F5 NETWORKS INC
Form 10-K/A
April 03, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K/A
Amendment No. 3
FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended September 30, 2005

or

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

Commission File Number 000-26041

F5 Networks, Inc.
(Exact name of Registrant as specified in its charter)

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

401 Elliott 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:
Common Stock, no par value
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 o No þ

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 o No þ

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 o No þ

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (229.405 of this chapter) is not contained herein, and will not be contained, to the best of 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. o

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

Large Accelerated Filer o Accelerated Filer þ Non-Accelerated Filer o

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

As of March 31, 2005, the aggregate market value of the Registrant s Common Stock held by non-affiliates of the Registrant was $1,886,824,225 based on the closing sales price of the Registrant s Common Stock on the Nasdaq National Market on that date.

As of December 5, 2005, the number of shares of the Registrant s Common Stock outstanding was 39,420,897.

DOCUMENTS INCORPORATED BY REFERENCE

Information required in response to Part III of 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 held on March 2, 2006.

EXPLANATION OF AMENDMENT

We are filing this Amendment No. 3 on Form 10-K/A for the fiscal year ended September 30, 2005 (Third Amendment) in response to comments received from the Securities and Exchange Commission. This Third Amendment provides additional disclosure to Item 6 (Selected Financial Data), Note 2 (Restatement of Consolidated Financial Statements) and Note 13 (Quarterly Results of Operations) to our consolidated financial statements in Item 8 which have no impact on our results of operations or financial condition. Item 6 has been amended to reflect the restated stock compensation cost reported for the fiscal years ended September 30, 2002, 2001, 2000 and 1999. Note 2 has been amended to reflect the restated stock compensation cost reported for the fiscal years ended September 30, 2005, 2004, 2003, 2002, 2001, 2000 and 1999. Note 13 has been amended to include interim balance sheet disclosures for the two-year period ended September 30, 2005. In addition, the Third Amendment includes updated certifications from our Chief Executive Officer (CEO) and Chief Accounting Officer (CAO) as Exhibits 31.1, 31.2 and 32.1. No other information in the Amendment No. 2 on Form 10-K/A for the fiscal year ended September 30, 2005 originally filed on December 12, 2006 is amended hereby.

This Amendment should be read in conjunction with our periodic filings made with the SEC subsequent to the date of the Original Report filed December 12, 2005, including any amendments to those filings, as well as any Current Reports filed on Form 8-K subsequent to the date of the Original Report.

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Item 6. Selected Financial Data

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and notes thereto and with Management s Discussion and Analysis of Financial Condition and Results of Operations and other financial data included elsewhere in this report. The restated consolidated balance sheet data as of September 30, 2005 and 2004 and the restated consolidated statement of operations data for the years ended September 30, 2005, 2004 and 2003 are derived from our audited financial statements and related notes that are included elsewhere in this report. The restated consolidated balance sheet data as of September 30, 2003, 2002, and 2001 and the restated consolidated statement of operations for the years ended September 30, 2002 and 2001 has been restated to conform to the financial statements included in this Form 10-K/A and has been derived from our unaudited financial statements and related notes which are not included in this report. Our historical results of operations are not necessarily indicative of results of operations to be expected for any future period.

See Management s Discussion and Analysis and Note 2, Restatement of Consolidated Financial Statements, of the Notes to Consolidated Financial Statements for more detailed information regarding the restatement of our consolidated financial statements for the years ended September 30, 2005, 2004 and 2003.

	Years Ended September 30,		
	2005	2004	2003
	(In thousands, except per share data)		
Consolidated Statement of Operations Data:	**As restated (1)**	**As restated (1)**	**As restated (1)**
Net revenues			
Products	$ 219,603	$ 126,169	$ 84,197
Services	61,807	45,021	31,698
Total	281,410	171,190	115,895
Cost of net revenues			
Products	48,990	28,406	17,843
Services	16,194	10,993	9,132
Total	65,184	39,399	26,975
Gross profit	216,226	131,791	88,920
Operating expenses(2)			
Sales and marketing	89,866	66,446	54,897
Research and development	31,516	24,438	19,455
General and administrative	25,486	15,761	12,210
Total	146,868	106,645	86,562
Income (loss) from operations	69,358	25,146	2,358
Other income, net	8,076	2,731	751
Income (loss) before income taxes	77,434	27,877	3,109
Provision (benefit) for income taxes	30,532	(8,451)	853
Net income (loss)	$ 46,902	$ 36,328	$ 2,256

Net income (loss) per share basic	$ 1.26	$ 1.09	$ 0.09
Weighted average shares basic	37,220	33,221	26,453
Net income (loss) per share diluted	$ 1.21	$ 1.01	$ 0.08
Weighted average shares diluted	38,761	35,961	28,175
Consolidated Balance Sheet Data:			
Cash, cash equivalents, and short-term investments(3)	$ 236,181	$ 140,501	
Restricted cash(4)	3,871	6,243	
Long-term investments(3)	128,834	81,792	
Total assets	537,739	360,593	
Long-term liabilities	9,964	6,228	
Total shareholders equity	460,167	307,745	

(1) See Note 2, Restatement of Consolidated Financial Statements, of the Notes to Consolidated Financial Statements.

(2) Amortization of unearned compensation reported in fiscal years 2001 through fiscal 2004 has been reclassified to conform to the current year s presentation. Specifically, amounts have been attributed to the respective categories within operating expenses.

(3) The combined overall increase in cash, cash equivalents,

short-term and long-term investments in fiscal 2004 was primarily due to the net proceeds of $113.6 million received from the sale of our common stock in a public offering in November 2003.

(4) Restricted cash represents escrow accounts established in connection with lease agreements for our facilities.

See Management s Discussion and Analysis and Note 2, Restatement of Consolidated Financial Statements, of the Notes to Consolidated Financial Statements for more detailed information regarding the restatement of our consolidated financial statements for the years ended September 30, 2002 and 2001.

