal. The quarterly performance stock grant is paid linearly above 80% of the targeted goals. At least 100% of both goals must be attained in order for the quarterly performance stock grant to be awarded over 100%. Each goal is evaluated individually and subject to the 80% achievement threshold and 100% over-achievement threshold. The remaining 33.33% of this annual equity awards RSU grant shall be subject to performance based vesting for each of the four quarter periods beginning with the fourth quarters of fiscal years 2011 and 2012 (16.66% in each period). The Compensation Committee of the Board of Directors will set applicable performance targets and vesting formulas for each of these periods. All RSUs granted as part of the retention awards program fully vest on August 1, 2013.

In August 2009, the Company granted 420,000 RSUs to certain current executive officers. Fifty percent of the aggregate number of RSUs granted at such time vest in equal quarterly increments over two years, until such portion of the grant is fully vested on August 1, 2011. Twenty-five percent of the RSU grant, or a portion thereof, was subject to the Company achieving specified quarterly revenue and EBITDA goals during the period beginning in the fourth quarter of fiscal year 2009 through the third quarter of fiscal year 2010 and the remaining twenty-five percent was subject to the Company achieving specified quarterly revenue and EBITDA goals during the period beginning in the fourth quarter of fiscal year 2010 through the third quarter of fiscal year 2011. In each case, 50% of the quarterly performance stock grant is based on achieving at least 80% of the quarterly revenue goal and the other 50% is based on achieving at least 80% of the quarterly EBITDA goal. The quarterly performance stock grant is paid linearly above 80% of the targeted goals. At least 100% of both goals must be attained in order for the quarterly performance stock grant to be awarded over 100%. Each goal is evaluated individually and subject to the 80% achievement threshold and 100% over-achievement threshold.

The Company recognizes compensation costs for awards with performance conditions when it concludes it is probable that the performance condition will be achieved. The Company reassesses the probability of vesting at each balance sheet date and adjusts compensation costs based on the probability assessment.

In November 2011, as part of the annual review of executive compensation by the Compensation Committee of the Board of Directors and a change in the grant date for the Company's annual equity awards program for the executive officers, the Company granted 82,968 RSUs to certain current executive officers.

**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 Company's nonvested restricted stock awards and restricted stock units do not have nonforfeitable rights to dividends or dividend equivalents.

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

	Years Ended September 30,		
	2011	2010	2009
<b>Numerator</b>			
Net income	\$ 241,397	\$ 151,153	\$ 91,535
<b>Denominator</b>			
Weighted average shares outstanding - basic	80,658	79,609	78,842

Edgar Filing: F5 NETWORKS INC - Form 10-K

Dilutive effect of common shares from stock options and restricted stock units	824	1,440	1,231
Weighted average shares outstanding diluted	81,482	81,049	80,073
Basic net income per share	\$ 2.99	\$ 1.90	\$ 1.16
Diluted net income per share	\$ 2.96	\$ 1.86	\$ 1.14

## Table of Contents

An immaterial amount of common shares potentially issuable from stock options for the years ended September 30, 2011, 2010 and 2009 are excluded from the calculation of diluted earnings per share because the exercise price was greater than the average market price of common stock for the respective period.

### ***Recent Accounting Pronouncements***

In May 2011, the FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS* (ASU 2011-04), which amends current fair value measurement and disclosure guidance to converge with International Financial Reporting Standards (IFRS) and provides increased transparency around valuation inputs and investment categorization. The amendments in this standard are effective for fiscal years, and interim periods within those years beginning after December 15, 2011. The Company will adopt ASU 2011-04 in the first quarter of fiscal 2013 and does not expect the adoption of this standard to have an impact on its consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income, Presentation of Comprehensive Income* (ASU 2011-05), which eliminates the option of presenting other comprehensive income as part of the statement of changes in stockholders' equity and instead requires the entity to present other comprehensive income as either a single statement of comprehensive income combined with net income or as two separate but continuous statements. The amendments in this standard are to be applied retrospectively and are effective for fiscal years, and interim periods within those years beginning after December 15, 2011. The Company will adopt ASU 2011-05 in the first quarter of fiscal 2013 and does not expect the adoption of this standard to have an impact on its consolidated financial statements.

In September 2011, the FASB issued ASU 2011-08, *Intangibles - Goodwill and Other, Testing Goodwill for Impairment* (ASU 2011-08), which simplifies how an entity tests goodwill for impairment by allowing the entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If an entity determines, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company is likely to early adopt this standard for the goodwill impairment test to be performed in fiscal 2012. This standard will impact how the Company assesses goodwill for impairment but will not change the measurement or recognition of a potential goodwill impairment charge.

## **2. Fair Value Measurements**

In accordance with the authoritative guidance on fair value measurements and disclosure under GAAP, the Company determines fair value using a fair value hierarchy that distinguishes between market participant assumptions developed based on market data obtained from sources independent of the reporting entity, and the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances and expands disclosure about fair value measurements.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date, essentially the exit price.

The levels of fair value hierarchy are:

**Level 1:** Quoted prices in active markets for identical assets and liabilities at the measurement date.

**Level 2:** Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

**Level 3:** Unobservable inputs for which there is little or no market data available. These inputs reflect management's assumptions of what market participants would use in pricing the asset or liability.



**Table of Contents**

Level 1 investments are valued based on quoted market prices in active markets and include the Company's cash equivalent investments. Level 2 investments, which include investments that are valued based on quoted prices in markets that are not active, broker or dealer quotations, actual trade data, benchmark yields or alternative pricing sources with reasonable levels of price transparency, include the Company's corporate bonds and notes, municipal bonds and notes, U.S. government securities and U.S. government agency securities. Fair values for the Company's level 2 investments are based on similar assets without applying significant judgments. In addition, all of the Company's level 2 investments have a sufficient level of trading volume to demonstrate that the fair values used are appropriate for these investments.

A financial instrument's level within the fair value hierarchy is based upon the lowest level of any input that is significant to the fair value measurement. However, the determination of what constitutes observable requires significant judgment by the Company. The Company considers observable data to be market data which is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market.

