

JUNIPER NETWORKS INC

Form 10-Q

March 09, 2007

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

(Mark One)

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

For the quarterly period ended September 30, 2006

OR

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

For the transition period from **to**

Commission file number 0-26339
JUNIPER NETWORKS, INC.

(Exact name of registrant as specified in its charter)

Delaware

*(State or other jurisdiction of
incorporation or organization)*

77-0422528

*(IRS Employer
Identification No.)*

1194 North Mathilda Avenue
Sunnyvale, California 94089

*(Address of principal executive offices,
including zip code)*

(408) 745-2000

*(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 filings requirements for the past 90 days. Yes ☒ No ☐

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

Large Accelerated Filer ☒ Accelerated Filer ☐ Non-Accelerated Filer ☐

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

There were approximately 569,234,000 shares of the Company's Common Stock, par value \$0.00001, outstanding as of February 28, 2007.

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EXPLANATORY NOTE

In this Form 10-Q, we are restating our condensed consolidated balance sheet as of December 31, 2005, the related consolidated statements of operations for the three and nine months ended September 30, 2005, and the related consolidated statement of cash flows for the nine months ended September 30, 2005 as a result of an independent stock option investigation commenced by our Board of Directors and Audit Committee. This restatement is more fully described in Note 2, Restatement of Condensed Consolidated Financial Statements, to Condensed Consolidated Financial Statements and in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations. In our Form 10-K for the year ended December 31, 2006 to be filed with the SEC (the 2006 Form 10-K), we are restating our audited consolidated financial statements and related disclosures for the years ended December 31, 2005 and 2004, and our consolidated statement of operations and consolidated balance sheet data for the years ended December 31, 2005, 2004, 2003 and 2002. In addition, we are restating the unaudited quarterly financial information and financial statements for interim periods of 2005 and unaudited condensed financial statements for the three months ended March 31, 2006.

Financial information included in the reports on Form 10-K, Form 10-Q and Form 8-K filed by Juniper Networks prior to August 10, 2006, and the related opinions of its independent registered public accounting firm, and all earnings press releases and similar communications issued by the Company prior to August 10, 2006 should not be relied upon and are superseded in their entirety by this Report and other reports on Form 10-Q and Form 8-K filed by the Company with the Securities and Exchange Commission on or after August 10, 2006.

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

Juniper Networks, Inc.
Condensed Consolidated Statements of Operations
(in thousands, except per share amounts)
(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
		As Restated		As Restated
		(1)		(1)
Net revenues:				
Product	\$ 467,237	\$ 466,427	\$ 1,410,152	\$ 1,282,439
Service	106,330	79,926	297,598	206,054
Total net revenues	573,567	546,353	1,707,750	1,488,493
Cost of revenues:				
Product(2)	140,787	132,239	421,221	366,410
Service(2)	49,398	39,522	142,834	104,992
Total cost of revenues	190,185	171,761	564,055	471,402
Gross margin	383,382	374,592	1,143,695	1,017,091
Operating expenses:				
Research and development(2)	123,389	94,689	353,299	257,639
Sales and marketing(2)	139,370	118,169	404,800	314,865
General and administrative(2)	24,542	27,177	71,807	58,646
Amortization of purchased intangibles	23,028	22,991	69,436	61,441
Impairment of goodwill and intangible assets			1,283,421	
In-process research and development		3,800		5,700
Other charges, net	15,310	(192)	21,064	(6,752)
Total operating expenses	325,639	266,634	2,203,827	691,539
Operating income (loss)	57,743	107,958	(1,060,132)	325,552
Interest and other income	28,610	15,567	73,366	40,062
Interest and other expense	(808)	(851)	(2,710)	(2,725)
Gain on investments		1,698		1,698
Income (loss) before income taxes	85,545	124,372	(989,476)	364,587
Provision for income taxes	27,271	40,876	82,943	118,743
Net income (loss)	\$ 58,274	\$ 83,496	\$ (1,072,419)	\$ 245,844
Net income (loss) per share:				
Basic	\$ 0.10	\$ 0.15	\$ (1.89)	\$ 0.45
Diluted	\$ 0.10	\$ 0.14	\$ (1.89)	\$ 0.41

Shares used in computing net income
(loss) per share:

Basic	568,561	561,775	566,862	550,340
Diluted	599,626	606,327	566,862	597,341

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

(2) Amortization of
stock-based
compensation
relates to the
following cost
and expense
categories by
period:

Cost of revenues	Product	\$ 484	\$ 324	\$ 1,481	\$ 691
Cost of revenues	Service	1,617	350	4,471	1,208
Research and development		9,364	4,185	28,784	9,769
Sales and marketing		8,071	1,947	24,184	4,935
General and administrative		3,319	376	10,176	983
Total		\$ 22,855	\$ 7,182	\$ 69,096	\$ 17,586

See accompanying Notes to the Condensed Consolidated Financial Statements

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Juniper Networks, Inc.
Condensed Consolidated Balance Sheets
(in thousands, except par values)
(unaudited)

	September 30, 2006	December 31, 2005(1) As Restated (1)
ASSETS		
Current assets:		
Cash and cash equivalents(2)	\$ 1,333,355	\$ 918,401
Short-term investments(2)	514,218	510,364
Accounts receivable, net	285,459	268,907
Deferred tax assets, net	123,972	144,439
Prepaid expenses and other current assets	37,937	46,676
Total current assets	2,294,941	1,888,787
Property and equipment, net	335,830	319,885
Long-term investments(2)	566,475	618,342
Restricted cash	45,348	66,074
Goodwill	3,625,038	4,879,701
Purchased intangible assets, net	192,957	269,920
Long-term deferred tax assets, net	116,878	111,236
Other long-term assets	28,381	29,666
Total assets	\$ 7,205,848	\$ 8,183,611
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 159,512	\$ 165,172
Accrued compensation	81,735	97,738
Accrued warranty	27,454	28,187
Deferred revenue	282,481	213,482
Income taxes payable	61,375	56,360
Other accrued liabilities	78,106	66,462
Total current liabilities	690,663	627,401
Long-term deferred revenue	63,477	39,330
Other long-term liabilities	24,861	28,687
Long-term debt	399,944	399,959
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock, \$0.00001 par value; 10,000 shares authorized; none issued and outstanding		

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Common stock, \$0.00001 par value, 1,000,000 shares authorized; 569,234 and 568,243 shares issued and outstanding at September 30, 2006 and December 31, 2005, respectively

Additional paid-in capital	7,631,581	7,458,662
Deferred stock compensation		(17,700)
Accumulated other comprehensive loss	(1,467)	(8,324)
Accumulated deficit	(1,603,217)	(344,410)
 Total stockholders' equity	 6,026,903	 7,088,234
 Total liabilities and stockholders' equity	 \$ 7,205,848	 \$ 8,183,611

(1) The condensed consolidated balance sheet as of December 31, 2005 has been restated to reflect the adjustments discussed in Note 2, Restatement of Condensed Consolidated Financial Statements.