	Years Ended September 30,					
	2002			2001		
	(In thousands, except per share data)					
	As reported	**Adjustments (3)**	**As restated (1)**	**As reported**	**Adjustments (3)**	**As restated (1)**
Consolidated Statement of Operations Data:						
Net revenues						
Products	$ 82,566	$	$ 82,566	$ 78,628	$	$ 78,628
Services	25,700		25,700	28,739		28,739
Total	108,266		108,266	107,367		107,367
Cost of net revenues						
Products	20,241	316	20,557	33,240	500	33,740
Services	10,238		10,238	12,265		12,265
Total	30,479	316	30,795	45,505	500	46,005
Gross profit	77,787	(316)	77,471	61,862	(500)	61,362
Operating expenses(2)						
Sales and marketing	50,786	2,887	53,673	51,199	3,467	54,666
Research and development	18,104	1,006	19,110	17,715	1,479	19,194
General and administrative	15,164	1,039	16,203	20,689	1,550	22,239
Restructuring charges	3,274		3,274	975		975
Total	87,328	4,932	92,260	90,578	6,496	97,074
Income (loss) from operations	(9,541)	(5,248)	(14,789)	(28,716)	(6,996)	(35,712)
Other income, net	1,420		1,420	2,021		2,021
Income (loss) before income taxes	(8,121)	(5,248)	(13,369)	(26,695)	(6,996)	(33,691)
Provision (benefit) for income taxes	489		489	4,095		4,095
Net income (loss)	$ (8,610)	$ (5,248)	$ (13,858)	$ (30,790)	$ (6,996)	$ (37,786)
Net income (loss) per share basic	$ (0.34)	$ (0.21)	$ (0.55)	$ (1.36)	$ (0.31)	$ (1.67)
Weighted average shares basic	25,323	$	25,323	22,644	$	22,644
Net income (loss) per share diluted	$ (0.34)	$ (0.21)	$ (0.55)	$ (1.36)	$ (0.31)	$ (1.67)
Weighted average shares diluted	25,323	$	25,323	22,644	$	22,644

	As of September 30,		
	2003	2002	2001
		(In thousands)	
	As reported	As reported	As reported
Consolidated Balance Sheet Data:			
Cash, cash equivalents, and short-term investments(3)	$ 44,878	$ 80,333	$ 69,783
Restricted cash(4)	6,000	6,000	6,000
Long-term investments(3)	34,132	1,346	
Total assets	148,173	126,289	124,663
Long-term liabilities	1,735	1,315	1,167
Total shareholders equity	110,429	93,685	96,488

(1) See Note 2, Restatement of Consolidated Financial Statements, of the Notes to Consolidated Financial Statements.

(2) Amortization of unearned compensation reported in fiscal years 2001 through fiscal 2004 has been reclassified to conform to the current year s presentation. Specifically, amounts have been attributed to the respective categories within operating expenses.

(3) The adjustments recorded in fiscal 2002 and 2001 consist of amortization of unearned compensation that was a result of the

Restatement discussed in Note 2, Restatement of Consolidated Financial Statements, of the Notes to the Consolidated Financial Statements.

(4) Restricted cash represents escrow accounts established in connection with lease agreements for our facilities.

Supplemental Unaudited Information Regarding Restatement Adjustments

The supplemental unaudited information presented below has been included to facilitate an understanding of the components of the Restatement adjustments to retained earnings at September 30, 2002:

	Cumulative effect of restatement on years prior to 2003	2002	2001	2000	1999
Stock-based compensation expense, as reported	**$ 7,682**	**$ 443**	**$ 2,625**	**$ 2,127**	**$ 2,487**
Adjustments	**20,234**	**5,248**	**6,996**	**7,826**	**164**
Stock-based compensation expense, restated	**$ 27,916**	**$ 5,691**	**$ 9,621**	**$ 9,953**	**$ 2,651**

The Company has not amended and does not intend to amend any of its previously filed Annual Reports on Form 10-K for the periods prior to October 1, 2002 affected by the Restatements. The additional compensation expense of approximately $20.2 million was incurred in fiscal years prior to the years associated with the audited consolidated financial statements presented herein. Retained earnings at September 30, 2002 was restated to reflect the after-tax effects of adjustments to stock-based compensation expenses for fiscal years 1999 through 2002.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of F5 Networks, Inc.:

We have completed an integrated audit of F5 Networks, Inc. s 2005 consolidated financial statements and of its internal control over financial reporting as of September 30, 2005 and audits of its 2004 and 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements and financial statement schedule

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the consolidated financial position of F5 Networks, Inc. and its subsidiaries at September 30, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2005 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes 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. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the consolidated financial statements, the Company has restated its 2005, 2004 and 2003 consolidated financial statements.

Internal control over financial reporting

Also, we have audited management s assessment, included in Management s Report on Internal Control over Financial Reporting appearing under Item 9A, that F5 Networks, Inc. did not maintain effective internal control over financial reporting as of September 30, 2005, because of errors identified related to the granting and modification of stock options and the related accounting for and disclosure of stock-based compensation expense, 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 maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management s assessment and on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides 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.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management s assessment. As of September 30, 2005, management has concluded that the Company did not maintain effective controls over the granting and modification of stock options and the related accounting for and disclosure of stock-based compensation expense. Specifically, effective controls, including monitoring, were not maintained to ensure the existence, completeness, accuracy, valuation and presentation of activity related to granting and modification of stock options. This control deficiency resulted in the misstatement of stock-based compensation expense, additional paid-in capital and related income tax accounts and related disclosures, and in the restatement of the Company s 2005, 2004 and 2003 annual consolidated financial statements and the interim consolidated financial statements for the first and second quarters of 2006 and all quarters of 2005 and 2004 and an audit adjustment to the interim consolidated financial statements for the third quarter of 2006. Further, this control deficiency could result in misstatements of the aforementioned accounts and disclosures that would result in a material misstatement of the Company s annual or interim consolidated financial statements that would not be prevented or detected. This material weakness was considered in evaluating the nature, timing, and extent of audit tests applied in our audit of the 2005 consolidated financial statements, and our opinion regarding the effectiveness of the Company s internal control over financial reporting does not affect our opinion on those financial statements.

Management and we previously concluded that the Company maintained effective internal control over financial reporting as of September 30, 2005. However, management subsequently has determined that the material weakness described above existed as of September 30, 2005. Accordingly, Management s Report on Internal Control over Financial Reporting has been restated and our present opinion on internal control over financial reporting, as presented herein, is different from that expressed in our previous report.