The Company's financial assets measured at fair value on a recurring basis subject to the disclosure requirements at September 30, 2011, were as follows (in thousands):

	Fair Value Measurements at Reporting Date Using			Fair Value at September 30, 2011
	Quoted Prices in Active Markets for Identical Securities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash equivalents	\$ 33,740	\$	\$	\$ 33,740
<b>Short-term investments</b>				
Available-for-sale securities	corporate bonds and notes	137,156		137,156
Available-for-sale securities	municipal bonds and notes	82,715		82,715
Available-for-sale securities	U.S. government securities	799		799
Available-for-sale securities	U.S. government agency securities			
		105,096		105,096
<b>Long-term investments</b>				
Available-for-sale securities	corporate bonds and notes	141,150		141,150
Available-for-sale securities	municipal bonds and notes	30,714		30,714
Available-for-sale securities	U.S. government agency securities			
		285,329		285,329
Available-for-sale securities	auction rate securities		13,010	13,010
Total	\$ 33,740	\$ 782,959	\$ 13,010	\$ 829,709

The Company's financial assets measured at fair value on a recurring basis subject to the disclosure requirements at September 30, 2010, were as follows (in thousands):

	Fair Value Measurements at Reporting Date Using			Fair Value at September 30, 2010
	Quoted Prices in Active Markets for Identical Securities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash equivalents	\$ 26,987	\$	\$	\$ 26,987
<b>Short-term investments</b>				
Available-for-sale securities	corporate bonds and notes	120,124		120,124
Available-for-sale securities	municipal bonds and notes	77,063		77,063
Available-for-sale securities	U.S. government agency securities	62,555		62,555

## Edgar Filing: F5 NETWORKS INC - Form 10-K

### Long-term investments

Available-for-sale securities	corporate bonds and notes	174,053	174,053
Available-for-sale securities	municipal bonds and notes	22,094	22,094
Available-for-sale securities	U.S. government agency securities	221,380	221,380
Available-for-sale securities	auction rate securities		16,043
<b>Total</b>		<b>\$ 26,987</b>	<b>\$ 720,299</b>

Due to the auction failures of the Company's auction rate securities (ARS) that began in the second quarter of fiscal year 2008, there are still no quoted prices in active markets for similar assets as of September 30, 2011. Therefore, the Company has classified its ARS as level 3 financial assets. The following table provides a reconciliation between the beginning and ending balances of items measured at fair value on a recurring basis in the tables above that used significant unobservable inputs (Level 3) (in thousands):

**Table of Contents**

	2011	2010
<b>Balance, beginning of period</b>	\$ 16,043	\$ 41,595
Total gains realized or unrealized:		
Included in earnings (other income, net)		1,491
Included in other comprehensive income	967	498
Recognition of put option to earnings		(1,491)
Settlements	(4,000)	(26,050)
Transfers into and/or out of level 3		
<b>Balance, end of period</b>	\$ 13,010	\$ 16,043
<b>Gains attributable to assets still held as of the end of the period</b>	967	498

Financial assets are considered Level 3 when their fair values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable or there is limited market activity such that the determination of fair value requires significant judgment or estimation. Level 3 investment securities primarily include certain ARS for which there was a decrease in the observation of market pricing. At September 30, 2011, the values of these securities were estimated primarily using discounted cash flow analysis that incorporated transaction details such as contractual terms, maturity, timing and amount of future cash flows, as well as assumptions about liquidity and credit valuation adjustments of marketplace participants at September 30, 2011.

The Company uses the fair value hierarchy for financial assets and liabilities. The Company's non-financial assets and liabilities, which include goodwill, intangible assets, and long-lived assets, are not required to be carried at fair value on a recurring basis. These non-financial assets and liabilities are measured at fair value on a non-recurring basis when there is an indicator of impairment, and they are recorded at fair value only when impairment is recognized. The Company reviews goodwill and intangible assets for impairment annually, during the second quarter of each fiscal year, or as circumstances indicate the possibility of impairment. The Company monitors the carrying value of long-lived assets for impairment whenever events or changes in circumstances indicate its carrying amount may not be recoverable. During the year ended September 30, 2011, the Company did not recognize any impairment charges related to goodwill, intangible assets, or long-lived assets.

**3. Short-Term and Long-Term Investments**

Short-term investments consist of the following (in thousands):

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>September 30, 2011</b>				
Corporate bonds and notes	\$ 137,087	\$ 251	\$ (182)	\$ 137,156
Municipal bonds and notes	82,687	62	(34)	82,715
U.S. government securities	799			799
U.S. government agency securities	105,050	55	(9)	105,096
	\$ 325,623	\$ 368	\$ (225)	\$ 325,766

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>September 30, 2010</b>				
Corporate bonds and notes	\$ 119,829	\$ 318	\$ (23)	\$ 120,124
Municipal bonds and notes	76,886	182	(5)	77,063
U.S. government agency securities	62,390	165		62,555
	\$ 259,105	\$ 665	\$ (28)	\$ 259,742

Edgar Filing: F5 NETWORKS INC - Form 10-K

Long-term investments consist of the following (in thousands):

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>September 30, 2011</b>				
Corporate bonds and notes	\$ 141,315	\$ 415	\$ (580)	\$ 141,150
Municipal bonds and notes	30,575	151	(12)	30,714
Auction rate securities	15,000		(1,990)	13,010
U.S. government agency securities	285,334	164	(169)	285,329
	\$ 472,224	\$ 730	\$ (2,751)	\$ 470,203

**Table of Contents**

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>September 30, 2010</b>				
Corporate bonds and notes	\$ 172,493	\$ 1,582	\$ (22)	\$ 174,053
Municipal bonds and notes	22,045	67	(18)	22,094
Auction rate securities	19,000		(2,957)	16,043
U.S. government agency securities	221,262	200	(82)	221,380
	\$ 434,800	\$ 1,849	\$ (3,079)	\$ 433,570

The amortized cost and fair value of fixed maturities at September 30, 2011, by contractual years-to-maturity, are presented below (in thousands):

	Cost or Amortized Cost	Fair Value
One year or less	\$ 325,623	\$ 325,766
Over one year	472,224	470,203
	\$ 797,847	\$ 795,969

The cost or amortized cost values of the Company's fixed maturities include \$15.0 million and \$19.0 million of available-for-sale ARS as of September 30, 2011 and 2010, respectively.

The following table summarizes investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for more than 12 months as of September 30, 2011 (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>September 30, 2011</b>						
Corporate bonds and notes	\$ 133,752	\$ (751)	\$ 4,019	\$ (11)	\$ 137,771	\$ (762)
Municipal bonds and notes	24,304	(38)	2,543	(8)	26,847	(46)
Auction rate securities			13,010	(1,990)	13,010	(1,990)
U.S. government agency securities	171,222	(178)			171,222	(178)
Total	\$ 329,278	\$ (967)	\$ 19,572	\$ (2,009)	\$ 348,850	\$ (2,976)

The Company invests in securities that are rated investment grade or better. The unrealized losses on investments for fiscal year 2011 were primarily caused by reductions in the values of the ARS due to the illiquid markets and were partially offset by unrealized gains related to interest rate decreases.

