F5 NETWORKS INC
Form 10-Q
August 06, 2010

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

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

For the quarterly period ended June 30, 2010

OR

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

For the transition period from _____ to _____

Commission File Number 000-26041

F5 NETWORKS, INC.

(Exact name of registrant as specified in its charter)

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

401 Elliott Avenue West
Seattle, Washington 98119

(Address of principal executive offices and zip code)

(206) 272-5555

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant 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 þ No o

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

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

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

The number of shares outstanding of the registrant s common stock as of August 4, 2010 was 80,467,642.

F5 NETWORKS, INC.
QUARTERLY REPORT ON FORM 10-Q
For the Quarter Ended June 30, 2010
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	June 30, 2010	September 30, 2009
ASSETS		
Current assets		
Cash and cash equivalents	$ 143,813	$ 110,837
Short-term investments	254,543	206,291
Restricted cash	2,400	
Accounts receivable, net of allowances of $3,999 and $3,651	102,829	106,973
Inventories	17,747	13,819
Deferred tax assets	7,868	8,010
Other current assets	30,886	22,252
Total current assets	560,086	468,182
Restricted cash	336	2,729
Property and equipment, net	35,991	39,371
Long-term investments	382,295	257,294
Deferred tax assets	37,762	49,018
Goodwill	233,526	231,883
Other assets, net	17,277	20,168
Total assets	$ 1,267,273	$ 1,068,645
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 22,657	$ 18,891
Accrued liabilities	47,990	53,232
Deferred revenue	188,661	150,891
Total current liabilities	259,308	223,014
Other long-term liabilities	15,386	14,373
Deferred revenue, long-term	50,977	32,238
Total long-term liabilities	66,363	46,611
Commitments and contingencies (Note 5)		
Shareholders equity		
Preferred stock, no par value; 10,000 shares authorized, no shares outstanding		
Common stock, no par value; 200,000 shares authorized, 79,977 and 78,325 shares issued and outstanding	504,708	462,786
Accumulated other comprehensive loss	(4,595)	(2,337)

Retained earnings	441,489	338,571
Total shareholders equity	941,602	799,020
Total liabilities and shareholders equity	$ 1,267,273	$ 1,068,645

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

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

	Three months ended June 30,		Nine months ended June 30,	
	2010	2009	2010	2009
Net revenues				
Products	$ 147,393	$ 95,619	$ 396,170	$ 297,649
Services	83,081	62,612	231,528	180,300
Total	230,474	158,231	627,698	477,949
Cost of net revenues				
Products	29,328	21,955	82,789	70,915
Services	15,251	11,710	42,335	35,355
Total	44,579	33,665	125,124	106,270
Gross profit	185,895	124,566	502,574	371,679
Operating expenses				
Sales and marketing	77,219	55,427	212,505	166,798
Research and development	30,889	25,070	86,743	78,149
General and administrative	17,658	12,764	49,627	40,624
Restructuring charges				4,329
Total	125,766	93,261	348,875	289,900
Income from operations	60,129	31,305	153,699	81,779
Other income, net	3,561	3,027	7,557	8,042
Income before income taxes	63,690	34,332	161,256	89,821
Provision for income taxes	23,195	11,556	58,338	26,636
Net income	$ 40,495	$ 22,776	$ 102,918	$ 63,185
Net income per share basic	$ 0.51	$ 0.29	$ 1.30	$ 0.80
Weighted average shares basic	79,864	78,603	79,386	78,958
Net income per share diluted	$ 0.50	$ 0.29	$ 1.27	$ 0.79
Weighted average shares diluted	81,031	79,612	80,870	80,014

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

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

	Nine Months Ended June 30, 2010				
	Common Stock		Accumulated Other Comprehensive Income	Retained	Total Shareholders
	Shares	Amount	(Loss)	Earnings	Equity
Balance, September 30, 2009	78,325	$ 462,786	$ (2,337)	$ 338,571	$ 799,020
Exercise of employee stock options	762	15,280			15,280
Issuance of stock under employee stock purchase plan	458	13,936			13,936
Issuance of restricted stock	1,397				
Repurchase of common stock	(965)	(55,000)			(55,000)
Tax benefit from employee stock transactions		16,715			16,715
Stock-based compensation		50,991			50,991
Comprehensive income:					
Net income				102,918	
Foreign currency translation adjustment			(1,170)		
Unrealized loss on securities, net of tax			(1,088)		
Comprehensive income					100,660
Balance, June 30, 2010	79,977	$ 504,708	$ (4,595)	$ 441,489	$ 941,602

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

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

	Nine months ended June 30,	
	2010	**2009**
Operating activities		
Net income	$ 102,918	$ 63,185
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized (gain) loss on disposition of assets and investments	(117)	20
Stock-based compensation	50,991	40,727
Provisions for doubtful accounts and sales returns	794	2,552
Depreciation and amortization	17,923	20,432
Deferred income taxes	10,659	1,352
Gain on auction rate securities put option	(1,491)	(3,788)
Loss on trading auction rate securities	1,491	3,788
Changes in operating assets and liabilities, net of amounts acquired:		
Accounts receivable	3,350	2,869
Inventories	(3,927)	(3,442)
Other current assets	(10,380)	(6,201)
Other assets	(1,651)	(512)
Accounts payable and accrued liabilities	154	(2,490)
Deferred revenue	56,507	24,873
Net cash provided by operating activities	227,221	143,365
Investing activities		
Purchases of investments	(571,072)	(329,694)
Sales and maturities of investments	397,702	256,091
Investment of restricted cash	(26)	5
Acquisition of intangible assets		(706)
Purchases of property and equipment	(10,119)	(8,232)
Net cash used in investing activities	(183,515)	(82,536)
Financing activities		
Excess tax benefits from share-based compensation	16,419	(2,758)
Proceeds from the exercise of stock options and purchases of stock under employee stock purchase plan	29,338	15,326
Repurchase of common stock	(55,000)	(63,311)
Net cash used in financing activities	(9,243)	(50,743)
Net increase in cash and cash equivalents	34,463	10,086
Effect of exchange rate changes on cash and cash equivalents	(1,487)	(100)
Cash and cash equivalents, beginning of period	110,837	78,303
Cash and cash equivalents, end of period	$ 143,813	$ 88,289

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

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

1. Summary of Significant Accounting Policies

Description of Business

F5 Networks, Inc. (the Company) provides products and services to help companies 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.