In our opinion, management s assessment that F5 Networks, Inc. did not maintain effective internal control over financial reporting as of September 30, 2005, is fairly stated, in all material respects, based on criteria established in *Internal Control Integrated Framework* issued by the COSO. Also, in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, F5 Networks, Inc. has not maintained effective internal control over financial reporting as of September 30, 2005, based on criteria established *in Internal Control Integrated Framework* issued by the COSO.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Seattle, Washington

December 9, 2005, except for the effect of the restatement discussed in Note 2 to the consolidated financial statements and the matter discussed in the penultimate paragraph of Management s Report on Internal Control over Financial Reporting, as to which the date is December 8, 2006

F5 NETWORKS, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share amounts)

	September 30, 2005 (as restated) (1)	September 30, 2004 (as restated) (1)
ASSETS		
Current assets		
Cash and cash equivalents	$ 51,867	$ 24,901
Short-term investments	184,314	115,600
Accounts receivable, net of allowances of $2,969 and $3,161	41,703	22,665
Inventories	2,699	1,696
Deferred tax assets	4,175	3,174
Other current assets	9,906	5,776
Total current assets	294,664	173,812
Restricted cash	3,871	6,243
Property and equipment, net	16,158	11,954
Long-term investments	128,834	81,792
Deferred tax assets	36,212	28,446
Goodwill	49,677	50,067
Other assets, net	8,323	8,279
Total assets	$ 537,739	$ 360,593
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 7,668	$ 4,840
Accrued liabilities	23,931	16,088
Deferred revenue	36,009	25,692
Total current liabilities	67,608	46,620
Other long-term liabilities	6,650	3,856
Deferred revenue, long-term	3,314	2,372
Total long-term liabilities	9,964	6,228
Commitments and contingencies		
Shareholders equity		
Preferred stock, no par value; 10,000 shares authorized, no shares outstanding		
Common stock, no par value; 100,000 shares authorized, 38,593 and 34,772 shares issued and outstanding	431,897	326,278
Accumulated other comprehensive loss	(1,430)	(498)
Unearned compensation		(833)

Retained earnings	29,700		(17,202)
Total shareholders equity	460,167		307,745
Total liabilities and shareholders equity	$ 537,739	$	360,593

(1) See Note 2, Restatement of Consolidated Financial Statements, of the Notes to Consolidated Financial Statements.

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

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

	Years Ended September 30,		
	2005	**2004**	**2003**
	(as restated) (1)	**(as restated) (1)**	**(as restated) (1)**
Net revenues			
Products	$ 219,603	$ 126,169	$ 84,197
Services	61,807	45,021	31,698
Total	281,410	171,190	115,895
Cost of net revenues			
Products	48,990	28,406	17,843
Services	16,194	10,993	9,132
Total	65,184	39,399	26,975
Gross profit	216,226	131,791	88,920
Operating expenses			
Sales and marketing	89,866	66,446	54,897
Research and development	31,516	24,438	19,455
General and administrative	25,486	15,761	12,210
Total	146,868	106,645	86,562
Income from operations	69,358	25,146	2,358
Other income, net	8,076	2,731	751
Income before income taxes	77,434	27,877	3,109
Provision (benefit) for income taxes	30,532	(8,451)	853
Net income	$ 46,902	$ 36,328	$ 2,256
Net income per share basic	$ 1.26	$ 1.09	$ 0.09
Weighted average shares basic	37,220	33,221	26,453
Net income per share diluted	$ 1.21	$ 1.01	$ 0.08
Weighted average shares diluted	38,761	35,961	28,175

(1) See Note 2,
Restatement of

Consolidated Financial Statements, of the Notes to Consolidated Financial Statements.

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

F5 NETWORKS, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
(in thousands)
(as restated) (1)

	Common Stock Shares	Common Stock Amount	Unearned Compensation	Accumulated Other Comprehensive Income/(Loss)	Retained Earnings (Deficit)	Total Shareholders Equity
			(In thousands)			
Balance, September 30, 2002	25,730	$ 128,876	$ (93)	$ 454	$ (35,552)	$ 93,685
Cumulative effect of restatement (Note 2)		22,670	(2,436)		(20,234)	
Balance, September 30, 2002, as restated	25,730	$ 151,546	$ (2,529)	$ 454	$ (55,786)	$ 93,685
Exercise of employee stock options	1,424	10,827				10,827
Issuance of stock under employee stock purchase plan	249	2,006				2,006
Unearned compensation		942	(942)			
Amortization of unearned compensation			1,914			1,914
Net income					2,256	
Foreign currency translation adjustment				(161)		
Unrealized loss on securities				(98)		
Comprehensive income						1,997
Balance, September 30, 2003, as restated	27,403	$ 165,321	$ (1,557)	$ 195	$ (53,530)	$ 110,429
Exercise of employee stock options	2,032	22,349				22,349
Issuance of stock under employee stock purchase plan	162	2,579				2,579
Issuance of common stock in a public offering (net of issuance costs of $6,682)	5,175	113,636				113,636
Tax benefit from employee stock transactions		21,925				21,925
Unearned compensation		468	(468)			
Amortization of unearned compensation			1,192			1,192
Net income					36,328	
Foreign currency translation adjustment				144		
Unrealized loss on securities				(837)		
Comprehensive income						35,635
Balance, September 30, 2004, as restated	34,772	$ 326,278	$ (833)	$ (498)	$ (17,202)	$ 307,745
Exercise of employee stock options	3,685	65,056				65,056
Issuance of stock under employee stock purchase plan	136	3,837				3,837

Tax benefit from employee stock transactions		32,153				32,153
Amortization of unearned compensation			833			833
Stock-based compensation		4,573				4,573
Net income					46,902	
Foreign currency translation adjustment				(161)		
Unrealized loss on securities				(771)		
Comprehensive income						45,970
Balance, September 30, 2005, as restated	38,593	$ 431,897	$	$ (1,430)	$ 29,700	$ 460,167

(1) See Note 2, Restatement of Consolidated Financial Statements, of the Notes to Consolidated Financial Statements.