ARS are variable-rate debt securities. The Company limits its investments in ARS to securities that carry an AAA/A- (or equivalent) rating from recognized rating agencies and limits the amount of credit exposure to any one issuer. At the time of the Company's initial investment and at the date of this report, all ARS were in compliance with the Company's investment policy. In the past, the auction process allowed investors to obtain immediate liquidity if so desired by selling the securities at their face amounts. Liquidity for these securities has historically been provided by an auction process that resets interest rates on these investments on average every 7-35 days. However, as has been reported in the financial press, the disruptions in the credit markets adversely affected the auction market for these types of securities.

**4. Balance Sheet Details**

*Other Assets*

Other assets consist of the following (in thousands):

**Table of Contents**

	Years Ended September 30,	
	2011	2010
Acquired and developed technology and software development cost	\$ 8,520	\$ 6,374
Deposits and other	8,540	9,377
Restricted cash	162	195
	\$ 17,222	\$ 15,946

Amortization expense related to other assets was approximately \$4.3 million, \$6.0 million, and \$6.7 million for the fiscal years ended September 30, 2011, 2010 and 2009, respectively.

Intangible assets consist of the following (in thousands):

	2011			2010		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Acquired and developed technology and software development cost	\$ 39,109	\$ (30,589)	\$ 8,520	\$ 33,474	\$ (27,100)	\$ 6,374
Customer relationships	2,699	(2,314)	385	2,699	(1,894)	805
Patents and trademarks	3,044	(2,214)	830	2,964	(1,832)	1,132
Trade names	200	(163)	37	200	(123)	77
Non-compete covenants	200	(200)		200	(200)	
	\$ 45,252	\$ (35,480)	\$ 9,772	\$ 39,537	\$ (31,149)	\$ 8,388

Estimated amortization expense for intangible assets for the five succeeding fiscal years is as follows (in thousands):

2012	\$ 4,428
2013	934
2014	867
2015	867
2016	867
	\$ 7,963

**Accrued Liabilities**

Accrued liabilities consist of the following (in thousands):

	Years Ended September 30,	
	2011	2010
Payroll and benefits	\$ 47,824	\$ 40,904
Sales and marketing	5,062	2,522
Income tax accruals	4,860	2,458
Other	10,156	15,884

\$ 67,902      \$ 61,768

***Other Long Term Liabilities***

Other long term liabilities consist of the following (in thousands):

	<b>Years Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>
Income tax accrual	\$ 5,675	\$ 7,029
Deferred rent and other	12,713	9,124
	<b>\$ 18,388</b>	<b>\$ 16,153</b>

**5. Income Taxes**

The United States and international components of income before income taxes are as follows (in thousands):



**Table of Contents**

	Years Ended September 30,		
	2011	2010	2009
United States	\$ 342,741	\$ 225,698	\$ 128,537
International	18,010	11,929	3,111
	\$ 360,751	\$ 237,627	\$ 131,648

The provision for income taxes (benefit) consists of the following (in thousands):

	Years Ended September 30,		
	2011	2010	2009
<b>Current</b>			
U.S. federal	\$ 103,620	\$ 79,802	\$ 41,948
State	7,397	4,722	1,631
Foreign	5,743	3,230	1,790
Total	116,760	87,754	45,369
<b>Deferred</b>			
U.S. federal	3,070	(2,049)	(3,317)
State	(144)	(1,091)	25
Foreign	(332)	1,860	(1,964)
Total	2,594	(1,280)	(5,256)
	\$ 119,354	\$ 86,474	\$ 40,113

The effective tax rate differs from the U.S. federal statutory rate as follows (in thousands):

	Years Ended September 30,		
	2011	2010	2009
Income tax provision at statutory rate	\$ 126,263	\$ 83,170	\$ 46,075
State taxes, net of federal benefit	5,999	2,871	2,121
Impact of foreign income taxes	(892)	915	(1,262)
Research and development and other credits	(5,486)	(2,124)	(5,954)
Domestic manufacturing deduction	(9,844)	(3,766)	(3,346)
Impact of stock compensation	5,310	2,825	2,411
Other	(1,996)	2,583	68
	\$ 119,354	\$ 86,474	\$ 40,113

The tax effects of the temporary differences that give rise to the deferred tax assets and liabilities are as follows (in thousands):

	Years Ended September 30,	
	2011	2010
<b>Deferred tax assets</b>		
Net operating loss carry-forwards	\$ 452	\$ 5,672
Allowance for doubtful accounts	898	1,644
Accrued compensation and benefits	4,879	4,003
Inventories and related reserves	1,564	2,063

Edgar Filing: F5 NETWORKS INC - Form 10-K

Stock-based compensation	8,969	6,247
Deferred revenue	19,400	16,260
Other accruals and reserves	9,629	7,829
Depreciation	1,403	5,239
Tax credit carry-forwards	1,657	4,065
	48,851	53,022
<b>Deferred tax liabilities</b>		
Purchased intangibles and other	(5,698)	(6,391)
<b>Net deferred tax assets</b>	\$ 43,153	\$ 46,631

At September 30, 2011, the Company had U.S. net operating loss carry-forwards of approximately \$1.2 million. All U.S. net operating loss carry-forwards relate to entities acquired by the Company and are limited in use by I.R.C. Sec. 382.

United States income and foreign withholding taxes have not been provided on approximately \$28.7 million of undistributed earnings from the Company's international subsidiaries. The Company has not recognized a deferred tax liability for the undistributed earnings of its foreign subsidiaries because the Company currently does not expect to remit those earnings in the foreseeable future. Determination of the amount of unrecognized deferred tax liability related to undistributed earnings of foreign subsidiaries is not practicable because such liability, if any, is dependent on circumstances existing if and when remittance occurs.

**Table of Contents**

The decrease in the effective tax rate from fiscal year 2010 to fiscal year 2011 was primarily due to an increased benefit resulting from the United States Domestic Production Activities Deduction, the reinstatement of the federal research and development credit on December 17, 2010 and a change in the Company's uncertain tax positions as a result of the settlement of audits and expiration of statutes of limitation in various jurisdictions.

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 fifty percent likelihood of being realized upon ultimate settlement with the relevant tax authority.