(2) Total cash, cash equivalents, short-term and long-term investments were \$2,414.0 million and \$2,047.1 million as of September 30, 2006 and December 31, 2005, respectively.

See accompanying Notes to the Condensed Consolidated Financial Statements

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Juniper Networks, Inc.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Nine Months Ended September 30,	
	2006	2005
		As Restated
		(1)
Operating Activities:		
Net (loss) income	\$ (1,072,419)	\$ 245,844
Adjustments to reconcile net (loss) income to net cash from operating activities:		
Depreciation and amortization	129,074	99,717
Stock-based compensation	69,096	17,586
In-process research and development		5,700
Impairment of goodwill and intangible assets	1,283,421	
Tax benefits from stock-based compensation		94,287
Excess tax benefits from stock-based compensation	(7,800)	
Gain on investments		(1,698)
Other non-cash charges	1,122	1,366
Changes in operating assets and liabilities:		
Accounts receivable, net	(15,609)	(43,481)
Prepaid expenses and other assets	27,066	(37,271)
Accounts payable	(6,206)	35,452
Accrued compensation	(16,004)	(12,090)
Accrued warranty	(1,264)	(1,347)
Other accrued liabilities	37,754	(16,179)
Deferred revenue	93,145	57,547
Net cash provided by operating activities	521,376	445,433
Investing Activities:		
Purchases of property and equipment	(69,819)	(58,873)
Purchases of available-for-sale investments	(398,327)	(639,350)
Maturities and sales of available-for-sale investments	450,640	540,938
Changes in restricted cash	20,726	(7,100)
Minority equity investments	(3,090)	(9,823)
Payments for business acquisitions, net of cash and cash equivalents	(15,102)	(199,060)
Net cash used in investing activities	(14,972)	(373,268)
Financing Activities:		
Proceeds from issuance of common stock	87,138	103,057
Purchases and subsequent retirement of common stock	(186,388)	
Excess tax benefits from stock-based compensation	7,800	
Net cash (used in) provided by financing activities	(91,450)	103,057
Net increase in cash and cash equivalents	414,954	175,222
Cash and cash equivalents at beginning of period	918,401	713,182

Cash and cash equivalents at end of period	\$ 1,333,355	\$ 888,404
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Supplemental Disclosure of Non-Cash Investing Activities:

Common stock issued in connection with acquisitions	\$ 10,343	\$ 221,221
Stock options assumed in connection with acquisitions	\$	\$ 65,185
Deferred stock compensation assumed in connection with acquisitions	\$	\$ 19,035

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

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Juniper Networks, Inc.
Notes to the Condensed Consolidated Financial Statements
(unaudited)

Note 1. Summary of Significant Accounting Policies

Description of Business

Juniper Networks, Inc. (Juniper Networks or the Company) designs and sells products and services that together provide its customers with Internet Protocol (IP) networking solutions. The Company is organized into the following three operating segments: Infrastructure, Service Layer Technologies (SLT) and Service. The Company s Infrastructure segment primarily offers scalable router products that are used to control and direct network traffic. The Company s SLT segment offers solutions that meet a broad array of its customers priorities, from securing the network and the data on the network, to maximizing existing bandwidth and acceleration of applications across a distributed network. Together, its secure networking solutions help enable its customers to convert networks that provide commoditized best efforts services into more valuable assets that provide differentiation, value and increased reliability and security to end users. The Company s Service segment delivers world-wide services, including technical support, professional services, as well as a number of education and training programs, to customers of the Infrastructure and SLT segments.

Basis of Presentation

The Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. The preparation of the Condensed Consolidated Financial Statements requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ materially from those estimates. In the opinion of management, all adjustments, including normal recurring accruals, considered necessary for a fair presentation have been included. The results of operations for the three and nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ended December 31, 2006. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors, Quantitative and Qualitative Disclosures About Market Risk and the Consolidated Financial Statements and Notes thereto included in the Company s 2006 Annual Report on Form 10-K (the 2006 Form 10-K) to be filed with the Securities and Exchange Commission (the SEC).

Stock-Based Compensation

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, (SFAS 123R) which requires the measurement and recognition of compensation expense for all stock-based awards made to employees and directors including employee stock options, restricted stock units (RSUs) and purchases under the Company s Employee Stock Purchase Plan based on estimated fair values. SFAS 123R supersedes the previous accounting under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), as allowed under Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), for periods beginning in 2006. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS 123R. The Company has applied the provisions of SAB 107 in conjunction with its adoption of SFAS 123R.

The Company adopted SFAS 123R using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of the Company s fiscal year 2006. The Company s Condensed Consolidated Financial Statements as of and for the three and nine months ended September 30, 2006 reflect the impact of SFAS 123R. In accordance with the modified prospective transition method, the Company s condensed consolidated financial statements for periods prior to 2006 have not been restated to reflect, and do not include, the impact of SFAS 123R.

SFAS 123R requires companies to estimate the fair value of stock-based awards on the date of grant using an option-pricing model. The Company uses the Black-Scholes-Merton option pricing model to determine the fair-value of stock options under SFAS 123R, consistent with that used for pro forma disclosures under SFAS 123. The fair

value of a RSU is equivalent to the market price of the Company's common stock on the grant date. The value of the portion of the stock-based award that is ultimately expected to vest is

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recognized as expense over the requisite service periods, or in the period of grant if the requisite service period has been provided, in the Company's Consolidated Statement of Operations.

Stock-based compensation expense recognized is based on the fair value of the actual awards vested or expected to vest. Stock-based compensation expense recognized in the Company's consolidated statement of operations for the three and nine months ended September 30, 2006 included (i) compensation expense for stock-based awards granted prior to, but not yet vested as of, December 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS 123 and (ii) compensation expense for the stock-based awards granted subsequent to December 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. In conjunction with the adoption of SFAS 123R, the Company changed its accounting policy of attributing the fair value of stock-based compensation to expense from the accelerated multiple-option approach provided by APB 25, as allowed under SFAS 123, to the straight-line single-option approach, as allowed under SFAS 123R. Compensation expense for all expected-to-vest stock-based awards that were granted on or prior to December 31, 2005 will continue to be recognized using the accelerated attribution method. Compensation expense for all expected-to-vest stock-based awards that were granted or modified subsequent to December 31, 2005 is recognized on a straight-line basis provided that the amount of compensation cost recognized at any date is no less than the portion of the grant-date value of the award that is vested at that date. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company's stock-based compensation expense required under APB 25 and the pro forma information required under SFAS 123 for the periods prior to 2006, the Company accounted for forfeitures as they occurred.