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

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

	Years Ended September 30,		
	2005 (as restated) (1)	**2004 (as restated) (1)**	**2003 (as restated) (1)**
Operating activities			
Net income	$ 46,902	$ 36,328	$ 2,256
Adjustments to reconcile net income to net cash provided by operating activities:			
Realized loss (gain) on disposition of assets	569	21	(14)
Realized (gain) loss on sale of investments		(3)	232
Stock-based compensation	5,406	1,192	1,914
Provision for doubtful accounts and sales returns	1,419	1,189	1,148
Depreciation and amortization	6,797	5,355	5,162
Deferred income taxes	(7,733)	(33,886)	
Tax benefit from employee stock option plans	32,153	21,685	
Changes in operating assets and liabilities, net of amounts acquired:			
Accounts receivable	(20,456)	(4,152)	354
Inventories	(1,002)	(928)	(408)
Other current assets	(3,604)	(642)	(54)
Other assets	(149)	(630)	(512)
Accounts payable and accrued liabilities	13,426	6,303	(320)
Deferred revenue	11,259	8,758	4,852
Net cash provided by operating activities	84,987	40,590	14,610
Investing activities			
Purchases of investments	(407,533)	(335,231)	(157,834)
Sales of investments	290,351	205,662	149,724
Investment of restricted cash	2,369	(168)	
Proceeds from the sale of property and equipment			14
Acquisition of intangible assets, net	(2,259)		
Acquisition of businesses, net of cash acquired	(395)	(29,201)	(27,373)
Purchases of property and equipment	(9,293)	(5,775)	(2,584)
Net cash used in investing activities	(126,760)	(164,713)	(38,053)
Financing activities			
Proceeds from secondary offering, net of issuance costs		113,636	
Proceeds from the exercise of stock options	68,867	24,832	12,833
Net cash provided by financing activities	68,867	138,468	12,833
Net increase (decrease) in cash and cash equivalents	27,094	14,345	(10,610)

Effect of exchange rate changes on cash and cash equivalents		(128)		205		160
Cash and cash equivalents, beginning of year		24,901		10,351		20,801
Cash and cash equivalents, end of year	$	51,867	$	24,901	$	10,351
Supplemental Information						
Cash paid for taxes	$	792	$	706	$	290

(1) See Note 2, Restatement of Consolidated Financial Statements, of the Notes to Consolidated Financial Statements.

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

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

Certain Risks and Uncertainties

The Company s products and services are concentrated in highly competitive markets characterized by rapid technological advances, frequent changes in customer requirements and evolving regulatory requirements and industry standards. Failure to anticipate or respond adequately to technological advances, changes in customer requirements and changes in regulatory requirements or industry standards could have a material adverse effect on the Company s business and operating results. Additionally, certain other factors could affect the Company s future operating results and cause actual results to differ materially from expectations, including but not limited to, the timely development, introduction and acceptance of additional new products and features by the Company or its competitors; competitive pricing pressures, increased sales discounts; the Company s ability to sustain, develop and effectively utilize distribution relationships; the Company s ability to attract, train and retain qualified personnel; the Company s ability to expand in international markets, and the unpredictability of the Company s sales cycle.

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.

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. The reclassifications had no impact on previously reported net income or shareholders equity.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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, warranties, valuation allowance on deferred tax assets and purchase price allocations. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments with purchased maturities of three months or less to be cash equivalents. The Company invests its cash and cash equivalents in deposits with three 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 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 are classified as long-term investments.

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.

The Company maintains its cash and investment balances with high credit quality financial institutions.

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 and marked-to-market at each reporting period. The fair value is determined using quoted market prices for the securities held.

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):

	Years Ended September 30,	
	2005	**2004**
Finished goods	$ 2,486	$ 1,452
Raw materials	213	244
	$ 2,699	$ 1,696

Restricted Cash

Restricted cash represents escrow accounts established in connection with lease agreements for the Company s corporate headquarters and, to a lesser extent, our international facilities. Under the terms of the lease for our corporate headquarters, the amount required to be held in escrow reduces and eventually eliminates at various dates throughout the duration of the lease term. During the fiscal year ended September 30, 2005, the amount required to be held in escrow decreased from $6.0 million to $3.6 million as set forth in the lease agreement for our corporate headquarters.

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):

	Years Ended September 30,	
	2005	**2004**
Computer equipment	$ 19,344	$ 18,499
Office furniture and equipment	5,326	5,895
Leasehold improvements	8,772	8,272
	33,442	32,666
Accumulated depreciation and amortization	(17,284)	(20,712)
	$ 16,158	$ 11,954

Depreciation and amortization expense totaled approximately $4.8 million, $4.0 million, and $4.7 million for the fiscal years ended September 30, 2005, 2004 and 2003, respectively.

Goodwill

Goodwill represents the excess purchase price over the estimated fair value of net assets acquired as of the acquisition date. The Company has adopted the requirements of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS No. 142). SFAS No. 142 requires goodwill to be tested for impairment on an annual basis and between annual tests in certain circumstances, and written down when impaired. Goodwill of $24.2 million was recorded in connection with the acquisition of uRoam, Inc. in fiscal year 2003 and goodwill of $25.5 million was recorded in connection with the acquisition of MagniFire Websystems Inc., in fiscal year 2004. The Company completed its annual impairment test in the second quarter of each fiscal year and concluded that there was no impairment of goodwill in either fiscal year 2005 or 2004.

Other Assets

Other assets primarily consist of software development costs and acquired technology.

Software development costs are charged to research and development expense until technological feasibility is established. The Company accounts for internally-generated software development costs in accordance with Statement of Financial Accounting Standards (SFAS) No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed. 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. 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 year 2005. During the fiscal year 2004, the Company capitalized $424,000 of software development costs. Related amortization costs of $272,000, $328,000, and $298,000 were recorded during the fiscal years 2005, 2004, and 2003, respectively.

Acquired technology is recorded at cost and amortized over its estimated useful life of five years. Acquired technology of $5.0 million in fiscal year 2004 and $3.0 million in fiscal year 2003 was recorded in connection with the acquisitions of MagniFire and uRoam, respectively. Related amortization expense, which is charged to cost of product revenues, totaled $1.6 million, $1.0 million and $100,000 during the fiscal years 2005, 2004 and 2003, respectively.

Impairment of Long-Lived Assets

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 an impairment by comparing the anticipated undiscounted net future cash flows to the related asset s carrying value. If an impairment exists, the asset is written down to its estimated fair value.