The following table provides a reconciliation of the beginning and ending amount of unrecognized tax benefits in fiscal years 2011, 2010 and 2009:

	2011	2010	2009
Balance, beginning of period	\$ 6,568	\$ 5,841	\$ 4,075
Gross increases related to prior period tax positions	1,198	442	642
Gross increases related to current period tax positions	1,659	432	1,124
Decreases relating to settlements with tax authorities	(243)		
Reductions due to lapses of statute of limitations	(3,230)	(147)	
Balance, end of period	\$ 5,952	\$ 6,568	\$ 5,841

The Company recognizes interest and, if applicable, penalties (not included in the unrecognized tax benefits table above) for any uncertain tax positions. This interest and penalty expense will be a component of income tax expense. In the years ended September 30, 2011, 2010 and 2009 the Company accrued approximately \$283,000, \$390,000 and \$193,000, respectively, of interest expense related to its liability for unrecognized tax benefits. No penalties were recognized in fiscal years 2011, 2010 and 2009 or accrued for at September 30, 2011, 2010 and 2009.

All unrecognized tax benefits, if recognized, would affect the effective tax rate. The Company does not anticipate that total unrecognized tax benefits will significantly change within the next twelve months.

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, 2007. Major jurisdictions where there are wholly owned subsidiaries of F5 Networks, Inc. which require income tax filings include the United Kingdom, Japan, Australia and Germany. The earliest periods open for review by local taxing authorities are fiscal years 2010, 2010, 2007 and 2007 for the United Kingdom, Japan, Australia and Germany, respectively. Within the next four fiscal quarters, the statute of limitations will begin to close on the fiscal years ended 2007 and 2008 tax returns filed in various states and the fiscal year ended 2008 federal income tax return.

**6. Stock-based Compensation**

The majority of awards consist of restricted stock units and to a lesser degree, stock options. Employees vest in restricted stock units and stock options ratably over the corresponding service term, generally one to four years. The Company's stock options expire 10 years from the date of grant. Restricted stock units are payable in shares of the Company's common stock as the periodic vesting requirements are satisfied. The value of a restricted stock unit is based upon the fair market value of the Company's common stock on the date of grant. The value of restricted stock units is determined using the intrinsic value method and is based on the number of shares granted and the quoted price of the Company's common stock on the date of grant. Alternatively, the Company used the Black-Scholes option pricing model to determine the fair value of its stock options. Compensation expense related to restricted stock units and stock options is recognized over the vesting period. The Company has adopted a number of stock-based compensation plans as discussed below.

*1998 Equity Incentive Plan.* In November 1998, the Company adopted the 1998 Equity Incentive Plan, or the 1998 Plan, which provided for discretionary grants of non-qualified and incentive stock options, stock purchase awards and stock bonuses for employees and other service providers. The 1998 Plan expired on November 11, 2008 and no shares remain available for awards under the 1998 Plan. Upon certain changes in control of the Company, all outstanding and unvested options or stock awards under the 1998 Plan will vest at the rate of 50%, unless assumed or substituted by the acquiring entity. During the fiscal years 2011 and 2010, the Company issued no stock options, stock purchase awards or stock bonuses under this plan. As of September 30, 2011, there were options to purchase 132,459 shares outstanding under the 1998

Plan.

57

**Table of Contents**

*2011 Employee Stock Purchase Plan.* In July 2011, the board of directors amended and restated the Company's 1999 Employee Stock Purchase Plan, or the Employee Stock Purchase Plan. A total of 6,000,000 shares of common stock have been reserved for issuance under the Employee Stock Purchase Plan. The Employee Stock Purchase Plan permits eligible employees to acquire shares of the Company's common stock through periodic payroll deductions of up to 15% of base compensation. No employee may purchase more than \$25,000 worth of stock, determined at the fair market value of the shares at the time such option is granted, in one calendar year. The Employee Stock Purchase Plan has been implemented in a series of offering periods, each 6 months in duration. The price at which the common stock may be purchased is 85% of the lesser of the fair market value of the Company's common stock on the first day of the applicable offering period or on the last day of the respective purchase period. As of September 30, 2011 there were 1,718,042 shares available for awards under the Employee Stock Purchase Plan.

*2000 Equity Incentive Plan.* In July 2000, the Company adopted the 2000 Employee Equity Incentive Plan, or the 2000 Plan, which provides for discretionary grants of non-qualified stock options, stock purchase awards and stock bonuses for non-executive employees and other service providers. A total of 7,000,000 shares of common stock were reserved for issuance under the 2000 Plan. Upon certain changes in control of the Company, all outstanding and unvested options or stock awards under the 2000 Plan will vest at the rate of 50%, unless assumed or substituted by the acquiring entity. As of September 30, 2011, there were options to purchase 165,088 shares outstanding and no shares available for awards under the 2000 Plan. The Company terminated the 2000 Plan effective November 1, 2008 and no additional shares may be issued from the 2000 Plan.

*Acquisition Incentive Plans.* In connection with the Company's acquisition of Acopia, the Company assumed the Acopia 2001 Stock Incentive Plan, or the Acopia Plan. Unvested options to acquire Acopia's common stock were converted into options to acquire the Company's common stock in connection with the acquisition. A total of 2,230,703 shares of common stock were reserved for issuance under the Acopia Plan. The plan provides for discretionary grants of non-qualified and incentive stock options, restricted stock awards and other stock-based awards to persons who were employees, officers, directors, consultants or advisors to Acopia on or prior to September 12, 2007. During the fiscal year 2011, the Company issued no stock options or restricted stock units under the Acopia Plan. As of September 30, 2011, there were options to purchase 26,287 shares outstanding and no shares available for awards under the Acopia Plan. The Company terminated the Acopia Plan effective November 1, 2008 and no additional shares may be issued from the Acopia Plan.

*2005 Equity Incentive Plan.* In December 2004, the Company adopted the 2005 Equity Incentive Plan, or the 2005 Plan, which provides for discretionary grants of non-statutory stock options and stock units for employees, including officers, and other service providers. A total of 12,400,000 shares of common stock have been reserved for issuance under the 2005 Plan. Upon certain changes in control of the Company, all outstanding and unvested options or stock awards under the 2005 Plan will vest at the rate of 50%, unless assumed or substituted by the acquiring entity. During the fiscal year 2011, the Company issued no stock options and 908,757 restricted stock units under the 2005 Plan. As of September 30, 2011, there were no options outstanding and 3,501,586 shares available for new awards under the 2005 Plan.