Prior to the adoption of SFAS 123R, stock-based compensation expense was recognized for employee stock awards and past acquisitions in the Company's consolidated statement of operations under the provisions of APB 25. In accordance with APB 25, no compensation expense was required for the employee stock purchases under the Company's Employee Stock Purchase Plan under APB 25. Stock-based compensation expense recorded for the three and nine months ended September 30, 2005 was \$7.2 million and \$17.6 million, respectively, was related to employee stock-based awards and stock options, RSUs, employee stock purchases under the Company's Employee Stock Purchase Plan, as well as the incremental fair value assumed from acquisitions. As a result of adopting SFAS 123R, stock-based compensation recorded for the three and nine months ended September 30, 2006 was \$22.9 million and \$69.1 million, respectively, or \$20.2 million and \$58.0 million higher than which would have been reported had the Company continued to account for stock-based compensation under APB 25. Net income for the three and nine months ended September 30, 2006 was approximately \$13.9 million and \$40.0 million, respectively, lower than that which would have been reported had the Company continued to account for stock-based compensation under APB 25. Unamortized deferred compensation associated with stock options assumed from past acquisitions and employee stock-based awards of \$17.7 million has been reclassified to additional paid-in capital in the Company's condensed consolidated balance sheet upon the adoption of SFAS 123R on January 1, 2006. Additional information is discussed in Note 2, Restatement of Condensed Consolidated Financial Statements, and Note 6, Stockholders' Equity.

In accordance with SFAS 123R, the Company has presented as financing cash flows the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options beginning in 2006. Tax benefits from employee stock plans of \$7.8 million, which related to tax deductions in excess of the compensation cost recognized, were presented as financing cash flows for the nine months ended September 30, 2006. Prior to the adoption of SFAS 123R, tax benefits from employee stock plans were presented as operating cash flows.

The following table summarizes the pro forma net income and earnings per share, net of related tax effect, had the Company applied the fair value recognition provisions of SFAS 123 to employee stock benefits (in millions, except per share amounts):

Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
As Restated (1)	As Restated (1)

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Net income as reported	\$	83.5	\$	245.8
Add: amortization of deferred stock compensation included in reported net income, net of tax		4.6		11.3
Deduct: total stock-based employee compensation expense determined under fair value based method, net of tax		(35.6)		(100.7)
Pro forma net income	\$	52.5	\$	156.4
Basic net income per share:				
As reported	\$	0.15	\$	0.45
Pro forma	\$	0.09	\$	0.28
Diluted net income per share:				
As reported	\$	0.14	\$	0.41
Pro forma	\$	0.09	\$	0.26

(1) See Note 2,
Restatement of
Condensed
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Statements, to
Condensed
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Financial
Statements.

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Juniper Networks sells products and services through its direct sales force and through its strategic distribution relationships and value-added resellers. The Company's products are integrated with software that is essential to the functionality of the equipment. Additionally, the Company provides unspecified upgrades and enhancements related to the integrated software through its maintenance contracts for most of its products. Accordingly, the Company accounts for revenue in accordance with Statement of Position No. 97-2, *Software Revenue Recognition*, and all related interpretations. The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery or performance has occurred, the sales price is fixed or determinable and collectibility is reasonably assured. Evidence of an arrangement generally consists of customer purchase orders and, in certain instances, sales contracts or agreements. Shipping terms and related documents, or written evidence of customer acceptance, when applicable, are used to verify delivery or performance. In instances where final acceptance of the product, system or solution is specified by the customer, revenue is deferred until all acceptance criteria have been met. The Company assesses whether the sales price is fixed or determinable based on payment terms and whether the sales price is subject to refund or adjustment. Collectibility is assessed based on the creditworthiness of the customer as determined by credit checks and the customer's payment history to the Company. Accounts receivable are recorded net of allowance for doubtful accounts, estimated customer returns and pricing credits.

For arrangements with multiple elements, the Company allocates revenue to each element using the residual method based on vendor specific objective evidence of fair value of the undelivered items. Under the residual method, the amount of revenue allocated to delivered elements equals the total arrangement consideration less the aggregate fair value of any undelivered elements. Vendor specific objective evidence of fair value is based on the price charged when the element is sold separately.

For sales to direct end-users and value-added resellers, the Company recognizes product revenue upon transfer of title and risk of loss, which is generally upon shipment. For the end-users and value-added resellers, the Company has no significant obligations for future performance such as rights of return or pricing credits. A portion of the Company's sales are made through distributors under agreements allowing for pricing credits and/or rights of return. Product revenue on sales made through these distributors is recognized upon sell-through as reported by the distributors to the Company. Deferred revenue on shipments to distributors reflects the effects of distributor pricing credits and the amount of gross margin expected to be realized upon sell through.

Sales and transfers of financial instruments are accounted for under Statement of Financial Accounting Standard No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS 140). The Company sells interests in accounts receivables as part of a distributor accounts receivable financing arrangement which was established by the Company with a major financing company. Receivables sold under such arrangements are removed from the balance sheet and the related transaction fees are recorded in the statement of operations at the time they are sold in accordance with SFAS 140. Specifically, the receivables are legally isolated from the Company, the purchasers have the right to pledge or exchange the receivables and the purchasers obtain effective control over the receivables.

The Company records reductions to revenue for estimated product returns and pricing adjustments, such as rebates and price protection, in the same period that the related revenue is recorded. The amount of these reductions is based on historical sales returns and price protection credits, specific criteria included in rebate agreements, and other factors known at the time.

Shipping charges billed to customers are included in product revenue and the related shipping costs are included in cost of product revenues. Costs associated with cooperative advertising programs are estimated and recorded as a reduction of revenue at the time the related sales are recognized.

Services include maintenance, training and professional services. In addition to providing unspecified upgrades and enhancements on a when and if available basis, the Company's maintenance contracts include 24-hour technical support, and hardware repair and replacement parts. Maintenance is offered under renewable contracts. Revenue from maintenance contracts is deferred and recognized ratably over the contractual support period, generally one year. Revenue from training and professional services is recognized as the services are completed or ratably over the contractual period.