Revenue Recognition

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

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

Whenever a software license, hardware, installation and post-contract customer support (PCS), elements are sold together, a portion of the sales price is allocated to each element based on their respective fair values as determined when the individual elements are sold separately. Revenues from the license of software are recognized when the software has been shipped and the customer is obligated to pay for the software. When rights of return are present and the Company cannot estimate returns, the Company 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 rights to upgrades, when and if available, a limited period of telephone support, updates, and bug fixes. Installation revenue is recognized when the product has been installed at the customer s site. Consulting services are customarily billed at fixed rates, plus out-of-pocket expenses, and revenues are recognized when the consulting has been completed. Training revenue is recognized when the training has been completed.

Shipping and Handling

Shipping and handling fees charged to our 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, 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. During the years ended September 30, 2005, 2004 and 2003 warranty expense was $2.2 million, $0.9 million and $0.3 million, respectively.

The following table summarizes the activity related to product warranties (in thousands):

	Years Ended September 30		
	2005	**2004**	**2003**
Balance, beginning of fiscal year	$ 1,062	$ 827	$ 650
Provision for warranties issued	2,233	923	291

Payments	(1,730)	(688)	(114)
Balance, end of fiscal year	$ 1,565	$ 1,062	$ 827

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 $1.7 million, $1.7 million and $1.0 million in advertising costs during the fiscal years 2005, 2004 and 2003, respectively.

Income Taxes

The Company utilizes the liability method of accounting for income taxes as set forth by Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, or SFAS 109. 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.

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 in accordance with Statement of Financial Accounting Standards No. 52 Foreign Currency Translation. 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.

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 were not significant during the fiscal year ended September 30, 2005. Net transaction losses of $466,000 and $544,000 were charged to operations for the fiscal year ended September 30, 2004 and 2003, respectively.

Segments

The Company complies with the requirements of Statement of Financial Accounting Standards (SFAS) No. 131, Disclosure about Segments of an Enterprise and Related Information, which establishes annual and interim reporting standards for an enterprise s operating segments and related disclosures about its products, services, geographic areas and major customers. Management has determined that the Company operates in one segment.

Stock-Based Compensation

On July 1, 2005, the Company adopted the fair value recognition provisions of Financial Accounting Standards Board (FASB) Statement No. 123(R), *Share-Based Payment*, (FAS 123R). Prior to July 1, 2005, the Company accounted for share-based payments under the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), and related Interpretations, as permitted by FASB Statement No. 123, *Accounting for Stock-Based Compensation* (FAS 123). In accordance with APB 25 no compensation cost was required to be recognized for options granted that had an exercise price equal to the market value of the underlying common stock on the date of grant.

The Company adopted FAS 123R using the modified-prospective-transition method. Under that transition method, compensation cost recognized in the fiscal year 2005 includes: a) compensation cost for all share-based payments granted prior to, but not yet vested as of July 1, 2005, based on the grant-date fair value estimated in accordance with the original provisions of FAS 123, and b) compensation cost for all share-based payments granted subsequent to July 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of FAS 123R.

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Effective July 1, 2005 the Company adopted the straight-line attribution method for recognizing compensation expense. Previously under the disclosure-only provisions of SFAS 123, the Company used the accelerated method of expense recognition pursuant to FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans* (FIN 28). For all unvested options outstanding as of July 1, 2005, the previously measured but unrecognized compensation expense, based on the fair value at the original grant date, will be recognized on an accelerated basis over the remaining vesting period. For share-based payments granted subsequent to July 1, 2005, compensation expense, based on the fair value on the date of grant, will be recognized on a straight-line basis over the vesting period.

The fair value of restricted stock units is based on the price of a share of our common stock on the date of grant. However, in determining the fair value of stock options, we use the Black-Scholes option pricing model that employs the following key assumptions.

	Stock Option Plan Years Ended September 30,			**Employee Stock Purchase Plan Years Ended September 30,**		
	2005	**2004**	**2003**	**2005**	**2004**	**2003**
Risk-free interest rate	3.53%	3.19%	2.33%	2.72%	1.14%	1.23%
Expected dividend						
Expected term	2.7 years	2.2 years	4.0 years	0.5 years	0.5 years	0.5 years
Expected volatility	68.17%	59.05%	49.95%	52.48%	50.18%	72.93%

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 our stock price commensurate with the expected life of the option. Expected term of the option is based on an evaluation of the historical employee stock option exercise behavior, the vesting terms of the respective option and a contractual life of ten years. Our stock price volatility and option lives involve management s best estimates at that time, both of which impact the fair value of the option calculated under the Black-Scholes methodology and, ultimately, the expense that will be recognized over the life of the option. SFAS 123R also requires that we recognize compensation expense for only the portion of options or stock units that are expected to vest. Therefore, the Company applies estimated forfeiture rates that are derived from historical employee termination behavior. The estimated forfeiture rate in the fourth quarter of fiscal 2005 is 5%. If the actual number of forfeitures differs from those estimated by management, additional adjustments to compensation expense may be required in future periods.

The weighted-average fair value of options granted in the fiscal years 2005, 2004 and 2003 was $18.68, $8.32 and $7.46, respectively.

The following table shows the pro forma effect on the Company s net income (loss) and net income (loss) per share for the years ended September 30, 2005, 2004 and 2003, had compensation expense been determined based upon the fair value at the grant date for awards consistent with the methodology prescribed by SFAS 123. The Company adopted SFAS 123R on July 1, 2005 the beginning of its fourth quarter of fiscal 2005; therefore, stock-based compensation expense shown in the pro forma table relates to expense through June 30, 2005 while the Company was still under the disclosure only provisions of SFAS 123. Stock-based compensation expense for the fourth quarter of fiscal 2005 has been included in results of operations. The following pro forma disclosure has been restated to reflect changes in assumptions and corrections of errors related to both our reported net income (loss) and to the pro forma stock-based compensation amounts as determined under SFAS No. 123, identified in connection with our Restatement (See Note 2, Restatement of Consolidated Financial Statements). The pro forma effects may not be representative of expense in future periods since the estimated fair value of stock options on the date of grant is amortized to expense over the vesting period, and additional options may be granted or options may be cancelled in future years.