Basis of Presentation

The year end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. In the opinion of management, the unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for their fair statement in conformity with accounting principles generally accepted in the United States of America. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted in accordance with the rules and regulations of the Securities and Exchange Commission. The information included in this Form 10-Q should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

Certain reclassifications have been made to the prior year s financial statements to conform to the fiscal year 2010 presentation. Such reclassifications did not affect total revenues, operating income or net income.

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 accounting guidance for software products.

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 reasonably assured and no significant performance obligations remain. In certain regions where the Company does not have the ability to reasonably estimate returns, the Company defers revenue on sales to its distributors until they have received information from the channel partner indicating that the distributor has sold the product to its customer. Payment terms to domestic customers are generally net 30 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. Where fair value of certain elements is not available, the Company recognizes revenue on the residual method based on the fair value of undelivered elements. Revenues from the sale of product are 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 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.

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FASB ASC Topic 985-605-25, *Software, Revenue Recognition, Multiple Elements*, (ASC 985-605-25), as amended, 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 vendor specific objective evidence (VSOE). 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 of fair value 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 has established and regularly validates the VSOE of fair value 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.

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 in certain circumstances, 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 2010, the Company completed its annual impairment test and concluded there was no impairment of goodwill. The Company also considered potential impairment indicators at June 30, 2010 and noted no indicators of impairment.

Stock-Based Compensation

The Company accounts for stock-based compensation using the straight-line attribution method for recognizing compensation expense. The Company recognized $17.4 million and $12.6 million of stock-based compensation expense for the three months ended June 30, 2010 and 2009, respectively, and $51.0 million and $40.7 million for the nine months ended June 30, 2010 and 2009, respectively. As of June 30, 2010, there was $42.8 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 stock options and restricted stock units (RSUs). On August 2, 2010, the Company awarded approximately 910,000 RSUs to

employees and executive officers pursuant to the Company s annual equity and retention 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. Alternatively, in determining the fair value of stock options, the Company used the Black-Scholes option pricing model that

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employed the following key assumptions. The risk-free rate was 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 was based on the annualized daily historical volatility of the Company s stock price commensurate with the expected life of the option. Expected term of the option was 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. The Company s stock price volatility and option lives were based on 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.

The Company recognizes 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. 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 Company s estimated forfeiture rate in the third quarter of fiscal year 2010 is 3.5% for grants awarded to the Company s executive officers and Board of Directors, and 10.5% for grants awarded to all other employees. 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 2009, the Company granted 420,000 RSUs to certain current executive officers (the 2009 Performance Award). 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 is 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.

In August 2008, the Company granted 383,400 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, 2010. Twenty-five percent of the RSU grant, or a portion thereof, was subject to the Company achieving specified percentage increases in total revenue during the period beginning in the fourth quarter of fiscal year 2008 through the third quarter of fiscal year 2009, relative to the same periods in fiscal years 2007 and 2008 (the 2008 Performance Award). Approximately half of this twenty-five percent was earned in fiscal year 2009. 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 2009 through the third quarter of fiscal year 2010, as set by the Compensation Committee of the Company s Board of Directors.

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.

Common Stock Repurchase

On October 22, 2008, the Company announced that its Board of Directors approved a new program to repurchase up to an additional $200 million of the Company s outstanding common stock. Acquisitions for the share repurchase program will be made from time to time in private transactions or open market purchases as permitted by securities laws and other legal requirements. The program can be terminated at any time. As of August 4, 2010, the Company had repurchased and retired 4,331,392 shares at an average price of $33.28 per share under the new program.

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.

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

	Three months ended June 30,		Nine months ended June 30,	
	2010	2009	2010	2009
Numerator				
Net income	$ 40,495	$ 22,776	$ 102,918	$ 63,185
Denominator				
Weighted average shares outstanding basic	79,864	78,603	79,386	78,958
Dilutive effect of common shares from stock options and restricted stock units	1,167	1,009	1,484	1,056
Weighted average shares outstanding diluted	81,031	79,612	80,870	80,014
Basic net income per share	$ 0.51	$ 0.29	$ 1.30	$ 0.80
Diluted net income per share	$ 0.50	$ 0.29	$ 1.27	$ 0.79

An immaterial amount of common shares potentially issuable from stock options for the three and nine months ended June 30, 2010, 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. Approximately 0.3 million and 0.5 million of common shares potentially issuable from stock options for the three and nine months ended June 30, 2009, respectively, are excluded from the calculation of diluted earnings per share because the exercise price was greater than the average market price of the Company s common stock for the respective period.

Comprehensive Income

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

	Three months ended June 30,		Nine months ended June 30,	
	2010	2009	2010	2009
Net Income	$ 40,495	$ 22,776	$ 102,918	$ 63,185
Unrealized (loss) gain on securities, net of tax	(277)	372	(1,088)	2,940
Foreign currency translation adjustment	(724)	300	(1,170)	(64)
Total comprehensive income	$ 39,494	$ 23,448	$ 100,660	$ 66,061

Recent Accounting Pronouncements

In December 2007, the FASB issued ASC 810-10, *Consolidation Overall* (ASC 810-10), which establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The Company adopted ASC 810-10 in the first quarter of fiscal year 2010. The adoption of this statement did not have any impact on the Company s consolidated financial position, results of operations or cash flows.

In October 2009, the FASB issued ASU 2009-13, *Multiple-Deliverable Revenue Arrangements,* (amendments to FASB ASC Topic 605, *Revenue Recognition*) (ASU 2009-13) and ASU 2009-14, *Certain Arrangements That Include Software Elements*, (amendments to FASB ASC Topic 985, *Software*) (ASU 2009-14). ASU 2009-13 requires entities to allocate revenue in an arrangement using estimated selling prices of the delivered goods and services based on a

selling price hierarchy. The amendments eliminate the residual method of revenue allocation and require revenue to be allocated using the relative selling price method. ASU 2009-14 removes tangible products from the scope of software revenue guidance and provides guidance on determining whether software deliverables in an arrangement that includes a tangible product are covered by the scope of the software revenue guidance. ASU 2009-13 and ASU 2009-14 should be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. The Company is currently evaluating the impact of the standards, but does not expect adoption of ASU 2009-13 or ASU 2009-14 to have a material impact on the Company s consolidated results of operations or financial condition.