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Goodwill and Purchased Intangible Assets

Goodwill is the excess of the purchase price over the fair value of identified net assets acquired in a business combination accounted for under the purchase method. Goodwill is not subject to amortization but is assessed annually, or as impairment indicators exist, for impairment by applying a fair-value based test. Goodwill impairment tests could result in further charges to earnings.

Purchased intangibles with finite lives are amortized on a straight-line basis over their respective estimated useful lives.

Impairment

The Company evaluates goodwill, at a minimum, on an annual basis and whenever events and changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment of goodwill is tested at the reporting unit level by comparing the reporting unit's carrying value, including goodwill, to the fair value of the reporting unit. The fair values of the reporting units are estimated using a combination of the income, or discounted cash flows, approach and the market approach, which utilizes comparable companies' data, if any. If the carrying value of the reporting unit exceeds the fair value, goodwill is considered impaired and a second step is performed to measure the amount of the impairment loss, if any.

The Company evaluates long-lived assets held-for-use for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An asset is considered impaired if its carrying amount exceeds the undiscounted future net cash flow the asset is expected to generate. If an asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair market value. The Company assesses the recoverability of its long-lived and intangible assets by determining whether the unamortized balances can be recovered through undiscounted future net cash flows of the related assets. The amount of impairment, if any, is measured based on projected discounted future net cash flows.

There was no impairment of goodwill or intangibles during the three months ended September 30, 2006. During the nine months ended September 30, 2006, the Company recognized non-cash impairment charges of \$1,280.0 million relating to goodwill and \$3.4 million relating to intangible assets.

Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, (FIN 48). FIN 48 applies to all tax positions related to income taxes subject to SFAS 109, *Accounting for Income Taxes*, including uncertain tax positions. Under FIN 48 a company will recognize the benefit from a tax position only if it is more-likely-than-not that the position would be sustained upon audit based solely on the technical merits of the tax position. FIN 48 clarifies how a company would measure the income tax benefits from the tax positions that are recognized, provides guidance as to the timing of the de-recognition of previously recognized tax benefits and describes the methods for classifying and disclosing the liabilities within the financial statements for any unrecognized tax benefits. FIN 48 also addresses when a company should record interest and penalties related to tax positions and how the interest and penalties may be classified within the income statement and presented in the balance sheet. Differences between the amounts recognized in the statements of financial position prior to and after the adoption of FIN 48 would be accounted for as a cumulative-effect adjustment to the beginning balance of retained earnings. Upon adoption, there is a possibility that the cumulative effect would result in an adjustment to the beginning balance of retained earnings. In addition, the application of FIN 48 may increase the Company's future effective tax rates and its future intra-period effective tax rate volatility. The Company is required to adopt FIN 48 as of January 1, 2007. The Company is currently evaluating the effect of the adoption of FIN 48 on its consolidated financial statements and is not yet in a position to determine such effects.

In September 2006, the SEC Staff published Staff Accounting Bulletin (SAB) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, (SAB 108). SAB 108 addresses quantifying the financial statement effects of misstatements and considering the effects of prior year uncorrected errors on the income statements as well as the balance sheets. SAB 108 does not change the requirements under SAB 99 regarding qualitative considerations in assessing the materiality of misstatements. SAB 108 is effective for fiscal years ending after November 15, 2006. The Company does not expect any material impact on its financial

statements from the adoption of this guidance.

In September 2006, the FASB issued FASB Statement (SFAS) No. 157, *Fair Value Measurement*, (SFAS 157). SFAS 157 provides enhanced guidance for using fair value to measure assets and liabilities. The guidance clarifies the principle for assessing fair

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value based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, the guidance establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data such as companies' own data. Under this guidance, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently evaluating SFAS 157 and expects to adopt this guidance beginning on January 1, 2008.

Reclassifications

Certain reclassifications have been made to prior year balances in order to conform to the current year's presentation.

Note 2. Restatement of Condensed Consolidated Financial Statements**Restatement of Previously Issued Financial Statements**

In this Form 10-Q, Juniper Networks is restating its condensed consolidated balance sheet as of December 31, 2005, the related consolidated statements of operations for the three and nine months ended September 30, 2005, and the related consolidated statement of cash flows for the nine months ended September 30, 2005 as a result of an independent stock option investigation commenced by the Company's Board of Directors and Audit Committee. In the Company's 2006 Form 10-K for the year ended December 31, 2006 to be filed with the SEC (the "2006 Form 10-K"), the Company is restating its consolidated balance sheet as of December 31, 2005 and 2004, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the fiscal years ended December 31, 2005 and 2004. The 2006 Form 10-K will also reflect the restatement of "Selected Consolidated Financial Data" in Item 6 for the fiscal years ended December 31, 2005, 2004, 2003, and 2002. In addition, the Company is restating its unaudited quarterly financial information and financial statements for interim periods of 2005, and unaudited condensed financial statements for the three months ended March 31, 2006.

Financial information included in the reports on Form 10-K, Form 10-Q and Form 8-K filed by Juniper Networks prior to August 10, 2006, and the related opinions of its independent registered public accounting firm, and all earnings press releases and similar communications issued by the Company, prior to August 10, 2006 should not be relied upon and are superseded in their entirety by this Report and other reports on Form 10-Q and Form 8-K filed by the Company with the SEC on or after August 10, 2006.

Stock Option Investigation

On May 22, 2006, the Company issued a press release and Form 8-K announcing that it had received a request for information relating to the Company's stock option granting practices from the U.S. Attorney's Office for the Eastern District of New York. In the same press release and Form 8-K, the Company announced that its Board of Directors (the "Board") had directed the Board's Audit Committee, comprised of outside directors, to conduct a review of the Company's stock option granting practices. On May 24, 2006, Company counsel received a letter from the SEC indicating that the SEC was conducting an inquiry regarding Juniper Networks.

The investigation was conducted with the assistance of independent counsel and forensic accountants (collectively the "Investigative Team"). The investigation focused on all stock option grants made to all employees, officers, directors and consultants during the period following the Company's initial public offering ("IPO") on June 24, 1999 to May 23, 2006 (the "relevant period"). In addition, the Audit Committee investigation involved testing and analyses of the Company's hiring, termination, leave of absence, grant notification and exercise practices regarding stock options and certain issues regarding grants made before the IPO. The scope of the investigation did not include a review of options granted by companies acquired by Juniper Networks. All of the companies acquired by Juniper Networks, with one exception, were privately held companies. None of the acquisitions was accounted for as a pooling of interests. All of the acquisitions were accounted for under the purchase method as provided by Statement of Financial Standards No. 141, *Business Combinations* and its predecessor Accounting Principles Board Opinion No. 16, *Business Combinations*.