	Years Ended September 30,		
	2005 (as restated) (1)	**2004 (as restated) (1)**	**2003 (as restated) (1)**
Net income, as reported	$ 46,902	$ 36,328	$ 2,256
Add: Stock-based employee compensation expense under APB No. 25 included in reported net income, net of tax effect	833	1,192	1,914
Deduct: Total stock-based employee compensation expense determined under the fair value methods, net of tax effect	7,161	19,356	24,402
Pro forma net income (loss).	$ 40,574	$ 18,164	$ (20,232)
Net income (loss) per share:			
As reported basic	$ 1.26	$ 1.09	$ 0.09
Pro forma basic	$ 1.09	$ 0.55	$ (0.76)
As reported diluted	$ 1.21	$ 1.01	$ 0.08
Pro forma diluted	$ 1.05	$ 0.51	$ (0.76)

(1) See Note 2, Restatement of Consolidated Financial Statements, of the Notes to Consolidated Financial Statements.

Earnings Per Share

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

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

Years Ended September 30,

	2005 (as restated) (1)	2004 (as restated) (1)	2003 (as restated) (1)
Numerator			
Net income	$ 46,902	$ 36,328	$ 2,256
Denominator			
Weighted average shares outstanding basic	37,220	33,221	26,453
Dilutive effect of common shares from stock options and restricted stock units	1,541	2,740	1,722
Weighted average shares outstanding diluted	38,761	35,961	28,175
Basic net income per share	$ 1.26	$ 1.09	$ 0.09
Diluted net income per share	$ 1.21	$ 1.01	$ 0.08

(1) See Note 2, Restatement of Consolidated Financial Statements, of the Notes to Consolidated Financial Statements.

Approximately 0.4 million, 1.4 million, and 2.6 million of common shares potentially issuable from stock options for the years ended September 30, 2005, 2004 and 2003 are excluded from the calculation of diluted earnings per share because the exercise price was greater than the market price.

Recent Accounting Pronouncements

In March 2004, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. EITF 03-1 provides guidance on other-than-temporary impairment models for marketable debt and equity securities accounted for under SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, and SFAS No. 124, Accounting for Certain Investments Held by Not-for-Profit Organizations, and non-marketable equity securities accounted for under the cost method. The EITF developed a basic three-step model to evaluate whether an investment is other-than-temporarily impaired. On September 30, 2004, the FASB approved the issuance of FASB Staff Position (FSP) EITF 03-1-1, which delays the effective date until additional guidance is issued for the application of the recognition and measurement provisions of EITF 03-1 to investments in securities that are impaired. In November 2005, the FASB issued FSP FAS 115-1 and FAS 124-1, The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments. This FSP addresses the determination as to when an investment is considered impaired, whether the impairment is other than temporary and the measurement of an impairment loss. This statement specifically nullifies the requirements of paragraph 10-18 of EITF 03-1 and references existing other-than-temporary impairment guidance. The guidance under this FSP is effective for reporting periods beginning after December 15, 2005. The Company does not expect the adoption of FSP FAS 115-1 and FAS 124-1 to have a material effect on the Company s results of operations or financial condition.

In May of 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections A Replacement of APB Opinion No. 20 and FASB Statement No. 3, which changes the requirements for the accounting and reporting of a change in accounting principle. The Statement applies to all voluntary changes in accounting principle and to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. This Statement requires retrospective application to prior periods financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company does not expect the adoption of this statement to have a material impact on the Company s financial condition or results of operations.

2. Restatement of Consolidated Financial Statements

On May 16, 2006, the Center for Financial Research and Analysis (CFRA) issued a report entitled Options Backdating, Which Companies Are At Risk? (the CFRA Report) in which CFRA reviewed the option prices of 100 public companies and, based upon an analysis of the exercise prices of option grants with reference to the companies stock prices, concluded that 17% of the subject companies were, in CFRA s view, at risk for having backdated option grants during the period 1997 to 2002. The Company was among the 17 companies so identified.

On May 18, 2006, the Company was contacted by the Securities and Exchange Commission (SEC) as part of an informal inquiry entitled *In the Matter of F5 Networks, Inc.,* (SEC File No. MHO-10462). On May 19, 2006, the Company received a grand jury subpoena issued by the U.S. District Court for the Eastern District of New York requesting documents related to the granting of stock options from 1995 through the present in connection with an inquiry into the Company s stock option practices by the United States Attorney s Office for the Eastern District of New York (the Department of Justice). The Company produced documents in response to these requests and is continuing to cooperate fully with the SEC regarding these inquires.

On May 22, 2006, the Company s Board of Directors (the Board of Directors) formed a special committee of outside directors with broad authority to conduct a review of the Company s stock option practices, including a review of the Company s underlying stock option documentation and procedures (the Special Committee). At that time, the Special Committee was composed of three members of the Board of Directors, one of which was also on the Audit Committee, Karl Guelich, Rich Malone and Gary Ames. In July 2006, the Special Committee was reconstituted to consist of two independent members of the Board of Directors, Gary Ames and Deborah Bevier (who joined the Company s Board of Directors on July 14, 2006). The Special Committee retained the law firm of Wilson Sonsini Goodrich & Rosati P.C. (Wilson Sonsini) as its independent outside legal counsel. Wilson Sonsini engaged Deloitte Financial Advisory Services LLP as independent accounting experts to aid in its investigation.

In the course of responding to the SEC and the Department of Justice s inquiries, the Company determined that there were potential problems with the accounting treatment of certain stock option grants. On July 20, 2006, the Company announced that the Audit Committee of the Board of Directors (the Audit Committee) had determined, after consultation with management, that the Company s financial statements and all earnings releases and similar communications relating to fiscal periods beginning on or after October 1, 2000, the first day of its fiscal year 2001, should be restated.

In October 2006, the Special Committee determined that the recorded grant dates for certain stock options granted during fiscal years 1999 through 2004 should not be relied upon as the measurement date for accounting purposes and that the accounting treatment used for the vesting of certain stock options was incorrect. Because the prices at the originally stated grant dates were lower than the prices on the actual measurement dates, the Company determined it should have recognized material amounts of stock-based compensation expense which were not previously accounted for in the Company s previously issued financial statements. Therefore, the Audit Committee after consultation with management concluded that the Company s previously filed unaudited interim and audited financial statement for the years ended September 30, 2005, 2004, 2003, 2002, 2001, 2000 and 1999 as well as the unaudited interim financial statements for the first and second quarters ended December 31, 2005 and 2004 and March 31, 2006 and 2005, should no longer be relied upon because these financial statements contained material misstatements.