In January 2010, the FASB issued ASU 2010-06, *Fair Value Measurements and Disclosures (Topic 820) Improving Disclosures about Fair Value Measurements* (ASU 2010-06). ASU 2010-06 increases disclosures to include transfers in and out of Levels 1 and 2 and clarifies inputs, valuation techniques and level of disaggregation to be disclosed. The Company adopted ASU

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2010-06 in the second quarter of fiscal year 2010. The adoption of this statement did not have any impact on the Company s consolidated financial position, results of operations or cash flows.

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.

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, or alternative pricing sources with reasonable levels of price transparency, include the Company s certificates of deposit, corporate bonds and notes, municipal bonds and notes and U.S. government 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 June 30, 2010, were as follows (in thousands):

	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Identical Securities (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Fair Value at June 30, 2010**
Cash equivalents	$ 19,091	$	$	$ 19,091
Short-term investments				
Available-for-sale securities certificates of deposit		249		249
Available-for-sale securities corporate bonds and notes		80,911		80,911
		106,040		106,040

Available-for-sale securities	municipal bonds and notes				
Available-for-sale securities	U.S. government securities		67,343		67,343
Long-term investments					
Available-for-sale securities	corporate bonds and notes		150,570		150,570
Available-for-sale securities	municipal bonds and notes		26,474		26,474
Available-for-sale securities	U.S. government securities		189,359		189,359
Available-for-sale securities	auction rate securities			15,892	15,892
Total		$ 19,091	$ 620,946	$ 15,892	$ 655,929

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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 June 30, 2010. 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 table above that used significant unobservable inputs (Level 3) (in thousands):

	Significant Unobservable Inputs (Level 3) (1)	Significant Unobservable Inputs (Level 3) (2)
Balance, beginning of period	$ 41,595	$ 53,350
Total losses realized or unrealized:		
Included in earnings (other income, net)	1,491	
Included in other comprehensive income	347	(3,108)
Recognition of put option to earnings	(1,491)	
Settlements	(26,050)	(34,350)
Transfers into and/or out of level 3		
Balance, June 30, 2010	$ 15,892	$ 15,892
Gains (losses) attributable to assets still held as of June 30, 2010	347	(3,108)

(1) Beginning balance represents the fair value of the Company s investments in ARS as of September 30, 2009

(2) Beginning balance represents the fair value (par value) of the Company s investments in ARS as of February 1, 2008 prior to auction failures

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 June 30, 2010, these securities were valued primarily using internal cash flow valuation that incorporates 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 June 30, 2010.

The Company adopted the fair value hierarchy for financial assets and liabilities on October 1, 2008, the first day of fiscal year 2009. On October 1, 2009, the first day of fiscal year 2010, the Company applied the fair value hierarchy to all non-financial assets and liabilities. The adoption did not have a material effect on the consolidated financial statements. 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 three months ended June 30, 2010, the Company did not recognize any impairment charges related to goodwill, intangible assets, or long-lived assets.

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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
June 30, 2010				
Certificates of deposit	$ 249	$	$	$ 249
Corporate bonds and notes	80,822	244	(155)	80,911
Municipal bonds and notes	105,660	384	(4)	106,040
U.S. government securities	67,254	92	(3)	67,343
	$ 253,985	$ 720	$ (162)	$ 254,543

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2009				
Certificates of deposit	$ 3,120	$ 2	$	$ 3,122
Corporate bonds and notes	34,325	201	(2)	34,524
Municipal bonds and notes	106,491	854		107,345
Auction rate securities	24,559			24,559
U.S. government securities	36,646	96	(1)	36,741
	$ 205,141	$ 1,153	$ (3)	$ 206,291

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

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2010				
Corporate bonds and notes	$ 150,515	$ 498	$ (443)	$ 150,570
Municipal bonds and notes	26,400	80	(6)	26,474
Auction rate securities	19,000		(3,108)	15,892
U.S. government securities	189,064	316	(21)	189,359
	$ 384,979	$ 894	$ (3,578)	$ 382,295

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2009				
Corporate bonds and notes	$ 48,194	$ 508	$ (24)	$ 48,678

Municipal bonds and notes	72,202	777		72,979
Auction rate securities	19,000		(3,455)	15,545
U.S. government securities	119,447	649	(4)	120,092
	$ 258,843	$ 1,934	$ (3,483)	$ 257,294

The cost or amortized cost and fair value of fixed maturities at June 30, 2010, by contractual years-to-maturity, are presented below (in thousands):

	Cost or Amortized Cost	Fair Value
One year or less	$ 253,985	$ 254,543
Over one year	384,979	382,295
	$ 638,964	$ 636,838

The cost or amortized cost values of the Company s ARS include $19.0 million of available-for-sale securities as of June 30, 2010 and $19.0 million of available-for-sale securities and $24.6 million of trading investment securities as of September 30, 2009.

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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 June 30, 2010 (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
June 30, 2010						
Corporate bonds and notes	$ 124,614	$ (598)	$	$	$ 124,614	$ (598)
Municipal bonds and notes	11,425	(10)			11,425	(10)
Auction rate securities			15,892	(3,108)	15,892	(3,108)
U.S. government securities	38,037	(24)			38,037	(24)
Total	$ 174,076	$ (632)	$ 15,892	$ (3,108)	$ 189,968	$ (3,740)

The Company invests in securities that are rated investment grade or better. The unrealized losses on investments for the first nine months of fiscal year 2010 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.

Beginning in February 2008, auctions failed for approximately $53.4 million in par value of municipal ARS the Company held because sell orders exceeded buy orders. The funds associated with failed auctions will not be accessible until a successful auction occurs or a buyer is found outside the auction process.