Consistent with the accounting literature and recent guidance from the SEC, the Company organized the grants during the relevant period into categories based on grant type and the process by which the grant was finalized. The Company analyzed the evidence from the Audit Committee's investigation related to each category including, but not

limited to, physical documents, electronic documents, underlying electronic data about documents, and witness interviews. Based on the relevant facts and circumstances, the Company applied the then appropriate accounting standards to determine, for every grant within each category, the proper measurement date. If

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the measurement date was not the originally assigned grant date, accounting adjustments were made as required, resulting in stock-based compensation expense and related tax effects.

Grants made by the Board of Directors or Compensation Committee to Officers or Directors

The Company has concluded that the measurement dates of several grants to executive officers who were reporting persons as that term is defined under Section 16 of the Securities Exchange Act of 1934, as amended, (Officers) and members of the Board of Directors made between June 1999 and June 2003 were incorrect. In general, during the relevant period, the Board or the Compensation Committee of the Board made grants to Officers and directors. Grants were sometimes approved at meetings of these bodies or by action by unanimous written consent. There were several instances in which grants to Officers or directors were given grant dates (and corresponding exercise prices) prior to the date on which formal corporate action making the grant was taken. In general, this appears to have been done to make the grant date coincide with either a specific event, such as the appointment or re-election of a director or with the purported date options were granted to non-Officers. In these cases, the Company has determined that the correct measurement date is the date on which the Board or Compensation Committee took the action to approve the grant. The Company also identified instances in which grants to Officers were granted effective upon a future event, such as the commencement of employment or closing of an acquisition. In these cases, the Company has determined that the date of the future event is the correct measurement date for such grants. In connection with the application of these measurement principles, and after accounting for forfeitures, the Company has adjusted the measurement of compensation cost for options covering 5.6 million shares of common stock resulting in an incremental stock-based compensation expense of \$80.3 million on a pre-tax basis over the respective awards' vesting terms. Juniper Networks CEO, Scott Kriens, received two stock option awards whose measurement dates for financial accounting purposes differ from the recorded grant dates for such awards. However, both options were exchanged and cancelled unexercised in 2001 as part of a company-wide option re-pricing program. Mr. Kriens has not exercised any stock options since 1998, approximately nine months before the Company's IPO.

In addition, there was one other grant to an Officer where approval of such grant was not reflected in minutes of a meeting or an action by unanimous written consent of the Board of Directors or the Compensation Committee. For this grant, the measurement date was determined based on the terms of the Officer's offer letter and the date his employment commenced. With respect to that grant, the Company has adjusted the measurement of compensation cost for options covering 1.5 million shares of common stock resulting in an incremental stock-based compensation expense of \$6.5 million on a pre-tax basis over the award's vesting terms after accounting for forfeitures.

Grants to Non-Officers

The Company has concluded that the measurement dates of a large number of grants to non-Officers during the period between June 1999 and December 2004 were incorrect. The Company's practice has been to grant stock options, except where prohibited, to nearly all full-time employees in connection with joining the Company. To facilitate the granting of options to Juniper Networks' rapidly growing workforce, the Board of Directors established a Stock Option Committee to grant options to non-Officer employees. Between June 1999 and June 2003, the dates for a large number of grants made by the Stock Option Committee were chosen with the benefit of hindsight as to the price of the Company's stock, so as to give favorable exercise prices. Moreover, the Stock Option Committee's process for finalizing and documenting these grants was often completed after the originally assigned grant date. Beginning with grants dated June 20, 2003, the Company implemented a number of new procedures and policies regarding the granting of options to non-Officer employees. After that, the pattern of consciously looking back for the most favorable dates for the employees ceased. However, the documentation and written approvals of grant dates still generally trailed the recorded grant dates. Based on all available facts and circumstances, the originally recorded measurement dates for the grants made by the Stock Option Committee during the period from July 1999 through December 2004 can not be relied upon in isolation as the correct measurement dates. In 2005, the Company made additional changes to its procedures. No grants in 2005 and 2006 required new measurement dates.

APB 25 defines the measurement date for determining stock-based compensation expense as the first date on which both (1) the number of shares that an individual employee is entitled to receive and (2) the option or purchase price, are known. Throughout the relevant period, the Company's stock administration department entered the option grant information for grants made by the Stock Option Committee into its Equity Edge stock administration system.

This system was used to monitor and administer the Company's stock option program. The data in Equity Edge were sent on a regular basis to designated brokers, allowing grantees to view their options information in their accounts via the Internet.

For grants made by the Stock Option Committee between June 1999 and December 2004, where there is no other reliable objective evidence pointing to an earlier single specific date that the number of shares and the individuals entitled to receive them and the price

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had become final, the Company has determined the Equity Edge entry date to be the most reliable measurement date for calculating additional stock-based compensation expense under APB 25. Using this measurement date, and after accounting for forfeitures, the Company has adjusted the measurement of compensation cost for options covering 74.2 million shares of common stock resulting in an incremental stock-based compensation expense of \$636.7 million on a pre-tax basis over the respective awards' vesting terms.

In many of the cases where the Equity Edge entry date was used as the measurement date, the formal Stock Option Committee granting documentation (consisting of unanimous written consents or minutes and related lists of recipients, amounts and types of awards) was not created or completed until a later date. Because the awards listed in the formal granting documentation did not differ from the grants entered into Equity Edge, the notice of the awards was made available to employees prior to the creation or completion of the granting documents, and because the completion of the documentation was treated as perfunctory, the Company determined that the Equity Edge entry date was the proper measurement date under APB 25 rather than the date the Stock Option Committee granting documentation was completed.

In a number of cases, there was reliable objective evidence pointing to a single specific date that the number of shares and the individuals entitled to receive them and the price had become final. Such evidence primarily consisted of electronic data indicating that the granting instrument and schedule were created prior to the Equity Edge entry date. The Company also relied on other evidence such as emails or written agreements to determine the date certain options became final. Such evidence was used to determine the measurement dates for options for which the Company has adjusted the measurement of compensation cost for options covering 27.9 million shares of common stock resulting in an incremental stock-based compensation expense of \$141.2 million on a pre-tax basis over the respective awards' vesting terms.