A majority of the restricted stock units granted in fiscal years 2011, 2010 and 2009 vest quarterly over a two-year period. The restricted stock units were granted during fiscal years 2011, 2010 and 2009 with a per-share weighted average fair value of \$94.99, \$86.32 and \$36.31, respectively. The fair value of restricted stock vested during fiscal years 2011, 2010 and 2009 was \$145.0 million, \$116.4 million and \$41.0 million, respectively.

A summary of restricted stock unit activity under the 2005 Plan is as follows:

	<b>Outstanding Stock Units</b>	<b>Weighted Average Grant Date Fair Value</b>
Balance, September 30, 2010	1,985,325	\$ 62.52
Units granted	908,757	94.99
Units vested	(1,316,253)	105.59
Units cancelled	(121,143)	56.04
Balance, September 30, 2011	1,456,686	\$ 44.40

A summary of stock option activity under all of the Company's plans is as follows:



**Table of Contents**

	Options Outstanding	
	Number of Shares	Weighted Average Exercise Price per Share
Balance, September 30, 2010	483,040	\$ 13.51
Options exercised	(150,416)	15.24
Options cancelled	(1,200)	33.92
Balance, September 30, 2011	331,424	\$ 12.66

No stock options were granted in fiscal years 2011, 2010 and 2009.

The total intrinsic value of options exercised during fiscal 2011, 2010 and 2009 was \$15.2 million, \$36.6 million and \$8.4 million, respectively.

	Number of Shares	Weighted Average Remaining Contractual Life (in Years) (In thousands)	Weighted Average Exercise Price per Share	Aggregate Intrinsic Value(1)
Stock options outstanding	331,424	2.31	\$ 12.66	\$ 19,353
Exercisable	331,424	2.31	\$ 12.66	\$ 19,353
Vested and expected to vest	331,424	2.31	\$ 12.66	\$ 19,353

(1) Aggregate intrinsic value represents the difference between the fair value of the Company's common stock underlying these options at September 30, 2011 and the related exercise prices.

As of September 30, 2011, equity based awards (including stock options and restricted stock units) are available for future issuance as follows:

	Awards Available for Grant
Balance, September 30, 2010	4,289,200
Granted	(908,757)
Cancelled	125,156
Additional shares reserved (terminated), net	(4,013)
Balance, September 30, 2011	3,501,586

**7. Commitments and Contingencies****Operating Leases**

The majority of the Company's operating lease payments relate to the Company's three building corporate headquarters in Seattle, Washington. The lease for all three buildings was amended and restated in April of 2010. This lease will now expire in 2022 with an option for renewal. One

## Edgar Filing: F5 NETWORKS INC - Form 10-K

of the buildings has been partially subleased through 2012. The Company also leases additional office space for product development and sales and support personnel in the United States and internationally.

In October 2006, the Company entered into an agreement to lease a total of approximately 137,000 square feet of office space in a building known as 333 Elliott West, which is adjacent to the three buildings that serve as the Company's corporate headquarters. The lease expires in 2018. During 2008, the Company entered into two separate sublease agreements to sublease approximately 112,500 square feet of building 333 Elliott West. One sublease will expire in 2013. In March 2010, the Company amended the second sublease, which expanded the subleased space by approximately 11,700 square feet and extended the term of the sublease to 2018.

Future minimum operating lease payments, net of sublease income, are as follows (in thousands):

	<b>Gross Lease Payments</b>	<b>Sublease Income</b>	<b>Net Lease Payments</b>
2012	42,317	4,321	37,996



**Table of Contents**

	<b>Gross Lease Payments</b>	<b>Sublease Income</b>	<b>Net Lease Payments</b>
2013	17,673	2,611	15,062
2014	16,185	338	15,847
2015	15,786	85	15,701
2016	15,072		15,072
Thereafter	65,370		65,370
	\$ 172,403	\$ 7,355	\$ 165,048

Rent expense under non-cancelable operating leases amounted to approximately \$19.0 million, \$17.5 million, and \$15.6 million for the fiscal years ended September 30, 2011, 2010, and 2009, respectively.

**Purchase Obligations**

Purchase obligations are comprised of purchase commitments with the Company's contract manufacturers. The agreement with the Company's primary contract manufacturer allows them to procure component inventory on the Company's behalf based on the Company's production forecast. The Company is obligated to purchase component inventory that the contract manufacturer procures in accordance with the forecast, unless cancellation is given within applicable lead times. As of September 30, 2011, the Company's purchase obligations were \$13.6 million.

**Litigation**

The Company is not aware of any pending legal proceedings that, individually or in the aggregate, are reasonably possible to 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 we allegedly infringe upon third-party intellectual property rights. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

**8. Restructuring Charges**

In January 2009, the Company initiated a restructuring plan to reduce its operating expenses which included the consolidation of facilities, accelerated depreciation on tenant improvements and a reduction in workforce. These initiatives are intended to conserve or generate cash in response to the uncertainties associated with the recent deterioration in the global economy. As a result of these initiatives, the Company recorded a restructuring charge of \$4.3 million in the second quarter of fiscal 2009. All accrued restructuring costs had been incurred as of September 30, 2011.

**9. Employee Benefit Plans**

The Company has a 401(k) savings plan whereby eligible employees may voluntarily contribute a percentage of their compensation. The Company may, at its discretion, match a portion of the employees' eligible contributions. Contributions by the Company to the plan during the years ended September 30, 2011, 2010, and 2009 were approximately \$4.7 million, \$3.8 million and \$3.3 million, respectively. Contributions made by the Company vest over four years.

**10. 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 does business in four main geographic regions: the Americas (primarily the United States); Europe, the Middle East, and Africa (EMEA); Japan; and the Asia Pacific region (APAC). 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. 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 revenue.

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

	<b>Years Ended September 30,</b>		
	<b>2011</b>	<b>2010</b>	<b>2009</b>
Americas	\$ 676,868	\$ 517,269	\$ 361,230
EMEA	240,453	201,259	150,776
Japan	74,824	59,151	56,792
Asia Pacific	159,689	104,293	84,281
	<b>\$ 1,151,834</b>	<b>\$ 881,972</b>	<b>\$ 653,079</b>

**Table of Contents**

One worldwide distributor accounted for 18.1%, 14.5% and 15.4% of total net revenues in fiscal years 2011, 2010 and 2009, respectively. Another worldwide distributor accounted for 10.7% of total net revenues in fiscal year 2011. Another worldwide distributor accounted for 10.2% of total net revenues in fiscal year 2010.