In October 2008, the Company entered into an agreement (the Agreement) with UBS whereby UBS would purchase eligible ARS it sold to the Company prior to February 13, 2008. Under the terms of the Agreement, and at the Company s discretion, UBS will purchase eligible ARS from the Company at par value (Put Option) during the period of June 30, 2010 through July 2, 2012. Prior to June 30, 2010, UBS purchased all of the eligible ARS the Company held for par value of $34.4 million.

At June 30, 2010, the Company held $15.9 million of ARS classified as available-for-sale securities in long-term investments as reflected in the Company s consolidated balance sheet. The Company believes that this is the appropriate presentation, as the Company does not believe it will be able to liquidate these securities in the next twelve months.

4. 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):

	June 30, 2010	September 30, 2009
Finished goods	$ 13,986	$ 8,326
Raw materials	3,761	5,493
	$ 17,747	$ 13,819

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5. Commitments and Contingencies

Guarantees and Product Warranties

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

The Company offers warranties of one year for hardware 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 June 30, 2010 and June 30, 2009 were not material.

Purchase Commitments

The Company currently has arrangements with contract manufacturers and other suppliers for the manufacturing of its products. The arrangement with the primary contract manufacturer allows them to procure component inventory on the Company s behalf based on a rolling production forecast provided by the Company. The Company is obligated to the purchase of component inventory that the contract manufacturer procures in accordance with the forecast, unless they give notice of order cancellation in advance of applicable lead times. As of June 30, 2010, the Company was committed to purchase approximately $15.7 million of such inventory during the next quarter.

Legal Proceedings

Derivative Suits. Beginning on or about May 24, 2006, several derivative actions were filed against certain of the Company s current and former directors and officers. These derivative lawsuits were filed in: (1) the Superior Court of King County, Washington, as In re F5 Networks, Inc. State Court Derivative Litigation (Case No. 06-2-17195-1 SEA), which consolidates Adams v. Amdahl, et al. (Case No. 06-2-17195-1 SEA), Wright v. Amdahl, et al. (Case No. 06-2-19159-5 SEA), and Sommer v. McAdam, et al. (Case No. 06-2-26248-4 SEA) (the State Court Derivative Litigation); and (2) in the U.S. District Court for the Western District of Washington, as In re F5 Networks, Inc. Derivative Litigation, Master File No. C06-0794RSL, which consolidates Hutton v. McAdam, et al. (Case No. 06-794RSL), Locals 302 and 612 of the International Union of Operating Engineers-Employers Construction Industry Retirement Trust v. McAdam et al. (Case No. C06-1057RSL), and Easton v. McAdam et al. (Case No. C06-1145RSL) (the Federal Court Derivative Litigation). On August 2, 2007, another derivative lawsuit, Barone v. McAdam et al. (Case No. C07-1200P) was filed in the U.S. District Court for the Western District of Washington. The Barone lawsuit was designated a related case to the Federal Court Derivative Litigation on September 4, 2007. The complaints generally allege that certain of the Company s current and former directors and officers, including, in general, each of the Company s current outside directors (other than Deborah L. Bevier and Scott Thompson who joined the Board of Directors in July 2006 and January 2008, respectively) breached their fiduciary duties to the Company by engaging in alleged wrongful conduct concerning the manipulation of certain stock option grant dates. The Company is named solely as a nominal defendant against whom the plaintiffs seek no recovery. The Company s combined motion to consolidate and stay the State Court Derivative Litigation was granted in a court order dated April 3, 2007. The Company s motion to dismiss the consolidated federal derivative actions based on plaintiffs failure to make demand on the Company s Board of Directors prior to filing suit was granted in a court order dated August 6, 2007 with leave to amend the allegations in plaintiffs complaint. Plaintiffs filed an amended consolidated federal derivative action complaint on September 14, 2007. The Company filed a motion to dismiss the amended complaint based on plaintiff s failure to make demand on the Company s Board of Directors prior to filing suit. On July 3, 2008, before ruling on the Company s pending dismissal motion, the federal court entered an order certifying certain issues of Washington state law to the Washington Supreme Court for resolution. The hearing in the Washington Supreme Court was held on March 24, 2009. On May 21, 2009, the Washington Supreme Court issued its opinion on the

certified issues submitted by the federal court. The Company s dismissal motion remains pending before the federal court and the Company intends to continue to vigorously pursue dismissal of the derivative actions.

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SEC and Department of Justice Inquiries. The Company previously received notice from both the SEC and the Department of Justice that they were conducting informal inquiries into the Company s historical stock option practices, and has fully cooperated with both agencies. In January 2010, the Company received notice from the SEC that the investigation concerning the Company s historical stock option practices has been completed and that no enforcement action has been recommended. The Company currently believes that the Department of Justice will take no further action in connection with its inquiry into the Company s historical stock option practices.

The Company is not aware of any additional pending legal proceedings that, individually or in the aggregate, would have a material adverse effect on the Company s business, operating results, or financial condition. The Company may in the future be party to litigation arising in the ordinary course of business, including claims that 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.

6. Income Taxes

The effective tax rate was 36.4% and 33.7% for the three months ended June 30, 2010 and 2009, respectively, and 36.2% and 29.7% for the nine months ended June 30, 2010 and 2009, respectively. The increase in effective tax rate was primarily due to the expiration of the federal research and development credit at December 31, 2009 and a favorable adjustment related to equity awards in a major foreign tax jurisdiction which was reflected in the effective tax rate for the nine months ended June 30, 2009.

At June 30, 2010, the Company has classified approximately $5.7 million of unrecognized tax liabilities as a non-current liability. The Company does not anticipate that total unrecognized tax benefits will significantly change within the next twelve months.

The Company recognizes interest and, if applicable, penalties for any uncertain tax positions. This interest and penalty expense will be a component of income tax expense. In the three months ended June 30, 2010, the Company accrued an immaterial amount of interest expense related to its liability for unrecognized tax benefits. All unrecognized tax benefits, if recognized, would affect the effective tax rate.

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. 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. Periods open for review by local taxing authorities are fiscal years 2007, 2009, 2006 and 2005 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 2006 and 2007 tax returns filed in various states and the fiscal year ended 2007 federal income tax return.