The Company also concluded that there were instances in which clerical errors or omissions regarding the persons to receive an award or the number of options to be granted were corrected after the date of award. In the case of most additions made to correct omissions and other corrections that were not reflected on the grant documentation at the time of the applicable grant date or in documentation existing at the time of grant, the Company has determined that a new measurement date should be established. The Company considered whether certain of such changes or additions should give rise to variable accounting treatment and concluded that such treatment was not appropriate because the grants represented independent decisions or events rather than a continuation or modification of the other grants. The Company believes that the correct measurement date for these grants is the date Stock Administration entered the correction or addition into Equity Edge, except where objective evidence identifies an earlier date on which the correction was approved. After accounting for forfeitures, the Company has adjusted the measurement of compensation cost for options covering 1.3 million shares of common stock resulting in an incremental stock-based compensation of \$11.9 million on a pre-tax basis over the respective awards' vesting terms.

Stock Option Grant Modifications Connected with Terminations or Leaves of Absences and Other

Compensation expense was also recognized as a result of modifications that were made to certain employee option grant awards in connection with certain employees' terminations or leaves of absence. Typically such modifications related to extensions of the time employees could exercise options following their termination of employment or that enabled the employee to vest in additional shares in relation to a leave of absence. For example, in connection with reductions in work force in 2001 and 2002, the Company increased the period for affected employees to exercise their options from 30 days to 90 days. The Company has incremental stock-based compensation expense associated with such terminations or leaves of absence of \$20.0 million on a pre-tax basis in the period of modification.

Compensation expense of \$0.2 million on a pre-tax basis was also recognized as a result of non-employee grants to consultants in exchange for services and other matters.

Judgment

In light of the significant judgment used in establishing revised measurement dates, alternate approaches to those used by the Company could have resulted in different compensation expense charges than those recorded in the restatement. The Company considered various alternative approaches. For example, in those cases where the formal documentation of a grant was completed after the date the grant was entered in Equity Edge, an alternative measurement date to using the Equity Edge entry date could be the creation date of the documentation. The Company

believes that the approaches used by it were the most appropriate under the circumstances.

Table of Contents***Summary of Stock-Based Compensation Adjustments***

The Company adjusted the measurement dates for options covering a total of 110.5 million, or 76%, of the 146.0 million shares of common stock covered by options granted during the relevant period.

The incremental impact on the condensed consolidated statement of operations from recognizing stock-based compensation expense through December 31, 2005 resulting from the investigation is summarized as follows (in millions):

Fiscal Year	Pre-Tax Expense	After Tax Expense
1998	\$	\$
1999	15.3	15.3
2000	283.3	201.6
2001	513.1	488.1
2002	48.0	48.0
2003	19.4	8.6
2004	10.9	7.5
2005	4.7	3.3
Total	\$ 894.7	\$ 772.4

In addition to the \$894.7 million recognized through fiscal 2005, \$2.1 million of unamortized deferred compensation remained as of December 31, 2005, bringing the total incremental impact from the investigation to approximately \$896.8 million. As required by SFAS 123R which was adopted on January 1, 2006, the unamortized deferred compensation of \$2.1 million has been reclassified to additional paid-in capital, along with the unamortized deferred compensation for stock options assumed from past acquisitions, in the Company's consolidated balance sheet. Beginning in 2006, the incremental amortization resulting from the investigation is included in stock-based compensation expense under the provisions of SFAS 123R. The incremental expense from the restatement of employee stock options is insignificant for the three and nine months ended September 30, 2006.

Additionally, the Company has restated the pro forma amortization of deferred stock compensation included in reported net income, net of tax, and total stock-based employee compensation expenses determined under fair value based method, net of tax, under SFAS 123 in Note 1 to reflect the impact of the stock-based compensation expense resulting from the correction of these past stock options grants. The Company also determined that the previously reported pro forma compensation expense for options assumed in a 2004 acquisition was inadvertently based on an incorrect fair value. The amount of pro forma stock-based compensation expense reported in the table below has been revised to reflect the proper fair value for options assumed from the 2004 acquisition. Such adjustment was previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

The following table presents the effect of the related adjustments on the pro forma calculation of the net income and net income per share for the three and nine months ended September 30, 2005, respectively (in millions, except per share amounts):

	Three Months Ended September 30, 2005			Nine Months Ended September 30, 2005		
	As previously		As restated	As previously		As restated
	reported	Adjustments		reported	Adjustments	
Net income	\$ 84.1	\$ (0.6)	\$ 83.5	\$ 248.5	\$ (2.7)	\$ 245.8
Add: Stock-based employee compensation	4.0	0.6	4.6	8.6	2.7	11.3

expense included in
reported net income

Deduct: Stock-based
employee compensation
expense determined
under fair value based
method for all awards

(26.4)	(9.2)	(35.6)	(78.4)	(22.3)	(100.7)
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Pro forma net income
(loss)

\$ 61.7	\$ (9.2)	\$ 52.5	\$ 178.7	\$ (22.3)	\$ 156.4
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Net income per share
basic, as reported

\$ 0.15	\$	\$ 0.15	\$ 0.45	\$	\$ 0.45
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Net income (loss) per
share basic, pro forma

\$ 0.11	\$ (0.02)	\$ 0.09	\$ 0.32	\$ (0.04)	\$ 0.28
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Net income per share
diluted, as reported

\$ 0.14	\$	\$ 0.14	\$ 0.42	\$ (0.01)	\$ 0.41
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Net income (loss) per
share diluted, pro forma

\$ 0.10	\$ (0.01)	\$ 0.09	\$ 0.29	\$ (0.03)	\$ 0.26
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Table of Contents**Other Matters**

After considering all available evidence, primarily the then current 2005 operating projections of future income, which remain appropriate, management has concluded that the previously recorded valuation allowance related to the tax benefit of stock options deductions should have been reversed in the fourth quarter of 2005. Accordingly, the Company decreased the valuation allowance as of December 31, 2005 by \$158.0 million with a corresponding credit to additional paid-in capital. The remaining valuation allowance balance of \$40.6 million relates to capital losses that will carry forward to offset future capital gains.

Additionally, the Company misclassified the tax benefit from deductions from stock options assumed in acquisitions. Accordingly, the Company has reduced additional paid-in capital for the years ended December 31, 2005 and 2004 by \$6.0 million and \$18.5 million, respectively, with a corresponding decrease to goodwill. The total reduction to both additional paid-in capital and goodwill as of December 31, 2005 was \$24.5 million.