**11. Quarterly Results of Operations**

The following presents the Company's unaudited quarterly results of operations for the eight quarters ended September 30, 2011. The information should be read in conjunction with the Company's financial statements and related notes included elsewhere in this report. This unaudited information has been prepared on the same basis as the audited financial statements and includes all adjustments, consisting only of normal recurring adjustments that were considered necessary for a fair statement of the Company's operating results for the quarters presented.

	Three Months Ended							
	Sept. 30, 2011	June 30, 2011	March 31, 2011	Dec. 31, 2010	Sept. 30, 2010	June 30, 2010	March 31, 2010	Dec. 31, 2009
(Unaudited and in thousands, except per share data)								
<b>Net revenues</b>								
Products	\$ 197,446	\$ 179,327	\$ 173,710	\$ 171,492	\$ 164,972	\$ 147,393	\$ 129,559	\$ 119,218
Services	117,169	111,386	103,862	97,442	89,302	83,081	76,509	71,938
<b>Total</b>	<b>314,615</b>	<b>290,713</b>	<b>277,572</b>	<b>268,934</b>	<b>254,274</b>	<b>230,474</b>	<b>206,068</b>	<b>191,156</b>
<b>Cost of net revenues</b>								
Products	34,485	31,803	31,423	31,614	31,045	29,328	27,419	26,042
Services	21,435	20,645	19,250	17,349	15,783	15,251	13,997	13,087
<b>Total</b>	<b>55,920</b>	<b>52,448</b>	<b>50,673</b>	<b>48,963</b>	<b>46,828</b>	<b>44,579</b>	<b>41,416</b>	<b>39,129</b>
<b>Gross profit</b>	<b>258,695</b>	<b>238,265</b>	<b>226,899</b>	<b>219,971</b>	<b>207,446</b>	<b>185,895</b>	<b>164,652</b>	<b>152,027</b>
<b>Operating expenses</b>								
Sales and marketing	100,945	93,633	89,332	86,825	80,696	77,219	69,644	65,642
Research and development	36,552	35,245	34,507	32,606	31,571	30,889	29,134	26,720
General and administrative	21,867	21,126	19,846	20,684	18,876	17,658	16,016	15,953
<b>Total operating expenses</b>	<b>159,364</b>	<b>150,004</b>	<b>143,685</b>	<b>140,115</b>	<b>131,143</b>	<b>125,766</b>	<b>114,794</b>	<b>108,315</b>
<b>Income from operations</b>	<b>99,331</b>	<b>88,261</b>	<b>83,214</b>	<b>79,856</b>	<b>76,303</b>	<b>60,129</b>	<b>49,858</b>	<b>43,712</b>
Other income, net	4,087	1,889	1,568	2,545	68	3,561	2,291	1,705
<b>Income before income taxes</b>	<b>103,418</b>	<b>90,150</b>	<b>84,782</b>	<b>82,401</b>	<b>76,371</b>	<b>63,690</b>	<b>52,149</b>	<b>45,417</b>
Provision for income taxes	35,808	27,601	29,207	26,738	28,136	23,195	19,005	16,138
<b>Net income</b>	<b>\$ 67,610</b>	<b>\$ 62,549</b>	<b>\$ 55,575</b>	<b>\$ 55,663</b>	<b>\$ 48,235</b>	<b>\$ 40,495</b>	<b>\$ 33,144</b>	<b>\$ 29,279</b>
Net income per share - basic	\$ 0.84	\$ 0.77	\$ 0.69	\$ 0.69	\$ 0.60	\$ 0.51	\$ 0.42	\$ 0.37
Weighted average shares - basic	80,317	80,866	80,809	80,644	80,268	79,864	79,394	78,906
Net income per share - diluted	\$ 0.84	\$ 0.77	\$ 0.68	\$ 0.68	\$ 0.59	\$ 0.50	\$ 0.41	\$ 0.36
Weighted average shares - diluted	80,766	81,497	81,622	81,648	81,253	81,031	80,737	80,333



---

**Table of Contents**

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

The Company maintains 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)) that are designed to ensure that required information is recorded, processed, summarized and reported within the required timeframe, as specified in the rules set forth by the Securities Exchange Commission. Our disclosure controls and procedures are also designed to ensure that information required to be disclosed is accumulated and communicated to management, including the 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 September 30, 2011 and, based on this evaluation, our Chief Executive Officer and Chief Accounting Officer have concluded that our disclosure controls and procedures were effective as of September 30, 2011.

**Management's Report on Internal Control over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Management conducted an assessment of the effectiveness of our internal control over financial reporting as of September 30, 2011. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated Framework*. Based on the results of this assessment and on those criteria, management concluded that our internal control over financial reporting was effective as of September 30, 2011.

PricewaterhouseCoopers LLP, an independent registered public accounting firm, has audited the Consolidated Financial Statements included in this Annual Report on Form 10-K and, as part of their audit, has issued its attestation report, included herein, on the effectiveness of our internal control over financial reporting.

**Changes in Internal Control over Financial Reporting**

During the fourth fiscal quarter, there were no changes to our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

**Item 9B. Other Information**

None.

**Table of Contents****PART III****Item 10. Directors, Executive Officers and Corporate Governance**

Certain information required by this item regarding the Company's directors and executive officers is incorporated herein by reference to the sections entitled Board of Directors Nominees and Continuing Directors, Corporate Governance Committees of the Board Audit Committee and Code of Ethics for Senior Financial Officers and Director Nomination, and Security Ownership of Certain Beneficial Owners and Management Section 16(a) Beneficial Ownership Reporting Compliance in the Company's definitive Proxy Statement that will be furnished to the SEC no later than January 28, 2012 (the Proxy Statement). Additional information regarding the Company's directors and executive officers is set forth in Item 1 of Part I of this Annual Report on Form 10-K under the caption Directors and Executive Officers of the Registrant.

**Item 11. Executive Compensation**

The information required by this item is incorporated by reference to the sections entitled Executive Compensation and Corporate Governance Committees of the Board Compensation Committee and Compensation Committee Interlocks and Insider Participation and Compensation Committee Report in the Proxy Statement.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters****Equity Compensation Plan Information**

The following table provides information as of September 30, 2011 with respect to the shares of Common Stock that may be issued under the Company's existing equity compensation plans.