7. Geographic Sales and Significant Customers

Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company is organized as, and operates in, one reportable segment: the development, marketing and sale of application delivery networking products that optimize the security, performance and availability of network applications, servers and storage systems. 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):

	Three months ended June 30,		Nine months ended June 30,	
	2010	**2009**	**2010**	**2009**
Americas	$ 135,584	$ 88,327	$ 364,996	$ 262,316
EMEA	50,900	36,035	146,504	112,099

Japan	15,185	12,728	43,112	41,233
Asia Pacific	28,805	21,141	73,086	62,301
	$ 230,474	$ 158,231	$ 627,698	$ 477,949

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Net revenues from international customers are primarily denominated in U.S. dollars and totaled $94.9 million and $69.9 million for the three months ended June 30, 2010 and 2009, respectively, and $262.7 million and $215.6 million for the nine months ended June 30, 2010 and 2009, respectively. One worldwide distributor accounted for 13.3% of total net revenue for the three month period ended June 30, 2010. Two worldwide distributors accounted for 23.3% of total net revenue for the nine month period ended June 30, 2010. One worldwide distributor accounted for 15.2% and 16.0% of total net revenue for the three and nine months ended June 30, 2009, respectively. No other distributors accounted for more than 10% of total net revenue or receivables.

Item 2. 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-looki 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 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 key indicators of future trends. We also consider overall revenue concentration by customer and by geographic region as additional indicators of current and future trends.

Cost of revenues and gross margins. We strive to control our cost of revenues and thereby maintain our gross margins. Significant items impacting cost of revenues are hardware costs paid to our contract manufacturers, third-party software license fees, amortization of developed technology and personnel and overhead expenses. Our margins have remained relatively stable; 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.

Liquidity and cash flows. Our financial condition remains strong with significant cash and investments and no long term debt. The increase in cash and investments for the first nine months of fiscal year 2010 was primarily due to net income from operations, with operating activities providing cash of $227.2 million. This increase was partially offset by $55.0 million of cash used to

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repurchase outstanding common stock under our stock repurchase program in the first three quarters of fiscal year 2010. Going forward, we believe the primary driver of cash flows will be net income from operations. Capital expenditures for the first nine months of fiscal year 2010 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 day s sales outstanding as important indicators of our financial health. Deferred revenues continued to increase in the third quarter of fiscal year 2010 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 day s sales outstanding for the third quarter of fiscal year 2010 was 40.

Summary of Critical Accounting Policies and Estimates

The preparation of our financial condition and results of operations requires us to make judgments and estimates that may have a significant impact upon our financial results. We believe that, of our significant accounting policies, the following require estimates and assumptions that require complex, subjective judgments by management, which can materially impact reported results: revenue recognition; reserve for doubtful accounts; reserve for product returns; reserve for warranties; accounting for income taxes; stock-based compensation; investments; goodwill impairment; and the fair value measurements of financial assets and liabilities. None of these accounting policies and estimates have significantly changed since our annual report on Form 10-K for the year ended September 30, 2009 (Form 10-K). Critical accounting policies and estimates are more fully described in Management s Discussion and Analysis of Financial Condition and Results of Operations in the Form 10-K. Actual results may differ from these estimates under different assumptions or conditions.

Results of Operations

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

	Three months ended June 30,		Nine months ended June 30,	
	2010	2009	2010	2009
	(in thousands, except percentages)			
Net Revenues				
Products	$ 147,393	$ 95,619	$ 396,170	$ 297,649
Services	83,081	62,612	231,528	180,300
Total	$ 230,474	$ 158,231	$ 627,698	$ 477,949
Percentage of net revenues				
Products	64.0%	60.4%	63.1%	62.3%
Services	36.0	39.6	36.9	37.7
Total	100.0%	100.0%	100.0%	100.0%

Net revenues. Total net revenues increased 45.7% and 31.3% for the three and nine months ended June 30, 2010, respectively, from the same periods in the prior year. Overall revenue growth for the three and nine months ended June 30, 2010 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 were 41.2% and 41.9% of total net revenues for the three and nine months ended June 30, 2010, respectively, compared to 44.2% and 45.1% for the same periods in the prior year, 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 54.1% and 33.1% for the three and nine months ended June 30, 2010, respectively, from the same periods in the prior year. The increase in net product revenues for the three and nine months ended June 30, 2010 was primarily due to an increase of $51.0 million and $97.9 million, respectively, in sales of our ADN products from the same periods in the prior year. Sales of our ADN products represented 95.5% and 95.3% of product revenues for the three and nine months ended June 30, 2010, respectively, compared to 93.9% of product revenues for both the three and nine months ended June 30, 2009, respectively.

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Net service revenues increased 32.7% and 28.4% for the three and nine months ended June 30, 2010, respectively, from the same periods in the prior year. The increase in net service revenues was primarily due to increases in the purchase or renewal of maintenance contracts driven by additions to our installed base of products.

Avnet Technology Solutions, one of our worldwide distributors, accounted for 13.3% of our total net revenue for the three months ended June 30, 2010. Avnet Technology Solutions and Tech Data, two of our worldwide distributors, accounted for 13.0% and 10.3% of our total net revenue for the nine months ended June 30, 2010, respectively. Avnet Technology Solutions accounted for 15.2% and 16.0% of our total net revenue for the three and nine months ended June 30, 2009, respectively. No other distributors accounted for more than 10% of total net revenue or receivables.

	Three months ended June 30,		Nine months ended June 30,	
	2010	2009	2010	2009
	(in thousands, except percentages)			
Cost of net revenues and Gross Margin				
Products	$ 29,328	$ 21,955	$ 82,789	$ 70,915
Services	15,251	11,710	42,335	35,355
Total	44,579	33,665	125,124	106,270
Gross profit	$ 185,895	$ 124,566	$ 502,574	$ 371,679
Percentage of net revenues and Gross Margin (as a percentage of related net revenue)				
Products	19.9%	23.0%	20.9%	23.8%
Services	18.4	18.7	18.3	19.6
Total	19.3	21.3	19.9	22.2
Gross profit	80.7%	78.7%	80.1%	77.8%

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 33.6% and 16.7% for the three and nine months ended June 30, 2010, respectively, as compared to the same periods in the prior year. The increase in cost of net product revenues was primarily due to a higher volume of units shipped along with an increase in warranty expense, partially offset by a decrease in expense related to obsolete inventory.