Because virtually all holders of options issued by the Company were not involved in or aware of the incorrect pricing, the Company intends to take actions to deal with certain adverse tax consequences that may be incurred by the holders of certain incorrectly priced options. The primary adverse tax consequences are that incorrectly priced stock options vesting after December 31, 2004 may subject the option holder to a penalty tax under IRC Section 409A (and, as applicable, similar penalty taxes under California and other state tax laws). The Company expects to incur future charges to resolve the adverse tax consequences of incorrectly priced options.

The Company misclassified the losses from the retirement of its treasury shares in fiscal 2004. Accordingly, the Company reduced its retained earnings (accumulated deficit) as of December 31, 2005 and 2004 by \$63.6 million with a corresponding increase to additional paid-in capital.

Effects of the Restatement Adjustments

The following table presents the effect of the stock-based compensation and related tax adjustments upon the Company's previously reported condensed consolidated statements of operations (in millions):

	Three months ended September 30, 2005			Nine months ended September 30, 2005		
	As previously Reported (1)	Adjustments	As restated	As previously Reported (1)	Adjustments	As restated
Net revenues:						
Product	\$ 466.4	\$	\$ 466.4	\$ 1,282.4	\$	\$ 1,282.4
Service	80.0		80.0	206.1		206.1
Total net revenues	546.4		546.4	1,488.5		1,488.5
Cost of revenues:						
Product(2)	132.4	(0.1)	132.3	366.2	0.2	366.4
Service(2)	39.4	0.1	39.5	104.7	0.3	105.0
Total cost of revenues	171.8		171.8	470.9	0.5	471.4
Gross margin	374.6		374.6	1,017.6	(0.5)	1,017.1
Operating expenses:						
Research and development(2)	94.4	0.3	94.7	256.1	1.5	257.6
Sales and marketing(2)	117.8	0.4	118.2	313.3	1.6	314.9
General and administrative(2)	27.1	0.1	27.2	58.5	0.1	58.6
	23.0		23.0	61.4		61.4

Amortization of purchased intangibles						
In-process research and development	3.8		3.8	5.7		5.7
Other charges, net	(0.2)		(0.2)	(6.7)		(6.7)
Total operating expenses	265.9	0.8	266.7	688.3	3.2	691.5
Operating income	108.7	(0.8)	107.9	329.3	(3.7)	325.6
Interest and other income	15.6		15.6	40.0		40.0
Gain on investments	1.7		1.7	1.7		1.7
Interest and other expense	(0.8)		(0.8)	(2.7)		(2.7)

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	Three months ended September 30, 2005			Nine months ended September 30, 2005		
	As previously Reported (1)	Adjustments	As restated	As previously Reported (1)	Adjustments	As restated
Income before income taxes	125.2	(0.8)	124.4	368.3	(3.7)	364.6
Provision (benefit) for income taxes	41.1	(0.2)	40.9	119.8	(1.0)	118.8
Net income	\$ 84.1	\$ (0.6)	\$ 83.5	\$ 248.5	\$ (2.7)	\$ 245.8
Net income per share:						
Basic	\$ 0.15	\$	\$ 0.15	\$ 0.45	\$	\$ 0.45
Diluted	\$ 0.14	\$	\$ 0.14	\$ 0.42	\$ (0.1)	0.41
Shares used in computing net income per share:						
Basic	\$ 561.8	\$	\$ 561.8	\$ 550.3	\$	\$ 550.3
Diluted	\$ 605.4	\$ 0.9	\$ 606.3	\$ 596.0	\$ 1.3	\$ 597.3

(1) Prior Period amounts have been reclassified in order to conform to the current year presentation.

(2) Amortization of stock-based compensation included in the following cost and expense categories by period:

Cost of revenues	Product	\$ 0.4	\$ (0.1)	\$ 0.3	\$ 0.5	\$ 0.2	\$ 0.7
Cost of revenues	Service	0.3	0.1	0.4	0.9	0.3	1.2
Research and development		3.8	0.4	4.2	8.3	1.5	9.8
Sales and marketing		1.6	0.3	1.9	3.3	1.6	4.9

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General and administrative	0.3	0.1	0.4	0.8	0.1	0.9
Total	\$ 6.4	\$ 0.8	\$ 7.2	\$ 13.8	\$ 3.7	\$ 17.5

The following table presents the effect of the stock-based compensation, related tax impact and other adjustments upon the Company's previously reported condensed consolidated balance sheet as of December 31, 2005 (in millions):

December 31, 2005			
	As previously reported	Adjustments	As restated
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 918.4	\$	\$ 918.4
Short-term investments	510.4		510.4
Accounts receivable, net	268.9		268.9
Deferred tax assets, net	74.1	70.3 (E)	144.4
Prepaid expenses and other current assets	46.7		46.7
Total current assets	1,818.5	70.3	1,888.8
Property and equipment, net	319.9		319.9
Long-term investments	618.3		618.3
Restricted cash	66.1		66.1
Goodwill	4,904.2	(24.5) (D)	4,879.7
Purchased intangible assets, net	269.9		269.9
Long-term deferred tax assets, net		111.2 (E)	111.2
Other assets	29.7		29.7
Total assets	\$ 8,026.6	\$ 157.0	\$ 8,183.6
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Accounts payable	\$ 165.2	\$	\$ 165.2
Accrued compensation	97.7		97.7
Accrued warranty	28.2		28.2
Deferred revenue	213.5		213.5
Income taxes payable	56.4		56.4
Other accrued liabilities	66.4		66.4
Total current liabilities	627.4		627.4
Long-term deferred revenue	39.3		39.3
Other long-term liabilities	60.2	(31.5) (E)	28.7
Long-term debt	400.0		400.0
Commitments and contingencies			
Stockholders' equity:			
Common stock			

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	December 31, 2005		
	As previously reported	Adjustments	As restated
Additional paid-in capital	6,432.0	1,026.6 (A)(B)(C)(D)(E)	7,458.6
Deferred stock compensation	(15.6)	(2.1) (C)	(17.7)
Accumulated other comprehensive (loss) gain	(8.3)		(8.3)
Retained earnings (accumulated deficit)	491.6	(836.0) (A)(B)	(344.4)
 Total stockholders' equity	 6,899.7	 188.5	 7,088.2
 Total liabilities and stockholders' equity	 \$ 8,026.6	 \$ 157.0	 \$ 8,183.6

(A) Includes impact of \$772.4 million, net of tax, increase in additional paid-in capital with corresponding decrease in retained earnings (accumulated deficit) related to stock-based compensation from the investigation.