Special Committee and Company Findings

On November 8, 2006, the Company announced that the Special Committee had completed its review of the Company s stock option practices and reported its final findings to the Board of Directors.

The Special Committee concluded that there were options grants where the Company (i) used improper measurement dates in connection with certain annual stock option grants to employees because the number of shares certain individual employees were entitled to receive was not determined until after the original grant date, (ii) granted options to certain new employees and board members prior to their start dates, (iii) did not have sufficient documentation to support certain measurement dates and did not obtain the necessary approvals for stock options issued to certain individuals, (iv) did not properly account for stock option grants issued to a consultant who later became an employee, and (v) did not properly account for stock options of certain individuals that were modified after the grant date. Based on its investigation, the Special Committee concluded that it continued to have confidence in the ability of the Company s current senior management to serve in their positions with integrity at the Company. The Special Committee was unable to reach any conclusions regarding the intent of former officers, directors and employees. Based on the Special Committee s findings, the Company has adopted and is implementing a number of remedial measures designed to improve its policies, controls, processes and procedures relating to the granting and modification of stock-based compensation and will provide additional training for personnel responsible for administration of the Company s equity compensation plans.

As a result of the Special Committee s investigation, as well as the Company s internal review of its stock option practices and historical financial statements, the Company has determined the following:

Improper Measurement Dates for Annual Stock Option Grants. In connection with the Company s annual stock option grants to certain employees in 2000, 2001, 2003 and 2004, the number of shares that certain individual employees were entitled to receive was not determined until after the original grant date, and therefore the measurement date for such options was subsequent to the original grant date. In addition, in connection with the Company s annual stock option grant to employees in 2000, the exercise price was not set in accordance with APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) and related interpretations. As a result, the Company has restated its historical financial statements to increase stock-based compensation expense by approximately $14.3 million recognized over the applicable vesting periods.

Improper Measurement Dates for Other Stock Option. Certain options to new employees and board members were granted on dates other than to their respective start date with the Company. As a result, the Company has restated its historical financial statements to increase stock-based compensation expense by approximately $1.3 million recognized over the applicable vesting periods.

Incomplete Documentation or Approval for Stock Option Grants. In 2000 and 2001 the Company did not have sufficient documentation to support certain measurement dates and did not obtain the required approvals for stock options. As a result, the Company has restated its historical financial statements to increase stock-based compensation expense by approximately $4.6 million recognized over the applicable vesting periods.

*Stock Options Grants to Non-*employees. In 2000, the Company did not properly accounted for stock option grants issued to a consultant who later became an employee. The Company erroneously accounted for the grant in accordance with APB No. 25 rather than FASB Statement No. 123, *Accounting for Stock-Based Compensation* (FAS 123) and related interpretations. As a result, the Company has restated its historical financial statements to increase stock-based compensation expense by approximately $3.0 million.

Modifications to Stock Option Grants. From 1999 through 2002, the Company did not properly account for stock options for certain individuals that were modified after the grant date. Some of these modifications were not identified in the Company s financial reporting processes and were therefore not properly reflected in its financial statements. As a result, The Company has restated its historical financial statements to increase stock-based compensation expense by approximately $843,000 recognized as of the date of the respective modifications.

As a result of the above, the Company has recorded additional non-cash stock-based compensation expense of approximately $24.1 million on stock option grants made from 1999 through 2004. In addition, the Company recorded approximately $1.7 million of additional compensation expense in 2005 related to its obligation under pre-existing commitments to reimburse employees for penalties incurred resulting from receipt of in-the-money option grants. Tax impacts of these additional expenses included; a reclassification of windfall tax benefits of $4.8 million in fiscal year 2004, which were previously recognized in paid-in-capital and now are required to be recognized as a tax benefit and additional tax expenses resulting from non-deductible employee compensation of $2.5 million, which together result in a net benefit of $2.3 million.

As a result of these findings the Company s restated consolidated financial statements reflect a decrease in net income of approximately $23.5 million for the periods 1999 through 2005. These charges had no impact on the Company s reported net sales or cash and cash equivalents.

The cumulative effect of the restatement adjustments on the Company s consolidated balance sheet at September 30, 2005 resulted in a decrease in retained earnings of $23.5 million, partially offset by an increase in additional paid-in capital of $19.5 million, which results in a net decrease in total shareholders equity of $4.0 million. All of the restatements of financial statements, financial data and related disclosures described in these Consolidated Financial Statements are collectively referred to elsewhere in these Consolidated Financial Statements as the restatement.

The information presented below has been included to facilitate an understanding of the components of the restatement adjustments to retained earnings. The following table is a summary of pre-tax adjustments made to stock-based compensation:

	2005	**2004**	**2003**	**Cumulative effect of restatement on years prior to 2003**	**2002**	**2001**	**2000**	**1999**

Stock-based compensation expense, as reported	$	$ 10	$ 83	$ 7,682	$ 443	$2,625	$2,127	$2,487
Adjustments	833	1,182	1,831	20,234	5,248	6,996	7,826	164
Stock-based compensation expense, restated	$833	$1,192	$1,914	$ 27,916	$5,691	$9,621	$9,953	$2,651

For explanatory purposes, the Company has classified the stock-based compensation and other adjustments that were affected by the restatement into the aforementioned categories as presented below. The classified amounts involve certain subjective judgments by management to the extent particular stock option related accounting errors may fall within more than one category to avoid double counting the adjustment amounts between categories (e.g., a stock option that is subject to date changes and/or combined with expenses resulting from consulting, transition or advisory roles). As such, the table below should be considered a reasonable representation of the magnitude of expenses in each category.