Cost of net service revenues. Cost of net service revenues consist of the salaries and related benefits of our professional services staff, travel, facilities and depreciation expenses. For the three and nine months ended June 30, 2010, cost of net service revenues as a percentage of net service revenues decreased to 18.4% and 18.3%, respectively, compared to 18.7% and 19.6% for the same periods in the prior year, respectively, primarily due to the scalability of our existing customer support infrastructure and increased revenue from maintenance contracts. Professional services headcount at the end of June 2010 increased to 405 from 316 at the end of June 2009. In addition, cost of net service revenues included stock-based compensation expense of $1.5 million and $4.3 million for the three and nine months ended June 30, 2010, respectively, compared to $1.1 million and $3.4 million for the same periods in the prior year, respectively.

	Three months ended June 30,		Nine months ended June 30,	
	2010	2009	2010	2009

	(in thousands, except percentages)			
Operating expenses				
Sales and marketing	$ 77,219	$ 55,427	$ 212,505	$ 166,798
Research and development	30,889	25,070	86,743	78,149
General and administrative	17,658	12,764	49,627	40,624
Restructuring charges				4,329
Total	$ 125,766	$ 93,261	$ 348,875	$ 289,900
Operating expenses (as a percentage of net revenue)				
Sales and marketing	33.5%	35.0%	33.9%	34.9%
Research and development	13.4	15.8	13.8	16.4
General and administrative	7.7	8.1	7.9	8.5
Restructuring charges				0.9
Total	54.6%	58.9%	55.6%	60.7%

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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 expenses increased 39.3% and 27.4% for the three and nine months ended June 30, 2010, respectively, from the comparable periods in the prior year. The increase in sales and marketing expense was primarily due to increases of $12.9 million and $30.6 million in commissions and personnel costs for the three and nine months ended June 30, 2010, respectively, from the comparable periods in the prior year. The increased commissions and personnel costs were driven by growth in sales and marketing employee headcount and increased sales volume for the corresponding period. Sales and marketing headcount at the end of June 2010 increased to 797 from 676 at the end of June 2009. Sales and marketing expense included stock-based compensation expense of $6.6 million and $19.7 million for the three and nine months ended June 30, 2010, respectively, compared to $5.1 million and $16.5 million for the same periods in the prior year, respectively. The increase in sales and marketing expense was also due to investments in marketing promotions and initiatives aimed at promoting our brand and creating market awareness of our technology and our products.

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 expenses increased 23.2% and 11.0% for the three and nine months ended June 30, 2010, respectively, from the comparable periods in the prior year. The increase in research and development expense was primarily due to increases of $2.1 million and $4.6 million in personnel costs for the three and nine months ended June 30, 2010, respectively, from the comparable periods in the prior year. Research and development headcount at the end of June 2010 increased to 482 from 429 at the end of June 2009. Research and development expense included stock-based compensation expense of $4.7 million and $14.2 million for the three and nine months ended June 30, 2010, respectively, compared to $3.8 million and $12.2 million for the same periods in the prior year, 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 expenses increased 38.3% and 22.2% for the three and nine months ended June 30, 2010, respectively, from the comparable periods in the prior year. The increase in general and administrative expense was primarily due to increases of $1.3 million and $2.8 million in personnel costs for the three and nine months ended June 30, 2010, respectively, from the comparable periods in the prior year. Stock-based compensation expense was $4.3 million and $12.0 million for the three and nine months ended June 30, 2010, respectively, compared to $2.4 million and $8.3 million for the same periods in the prior year, respectively. General and administrative headcount at the end of June 2010 increased to 215 from 183 at the end of June 2009.

	Three months ended June 30,		Nine months ended June 30,	
	2010	2009	2010	2009
	(in thousands, except percentages)			
Other Income and Income Taxes				
Income from operations	$ 60,129	$ 31,305	$ 153,699	$ 81,779
Other income, net	3,561	3,027	7,557	8,042
Income before income taxes	63,690	34,332	161,256	89,821
Provision for income taxes	23,195	11,556	58,338	26,636
Net income	$ 40,495	$ 22,776	$ 102,918	$ 63,185

Other income and income taxes (as percentage of net revenue)				
Income from operations	26.1%	19.8%	24.5%	17.1%
Other income, net	1.5	1.9	1.2	1.7
Income before income taxes	27.6	21.7	25.7	18.8
Provision for income taxes	10.0	7.3	9.3	5.6
Net income	17.6%	14.4%	16.4%	13.2%

Other income, net. Other income, net, consists of interest income and foreign currency transaction gains and losses. Other income, net, increased 17.6% for the three months ended June 30, 2010, compared to the same period in the prior year. Other income, net, decreased 6.0% for the nine months ended June 30, 2010, compared to the same period in the prior year. The decrease in other income, net for the nine months ended June 30, 2010 was primarily due to a $1.8 million decrease in interest income, partially offset by a decrease in foreign currency transaction losses as compared to the same period in the prior year. The decrease in interest income for the nine months ended June 30, 2010 was primarily due to a decline in interest rates from the prior year.

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Provision for income taxes. We recorded a 36.4% and 36.2% provision for income taxes for the three and nine month periods ended June 30, 2010, respectively. At June 30, 2010, 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 these assets are more likely than not to be realized. In making this determination we have considered projected future taxable income and ongoing prudent and feasible tax planning strategies in assessing the appropriateness of a valuation allowance. Our net deferred tax assets at June 30, 2010 and June 30, 2009 were $45.6 million and $49.8 million, respectively. Our worldwide effective tax rate may fluctuate based on a number of factors including variations in projected taxable income in the 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 exposures related to business and income tax positions we have taken that could be challenged by taxing authorities. The ultimate resolution of these potential exposures may be greater or less than the liabilities recorded which could result in an adjustment to our future tax expense.