Plan Category	Column A Number of securities to be issued upon exercise of outstanding options and rights	Column B Weighted-average exercise price of outstanding options and rights (3)	Column C Number of securities remaining available for future issuance under equity compensation plans (total securities authorized but unissued under the plans, less Column A)
Equity compensation plans approved by security holders(1)	1,589,145 (2)	\$ 13.05	5,219,628 (4)
Equity compensation plans not approved by security holders(5)	212,234	\$ 12.40	
<b>Total</b>	<b>1,801,379</b>	<b>\$ 12.66</b>	<b>5,219,628</b>

- (1) Consists of the F5 Networks, Inc. Amended and Restated 1998 Equity Incentive Plan (the 1998 Equity Incentive Plan), and the F5 Networks, Inc. 2005 Equity Incentive Plan (the 2005 Equity Incentive Plan). No additional options may be granted under the 1998 Equity Incentive Plan.
- (2) Includes 132,459 shares issuable upon vesting of outstanding options and 1,456,686 shares issuable upon vesting of outstanding RSUs granted under the 2005 Equity Incentive Plan.
- (3) The weighted-average exercise price does not take into account the shares issuable upon vesting of outstanding RSUs, which have no exercise price.
- (4) Includes 1,718,042 shares reserved for issuance under the Employee Stock Purchase Plan.

## Edgar Filing: F5 NETWORKS INC - Form 10-K

- (5) Consists of the F5 Networks, Inc. 2000 Employee Equity Incentive Plan (the 2000 Equity Incentive Plan ), F5 Networks, Inc. uRoam Acquisition Equity Incentive Plan (the uRoam Equity Incentive Plan ), F5 Networks, Inc. MagniFire Acquisition Equity Incentive Plan (the MagniFire Equity Incentive Plan ), F5 Networks, Inc. Assumed Acopia Networks Inc. 2001 Stock Incentive Plan (the Acopia 2001 Plan ) and F5 Networks, Inc. Acopia Acquisition Equity Incentive Plan (the Acopia Acquisition Plan ). The material features of each of these equity compensation plans are set forth in Note 7 in our financial statements, Summary of

## **Table of Contents**

Significant Accounting Policies Shareholders Equity included in our Annual Report to Shareholders on Form 10-K for the year ended September 30, 2011. As of the date of assumption of the Acopia 2001 Plan, there were options to purchase 426,821 shares outstanding under the Acopia 2001 Plan, with a weighted average exercise price of \$18.94. The Company terminated the 2000 Equity Incentive Plan, Acopia 2001 Plan and the Acopia Acquisition Plan effective November 1, 2008 and no additional shares may be issued from those Plans. In addition, no additional options may be granted under the uRoam Equity Incentive Plan or the MagniFire Equity Incentive Plan.

The information required by Item 403 of Regulation S-K is incorporated by reference to the section entitled Security Ownership of Certain Beneficial Owners and Management in the Proxy Statement.

### **Item 13. *Certain Relationships and Related Transactions, and Director Independence***

The information required by this item is incorporated by reference to the sections entitled Board of Directors Director Independence and Corporate Governance Related Person Transactions Policy and Procedures and Certain Relationships and Related Person Transactions in the Proxy Statement.

### **Item 14. *Principal Accountant Fees and Services***

The information required by this item is incorporated by reference to the section entitled Executive Compensation Fees Paid to PricewaterhouseCoopers LLP and Audit Committee Pre-Approval Procedures and Annual Independence Determination in the Proxy Statement.

## **PART IV**

### **Item 15. *Exhibits and Financial Statement Schedules***

(a) Documents filed as part of this report are as follows:

#### *1. Consolidated Financial Statements:*

Our Consolidated Financial Statements are listed in the Index to Consolidated Financial Statements.

#### *2. Financial Statement Schedule:*

Financial statement schedules have been omitted because the information required to be set forth therein is not applicable or is shown in the Consolidated Financial Statements or the notes hereto.

#### *3. Exhibits:*

The required exhibits are included at the end of this Annual Report on Form 10-K and are described in the Exhibit Index immediately preceding the first exhibit.



**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

F5 NETWORKS, INC.

By: /s/ JOHN MCADAM  
John McAdam  
*Chief Executive Officer and President*

Dated: November 22, 2011

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

	<b>Signature</b>	<b>Title</b>	<b>Date</b>
By:	/s/ JOHN MCADAM  John McAdam	Chief Executive Officer, President, and  Director (principal executive officer)	November 22, 2011
By:	/s/ JOHN RODRIGUEZ  John Rodriguez	Senior Vice President, Chief Accounting  Officer (principal financial officer and  principal accounting officer)	November 22, 2011
By:	/s/ A. GARY AMES  A. Gary Ames	Director	November 22, 2011
By:	/s/ DEBORAH L. BEVIER  Deborah L. Bevier	Director	November 22, 2011
By:	/s/ JONATHAN CHADWICK  Jonathan Chadwick	Director	November 22, 2011
By:	/s/ KARL D. GUELICH  Karl D. Guelich	Director	November 22, 2011
By:	/s/ ALAN J. HIGGINSON  Alan J. Higginson	Director	November 22, 2011
By:	/s/ SCOTT THOMPSON  Scott Thompson	Director	November 22, 2011

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit</b>	
<b>Number</b>	<b>Exhibit Description</b>
2.1	Agreement and Plan of Merger dated as of May 31, 2004, by and among the Registrant, Fire5, Inc., a wholly owned subsidiary of the Registrant, MagniFire Websystems, Inc., and Lucent Venture Partners III LLC(1)
2.2	Agreement and Plan of Merger, dated September 6, 2005, among the Registrant, Sparrow Acquisition Corp., Swan Labs Corporation and the other parties referred to therein.(2)
2.3	Agreement and Plan of Merger, dated August 6, 2007, among the Registrant, Checkmate Acquisition Corp., Acopia Networks, Inc. and Charles River Ventures, LLC.(18)
3.1	Second Amended and Restated Articles of Incorporation of the Registrant(3)
3.2	Amended and Restated Bylaws of the Registrant(3)
3.3	Second Amended and Restated Bylaws of F5 Networks, Inc.(22)
3.4	Third Amended and Restated Bylaws of F5 Networks, Inc.(23)
4.1	Specimen Common Stock Certificate(3)
10.1	Amended and Restated Office Lease Agreement dated April 3, 2000, between the Registrant and 401 Elliott West LLC(4)
10.2	Sublease Agreement dated March 30, 2001 between the Registrant and Cell Therapeutics, Inc.(5)
10.3	uRoam Acquisition Equity Incentive Plan(6) §
10.4	Form of Indemnification Agreement between the Registrant and each of its directors and certain of its officers(3) §
10.5	1998 Equity Incentive Plan, as amended(7) §
10.6	Form of Option Agreement under the 1998 Equity Incentive Plan(3) §
10.7	Amended and Restated Directors Nonqualified Stock Option Plan(3) §
10.8	Form of Option Agreement under the Amended and Restated Directors Nonqualified Stock Option Plan(3) §
10.9	Amended and Restated 1996 Stock Option Plan(3) §
10.10	Form of Option Agreement under the Amended and Restated 1996 Stock Option Plan(3) §
10.11	1999 Non-Employee Directors Stock Option Plan(3) §
10.12	Form of Option Agreement under 1999 Non-Employee Directors Stock Option Plan(3) §
10.13	NonQualified Stock Option Agreement between John McAdam and the Registrant dated July 24, 2000(8) §
10.14	2000 Employee Equity Incentive Plan(9) §
10.15	Form of Option Agreement under the 2000 Equity Incentive Plan(10) §
10.16	NonQualified Stock Option Agreement between M. Thomas Hull and the Registrant dated October 20, 2003(11) §
10.17*	2011 Employee Stock Purchase Plan §
10.18	MagniFire Acquisition Equity Incentive Plan(13) §
10.19	NonQualified Stock Option Agreement between Karl Triebes and the Registrant dated August 16, 2004(13)
10.20	Incentive Compensation Plan for Executive Officers(13) §