Adjustments to Stock-Based Compensation by Category	Years Ended September 30, (in thousands) 2005	2004	2003	Cumulative effect on years prior to 2003
Improper measurement dates for annual stock option grants	$ 464	$ 719	$ 1,407	$ 11,717
Modifications to stock option grants	335	356	152	
Incomplete documentation or approval for stock option grants				4,625
Improper measurement dates for other stock option grants	34	107	272	904
Stock option grants to non-employees				2,988
Total adjustments to income before income taxes	833	1,182	1,831	20,234
Payroll related liabilities	1,700			
Total adjustments to net income	2,533	1,182	1,831	20,234
Income tax impact of restatement adjustments	2,298	(4,557)		
Total adjustments to net income	$ 4,831	$ (3,375)	$ 1,831	$ 20,234

In order to further enhance investor understanding of the effects of the matters described in the section entitled Special Committee and Company Findings and to provide context for the disclosure and the composition of the cumulative adjustment to opening retained earnings we have provided the information below, which shows the accounting periods to which the stock compensation adjustments relate. The Company s financial statements for such periods and the related SEC reports for such periods have not been amended. Accordingly, for illustrative purposes, the table below applies the stock compensation adjustments amounts to the captions and periods shown to facilitate an understanding of the amount by which opening retained earnings has been adjusted. In addition to the stock compensation adjustment shown in the table below, the Company has also included the effect of the payroll related liability referred to above and the related tax effects of all adjustments so as to reconcile to the impact on the Company s retained earnings balance as of October 1, 2002.

Adjustments to Stock-Based Compensation to Consolidated Statements of Operations	Years Ended September 30, (in thousands) 2005	2004	2003	Cumulative effect on years prior to 2003	2002	2001	2000	1999
Adjustments to:								
Costs and Expenses								
Stock-based compensation:								
Cost of goods sold	$ 27	$ 20	$ 70	$ 1,117	$ 316	$ 500	$ 301	$
Sales and marketing	613	1,068	1,393	7,485	2,887	3,467	1,131	
Research and development	167	77	195	2,701	1,006	1,479	216	

General and administrative	26	17	173	8,931	1,039	1,550	6,178	164
Income before income taxes	833	1,182	1,831	20,234	5,248	6,996	7,826	164
Payroll related liabilities	1,700							
Total adjustments to net income	2,533	1,182	1,831	20,234	5,248	6,996	7,826	164
Income tax impact of restatement adjustments	2,298	(4,557)						
Total adjustments to net income	$ 4,831	$ (3,375)	$ 1,831	$ 20,234	$ 5,248	$ 6,996	$ 7,826	$ 164

These adjustments, along with the stock-based items referenced above, did not affect the Company s previously reported cash and cash equivalents and investments balances in prior periods. The following tables present the effect of the restatement adjustments by financial statement line item for the Consolidated Balance Sheets, Statements of Operations and Statements of Cash Flows.

Consolidated Balance Sheets as of September 30, 2005 and 2004 (in thousands):

	September 30, 2005			September 30, 2004		
	As previously reported	**Adjustments**	**As restated**	**As previously reported**	**Adjustments**	**As restated**
ASSETS						
Current assets						
Cash and cash equivalents	$ 51,867	$	$ 51,867	$ 24,901	$	$ 24,901
Short-term investments	184,314		184,314	115,600		115,600
Accounts receivable, net	41,703		41,703	22,665		22,665
Inventories	2,699		2,699	1,696		1,696
Deferred tax assets	3,935	240	4,175	2,934	240	3,174
Other current assets	9,906		9,906	5,776		5,776
Total current assets	294,424	240	294,664	173,572	240	173,812
Restricted cash	3,871		3,871	6,243		6,243
Property and equipment, net	16,158		16,158	11,954		11,954
Long-term investments	128,834		128,834	81,792		81,792
Deferred tax assets	36,212		36,212	28,446		28,446
Goodwill	49,677		49,677	50,067		50,067
Other assets, net	8,323		8,323	8,279		8,279
Total assets	$ 537,499	$ 240	$ 537,739	$ 360,353	$ 240	$ 360,593
LIABILITIES AND SHAREHOLDERS EQUITY						
Current liabilities						
Accounts payable	$ 7,668	$	$ 7,668	$ 4,840	$	$ 4,840
Accrued liabilities	19,648	4,283	23,931	15,948	140	16,088
Deferred revenue	36,009		36,009	25,692		25,692
Total current liabilities	63,325	4,283	67,608	46,480	140	46,620
Other long-term liabilities	6,650		6,650	3,856		3,856
Deferred revenue, long-term	3,314		3,314	2,372		2,372
Total long-term liabilities	9,964		9,964	6,228		6,228
Commitments and contingencies						
Shareholders equity						
Preferred stock						
Common stock	412,419	19,478	431,897	306,655	19,623	326,278

Accumulated other comprehensive loss	(1,430)		(1,430)	(498)		(498)
Unearned compensation					(833)	(833)
Retained earnings	53,221	(23,521)	29,700	1,488	(18,690)	(17,202)
Total shareholders equity	464,210	(4,043)	460,167	307,645	100	307,745
Total liabilities and shareholders equity	$ 537,499	$ 240	$ 537,739	$ 360,353	$ 240	$ 360,593

Consolidated Statement of Operations for the years ended September 30, 2005, 2004 and 2003 (in thousands, except per share amounts):

	Year Ended September 30,								
	2005			2004			2003		
	As previously reported	**Adjustments**	**As restated**	**As previously reported**	**Adjustments**	**As restated**	**As previously reported**	**Adjustments**	**As restated**
Net revenues									
Products	$ 219,603	$	$ 219,603	$ 126,169	$	$ 126,169	$ 84,197	$	$ 84,197
Services	61,807		61,807	45,021		45,021	31,698		31,698
Total	281,410		281,410	171,190		171,190	115,895		115,895
Cost of net revenues									
Products	48,985	$ 5	48,990	28,404	$ 2	28,406	17,837	$ 6	17,843
Services	16,172	22	16,194	10,975	18	10,993	9,068	64	9,132
Total	65,157	27	65,184	39,379	20	39,399	26,905	70	26,975
Gross profit	216,253	(27)	216,226	131,811	(20)	131,791	88,990	(70)	88,920
Operating expenses									
Sales and marketing	89,253	613	89,866	65,378	1,068	66,446	53,504	1,393	54,897
Research and development	31,349	167	31,516	24,361	77	24,438	19,260	195	19,455
General and administrative	23,760	1,726	25,486	15,744	17	15,761	12,037	173	12,210
Total	144,362	2,506	146,868	105,483	1,162	106,645	84,801	1,761	86,562