Liquidity and Capital Resources

Cash and cash equivalents, short-term investments and long-term investments totaled $780.6 million as of June 30, 2010 compared to $574.4 million as of September 30, 2009, representing an increase of $206.2 million. The increase was primarily due to cash provided by operating activities of $227.2 million for the nine months ended June 30, 2010 which was partially offset by $55.0 million of additional cash required for the repurchase of outstanding common stock under our stock repurchase program. The increase in cash flow from operations for the first nine months of fiscal year 2010 resulted from increased net income combined with changes in operating assets and liabilities, as adjusted for various non-cash items including stock-based compensation, depreciation and amortization charges. Based on our current operating and capital expenditure forecasts, we believe that our existing cash and investment balances, excluding auction rate securities (ARS), together with cash generated from operations should be sufficient to meet our operating requirements for the foreseeable future.

At June 30, 2010, we held $15.9 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 Quarterly Report on Form 10-Q, 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. The underlying assets of the municipal ARS we hold, including the securities for which auctions have failed, are generally student loans which are guaranteed by the U.S. government.

We have no reason to believe that any of the underlying issuers of our ARS are presently at risk of default. Through June 30, 2010, 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 $19.0 million (par value) of our ARS as long-term as of June 30, 2010.

In October 2008, we entered into an agreement (the Agreement) with UBS whereby UBS would purchase eligible ARS it sold to us prior to February 13, 2008. Under the terms of the Agreement, and at our discretion, UBS will purchase eligible ARS from us at par value (Put Option) during the period of June 30, 2010 through July 2, 2012. Prior to June 30, 2010, UBS purchased all of the eligible ARS we held for par value of $34.4 million.

Cash used in investing activities was $75.8 million and $183.5 million for the three and nine months ended June 30, 2010, respectively, compared to cash used in investing activities of $71.8 million and $82.5 million for the same periods in the prior year, respectively. Investing activities include purchases, sales and maturities of available-for-sale securities, capital expenditures and changes in restricted cash requirements. The amount of cash used in investing activities for the three and nine months ended June 30, 2010 was primarily due to the purchase of investments and capital expenditures related to maintaining our operations worldwide partially offset by the sales and maturity of investments.

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Cash used in financing activities was $3.1 million and $9.2 million for the three and nine months ended June 30, 2010, respectively, compared to cash used in financing activities of $6.2 million and $50.7 million for the same periods in the prior year, respectively. Our financing activities for the three months ended June 30, 2010 consisted of cash required for the repurchase of outstanding common stock under our stock repurchase program of $20.0 million, partially offset by cash received from the exercise of employee stock options and stock purchases under our employee stock purchase plan of $10.2 million and tax benefits related to share-based compensation of $6.7 million. Our financing activities for the nine months ended June 30, 2010 consisted of cash required for the repurchase of outstanding common stock under our stock repurchase program of $55.0 million, partially offset by cash received from the exercise of employee stock options and stock purchases under our employee stock purchase plan of $29.3 million and tax benefits related to share-based compensation of $16.4 million.

Obligations and Commitments

As of June 30, 2010, our principal commitments consisted of obligations outstanding under operating leases. We lease our facilities under operating leases that expire at various dates through 2022. On April 5, 2010, we entered into a Second Amended and Restated Lease Agreement for our corporate headquarters, extending the term of the Amended and Restated Lease Agreement dated April 3, 2000 through July 2022. There have been no other material changes in our principal lease commitments compared to those discussed in the Form 10-K. In connection with the lease agreement for our corporate headquarters, we established a restricted escrow account collateralized by a certificate of deposit that has been included on our balance sheet as a component of restricted cash. The total amount required in escrow reduces at various dates as set forth by the lease agreement. The amount required in escrow at June 30, 2010 was $2.4 million as set forth by the lease agreement.

We outsource the manufacturing of our pre-configured hardware platforms to contract manufacturers who assemble each product to our specifications. Our agreement with our largest contract manufacturer allows them to procure component inventory on our behalf based upon a rolling production forecast. We are contractually obligated to purchase the component inventory in accordance with the forecast, unless we give notice of order cancellation in advance of applicable lead times. As of June 30, 2010, we were committed to purchase approximately $15.7 million of such inventory during the next quarter.

Recent Accounting Pronouncements

The anticipated impact of recent accounting pronouncements is discussed in Note 1 to the accompanying Notes to Consolidated Financial Statements of this Quarterly Report on Form 10-Q.

Risk Factors that May Affect Future Results

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

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

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.

The current life cycle of our products is typically 12 to 24 months. The introduction of new products or product enhancements may shorten the life cycle of our existing products, or replace sales of some of our current products, thereby offsetting the benefit of even a successful product introduction, and may cause customers to defer purchasing our existing products in anticipation of the new products. This could harm our operating results by decreasing sales, increasing our inventory levels of older products and exposing us

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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, 2009 and the nine months ended June 30, 2010, we derived approximately 93.7% and 95.3%, respectively, of our net product revenues, or approximately 58.3% and 60.1%, respectively, 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 of 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 Cisco, Citrix, Brocade and Radware. In the adjacent WAN Optimization Controller market, we compete with Riverbed, Juniper, Blue Coat Systems, Cisco and Citrix. In the file virtualization market, we compete with EMC. 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.

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

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

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

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operations. In addition, we may experience substantial period-to-period fluctuations in future operating results due to the erosion of our average selling prices.

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

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

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

We 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

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Directive laws, which are being adopted by certain European Economic Area countries on a country-by-country basis. Failure to comply with these and similar laws on a timely basis, or at all, could have a material adverse effect on our business, operating results and financial condition. Any decreased use of our products or limitation on our ability to export or sell our products would likely adversely affect our business, operating results and financial condition.

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

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

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. In the ordinary course of our business, we are involved in disputes and licensing discussions with others regarding their claimed proprietary rights and cannot assure you that we will always successfully defend ourselves against such claims. If we are found to infringe the proprietary rights of others, or if we otherwise settle such claims, we could be compelled to pay damages or royalties and either obtain a license to those intellectual property rights or alter our products so that they no longer infringe upon such proprietary rights. Any license could be very expensive to obtain or may not be available at all. Similarly, changing our products or processes to avoid infringing upon the rights of others may be costly or impractical. In addition, we have initiated, and may in the future initiate, claims or litigation against third parties for infringement of our proprietary rights, 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, 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 together accounted for 23.3% of our total net revenue for the nine months ended June 30, 2010. One worldwide distributor of our products accounted for 15.4% of our total net revenue for fiscal year 2009 and two worldwide distributors of our products together accounted for 24.5% of our total net revenue for fiscal year 2008. 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

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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.