**Table of Contents**

10.21	2005 Equity Incentive Plan(14) §
10.22	Form of Restricted Stock Unit agreement under the 2005 Equity Incentive Plan (with acceleration upon change of control)(15) §
10.23	Form of Restricted Stock Unit agreement under the 2005 Equity Incentive Plan (no acceleration upon change of control)(15) §
10.24	Amendment to F5 Networks, Inc. 2005 Equity Incentive Plan Award Agreement, dated March 8, 2006, between the Registrant and John Rodriguez(16) §
10.25	Amendment to F5 Networks, Inc. 2005 Equity Incentive Plan Award Agreement, dated March 8, 2006, between the Registrant and Andy Reinland(16) §
10.27	Office Lease Agreement with Selig Real Estate Holdings IIX, L.L.C. dated October 31, 2006(17)
10.28	First Amendment to Sublease Agreement dated April 13, 2001 between the Registrant and Cell Therapeutics, Inc.(19)
10.29	Second Amendment to Sublease Agreement dated March 6, 2002 between the Registrant and Cell Therapeutics, Inc.(19)
10.30	Third Amendment to Sublease Agreement dated as of December 22, 2005 between the Registrant and Cell Therapeutics, Inc.(19)
10.31	Assumed Acopia Networks, Inc. 2001 Stock Incentive Plan(20) §
10.32	Acopia Acquisition Equity Incentive Plan(20) §
10.33	Form of Restricted Stock Unit Agreement under the Acopia Acquisition Equity Incentive Plan (with acceleration upon change of control)(21) §
10.34	Form of Restricted Stock Unit Agreement under the Acopia Acquisition Equity Incentive Plan (no acceleration upon change of control)(21) §
10.35	Form of Change of Control Agreement between F5 Networks, Inc. and each of John McAdam, John Rodriguez, Karl Triebes, Edward J. Eames, Dan Matte and certain other executive officers(24)
10.36	2005 Equity Incentive Plan, as amended January 2009(25)
10.37	Form of Restricted Stock Unit Agreement under the 2005 Equity Incentive Plan as amended (with acceleration upon change of control) as revised July 2009(26)
21.1*	Subsidiaries of the Registrant
23.1*	Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm
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
101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document

---

**Table of Contents**

\* Filed herewith.

\*\* XBRL (Extensible Business Reporting Language) information is furnished and not filed herewith, is not a part of a registration statement or Prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

§ Indicates a management contract or compensatory plan or arrangement.

- (1) Incorporated by reference from Current Report on Form 8-K dated May 31, 2004 and filed with the SEC on June 2, 2004.
- (2) Incorporated by reference from Current Report on Form 8-K dated October 4, 2005 and filed with the SEC on October 5, 2005.
- (3) Incorporated by reference from Registration Statement on Form S-1, File No. 333-75817.
- (4) Incorporated by reference from Quarterly Report on Form 10-Q for the quarter ended June 30, 2000.
- (5) Incorporated by reference from Quarterly Report on Form 10-Q for the quarter ended June 30, 2001.
- (6) Incorporated by reference from Registration Statement on Form S-8, File No. 333-109895.
- (7) Incorporated by reference from Registration Statement on Form S-8, File No. 333-104169.
- (8) Incorporated by reference from Annual Report on Form 10-K for the year ended September 30, 2000.
- (9) Incorporated by reference from Registration Statement on Form S-8, File No. 333-51878.
- (10) Incorporated by reference from Annual Report on Form 10-K for the year ended September 30, 2001.
- (11) Incorporated by reference from Registration Statement on Form S-8, File No. 333-112022.
- (13) Incorporated by reference from Annual Report on Form 10-K for the year ended September 30, 2004.
- (14) Incorporated by reference from Quarterly Report on Form 10-Q for the quarter ended March 31, 2005.
- (15) Incorporated by reference from Quarterly Report on Form 10-Q for the quarter ended June 30, 2005.
- (16) Incorporated by reference from Current Report on Form 8-K dated March 8, 2006 and filed with the SEC on March 10, 2006.
- (17) Incorporated by reference from Current Report on Form 8-K dated October 31, 2006 and filed with the SEC on November 3, 2006.
- (18) Incorporated by reference from Current Report on Form 8-K dated August 6, 2007 and filed with the SEC on August 8, 2007.
- (19) Incorporated by reference from Annual Report on Form 10-K for the year ended September 30, 2006.
- (20) Incorporated by reference from Registration Statement on Form S-8, File No. 333-146195.
- (21) Incorporated by reference from Annual Report on Form 10-K for the year ended September 30, 2007.
- (22) Incorporated by reference from Annual Report on Form 10-K for the year ended September 30, 2008.
- (23) Incorporated by reference from Quarterly Report on Form 10-Q for the quarter ended December 31, 2008.
- (24) Incorporated by reference from Current Report on Form 8-K dated April 29, 2009 and filed with the SEC on May 4, 2009.
- (25) Incorporated by reference from Quarterly Report on Form 10-Q for the quarter ended March 31, 2009.
- (26) Incorporated by reference from Quarterly Report on Form 10-Q for the quarter ended June 30, 2009.