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 June 30, 2010, the fair value of our AAA/A- (or equivalent) rated municipal auction rate securities (ARS) was approximately $15.9 million. 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. 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 June 30, 2010.

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 44.7% and 42.5% of our net revenues for the fiscal years ended September 30, 2009 and 2008, respectively, and 41.9% for the nine months ended June 30, 2010. In particular, in fiscal year 2009, we derived 8.7% of our total revenue from the Japanese market. This revenue is dependent on a number of factors outside our control, including the viability and success of our resellers and the strength of the Japanese economy.

Changes in governmental regulations could negatively affect our revenues

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

international and domestic sales and adversely affect our revenues, business and operations.

Acquisitions 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

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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 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 or stock options. The loss of services of any of our key personnel, the inability to retain and attract qualified personnel in the future or delays in hiring qualified personnel may harm our business and results of operations.

We face litigation risks

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

Our historical stock option practices and the restatement of our prior financial statements have exposed us to greater risks associated with litigation. Beginning in May 2006 several derivative actions were filed against certain current and former directors and officers (as discussed further in Item 1, Note 5, Commitments and Contingencies Legal Proceedings) based on allegations relating to our historical stock option practices. We cannot assure you that this current litigation will result in the same conclusions reached by the special committee of outside directors formed by our Board of Directors to conduct a review of our stock option practices (the Special Committee). Furthermore, if we are subject to adverse findings in any of these matters, we could be required to pay damages or penalties or have other remedies imposed upon us which could adversely affect our business, results of operations or financial condition.

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

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preventing changes in control or management of our company, which could have an adverse effect on the market price of our common stock. In addition, our articles of incorporation provide for a staggered board, which may make it more difficult for a third party to gain control of our Board of Directors. Similarly, state anti-takeover laws in the State of Washington related to corporate takeovers may prevent or delay a change of control of our company.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

At June 30, 2010, the fair value of our AAA/A- (or equivalent) rated municipal ARS was approximately $15.9 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 which 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, will not 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 $19.0 million (par value) of securities as long-term as of June 30, 2010.

Management believes there have been no other material changes to our quantitative and qualitative disclosures about market risk during the nine month period ended June 30, 2010, compared to those discussed in our Annual Report on Form 10-K for the year ended September 30, 2009.

Item 4. Controls and Procedures

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

Our management, with the participation of our Chief Executive Officer and Chief Accounting Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2010. Based upon that evaluation, our Chief Executive Officer and Chief Accounting Officer have concluded that our disclosure controls and procedures were effective as of June 30, 2010.

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

PART II OTHER INFORMATION

Item 1. Legal Proceedings

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

Reference is made to Item 1, Note 5, Commitments and Contingencies Legal Proceedings, of Part I of this Quarterly Report on Form 10-Q and Item 3, Legal Proceedings, in the Form 10-K, filed November 20, 2009 for descriptions of our legal proceedings. We continue to believe that the resolution of these legal proceedings will not have a material adverse effect on us and there have been no material developments since the time of the Form 10-K filing, except as noted in Item 1, Note 5 of Part I of this Quarterly Report on Form 10-Q.

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Item 1A. Risk Factors

Information regarding risk factors appears in Part I Item 2 of this Quarterly Report on Form 10-Q, Management s Discussion and Analysis of Financial Condition and Results of Operations Risk Factors that May Affect Future Results. This information includes previously disclosed material changes to the risk factors set forth in Part I Item 1A of the Form 10-K.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On October 22, 2008, the Company announced that its Board of Directors approved a new program to repurchase up to an additional $200 million of the Company s outstanding common stock. Acquisitions for the share repurchase program will be made from time to time in private transactions or open market purchases as permitted by securities laws and other legal requirements. The program may be discontinued at any time. As of August 4, 2010, the Company had repurchased and retired 4,331,392 shares at an average price of $33.28 per share under the new program.

Shares repurchased and retired as of August 4, 2010 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, 2008 October 31, 2008		$		$ 200,000
November 1, 2008 November 30, 2008	543,100	$ 22.87	543,100	$ 187,553
December 1, 2008 December 31, 2008	329,920	$ 22.84	329,920	$ 180,000
January 1, 2009 January 31, 2009		$		$ 180,000
February 1, 2009 February 28, 2009	636,895	$ 21.34	636,895	$ 166,377
March 1, 2009 March 31, 2009	703,811	$ 19.58	703,811	$ 152,563
April 1, 2009 April 30, 2009		$		$ 152,563
May 1, 2009 May 31, 2009		$		$ 152,563
June 1, 2009 June 30, 2009	463,900	$ 34.17	463,900	$ 136,689
July 1, 2009 July 31, 2009	146,700	$ 35.51	146,700	$ 131,473
August 1, 2009 August 31, 2009	320,700	$ 36.01	320,700	$ 119,907
September 1, 2009 September 30, 2009	199,021	$ 36.85	199,021	$ 112,564
October 1, 2009 October 31, 2009		$		$ 112,564
November 1, 2009 November 30, 2009	177,950	$ 47.36	177,950	$ 104,128
December 1, 2009 December 31, 2009	131,210	$ 49.98	131,210	$ 97,564
January 1, 2010 January 31, 2010		$		$ 97,564
February 1, 2010 February 28, 2010	212,430	$ 51.07	212,430	$ 86,703
March 1, 2010 March 31, 2010	152,528	$ 59.87	152,528	$ 77,563
April 1, 2010 April 30, 2010	23,100	$ 70.56	23,100	$ 75,932
May 1, 2010 May 31, 2010	176,365	$ 68.23	176,365	$ 63,890
June 1, 2010 June 30, 2010	91,562	$ 69.04	91,562	$ 57,564
July 1, 2010 July 31, 2010	5,000	$ 85.81	5,000	$ 57,135
August 1, 2010 August 4, 2010	17,200	$ 86.00	17,200	$ 55,655

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Item 6. Exhibits

Exhibit Number	Exhibit Description
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

* 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.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 6th day of August, 2010.

F5 NETWORKS, INC.

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

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