(B) Includes impact of a \$63.6 million increase in additional paid-in capital with a corresponding decrease in retained earnings (accumulated deficit) related to misclassified

losses from the retirement of the Company's treasury shares.

(C) Includes impact of \$2.1 million increase in additional paid-in capital with a corresponding increase in deferred compensation related to unamortized stock-based compensation.

(D) Includes impact of \$24.5 million decrease in additional paid-in capital with corresponding decrease in goodwill related to misclassified tax benefit from deductions from stock options assumed in acquisitions.

(E) Includes impact of \$158.0 million and \$55.0 million increases in additional paid-in capital with a corresponding decrease in the valuation allowance related to deferred tax

assets from
stock options
deductions and
on stock-based
compensation
from the
investigation,
respectively.
Amounts impact
current and
long-term net
deferred tax
assets.

The effect of restatement adjustments on each component of stockholders' equity at the end of each year is summarized as follows (in millions):

Fiscal Year	Common Stock & Additional Paid-In Capital	Deferred Stock Compensation	Accumulated Deficit	Net Impact to Stockholders Equity
1998	\$	\$	\$	\$
1999	215.3	(200.0)	(15.3)	
2000	479.6	(278.0)	(201.6)	
2001	74.9	413.2	(488.1)	
2002	21.5	26.5	(48.0)	
2003	(10.6)	19.2	(8.6)	
2004	41.3	11.3	(71.1)	(18.5)
2005	204.6	5.7	(3.3)	207.0
Total	\$ 1,026.6	\$ (2.1)	\$ (836.0)	\$ 188.5

The following table presents the effects of the restatement adjustments on the Company's previously reported condensed consolidated statements of cash flows (in millions):

	Nine months ended September 30, 2005		
	As previously reported		
	reported	Adjustments	As restated
Operating Activities			
Net Income	\$ 248.5	\$ (2.7)	\$ 245.8
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation and amortization	99.7		99.7
Stock-based compensation	13.9	3.7	17.6
In-process research and development	5.7		5.7
Non-cash portion of debt issuance costs and disposal of property and equipments	1.4		1.4
Gains on investments	(1.7)		(1.7)

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Tax benefits from stock-based compensation	95.3	(1.0)	94.3
Changes in operation assets and liabilities:			
Accounts receivable, net	(43.5)		(43.5)
Prepaid expenses, other current assets and other long-term assets	(37.3)		(37.3)
Accounts payable	35.5		35.5
Accrued compensation	(12.1)		(12.1)
Accrued warranty	(1.3)		(1.3)
Other accrued liabilities	(16.2)		(16.2)
Deferred revenue	57.5		57.5
Net cash provided by operating activities	445.4		445.4
Investing Activities			
Purchases of property and equipment	(58.9)		(58.9)
Purchases of available-for-sale investments	(639.3)		(639.3)
Maturities and sales of available-for-sale investments	540.9		540.9
Increase in restricted cash	(7.1)		(7.1)
Minority equity investments	(9.8)		(9.8)
Payments for business acquisitions, net of cash and cash equivalents	(199.1)		(199.1)
Net cash used in investing activities	(373.3)		(373.3)

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	Nine months ended September 30, 2005		
	As		
	previously		
	reported	Adjustments	As restated
Financing Activities			
Proceeds from issuance of common stock	103.1		103.1
Purchases and subsequent retirement of common stock			
Tax benefits from stock-based compensation			
Net cash provided by financing activities	\$ 103.1	\$	\$ 103.1
Net increase in cash and cash equivalents	\$ 175.2	\$	\$ 175.2
Cash and cash equivalents at beginning of period	\$ 713.2	\$	\$ 713.2
Cash and cash equivalents at end of period	\$ 888.4	\$	\$ 888.4

Note 3. Goodwill and Purchased Intangible Assets***Goodwill***

The Company allocated the purchase price to the tangible and intangible assets acquired and liabilities assumed based on their fair values. The excess purchase price over those fair values is recorded as goodwill. The purchase price allocation and goodwill are subject to change due to the release of the amounts held in escrow to secure certain indemnity obligations, additional contingent payments and changes in acquisition related assets and liabilities. Changes in the Company's goodwill are as follows (in millions):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
		As Restated		As Restated
		(1)		(1)
Beginning balance	\$ 3,627.2	\$ 4,557.6	\$ 4,879.6	\$ 4,409.4
Goodwill acquired during the period		250.6		393.2
Impairment of goodwill			(1,280.0)	
Escrow and other additions to existing goodwill	(2.2)	(0.2)	25.4	5.4
Ending balance	\$ 3,625.0	\$ 4,808.0	\$ 3,625.0	\$ 4,808.0

(1) See Note 2, Restatement of Condensed Consolidated Financial Statements, to Condensed Consolidated

Financial
Statements.

In the three months ended June 30, 2006, the Company concluded that the carrying value of goodwill for the SLT segment was impaired and recorded a goodwill impairment charge of \$1,280.0 million which is included in the Company's consolidated statements of operations for nine months ended September 30, 2006. There was no impairment of goodwill in the three months ended September 30, 2006. The Company made its determination to perform an impairment review in the early May 2006 time frame. A significant portion of the goodwill was initially recorded based on stock prices at the time related merger agreements were executed and announced. The impairment of goodwill was primarily attributable to the decline in the Company's market capitalization that occurred over a period of approximately six months prior to the impairment review and, to a lesser extent, a decrease in the forecasted future cash flows used in the income approach. The first step of the impairment test compared the fair value of each reporting unit to its carrying value, including the goodwill related to the respective reporting units. The Company determined that it has four reporting units at the time of the impairment test, consisting of Infrastructure and Service which were the same as the respective segments and Security and Application Acceleration which were the two components of the SLT segment. The Company utilized independent external service providers to calculate the fair value of the reporting units using a combination of the income and market approaches. The income approach requires estimates of expected revenue, gross margin and operating expenses in order to discount the sum of undiscounted future cash flows using each particular reporting unit's weighted average cost of capital. The Company's growth estimates were based on historical data and internal estimates developed as part of its long-term planning process. The Company tested the reasonableness of the inputs and outcomes of its discounted cash flow analysis by comparing to available market data. In determining the carrying value of the reporting unit, the Company allocated the fair values of shared tangible net assets to each reporting unit based on revenue. As the fair values of the Security and Application Acceleration reporting units were lower than the allocated book values, the Company performed step two of the goodwill impairment calculation for those two reporting units within the SLT segment.

During the second step of the goodwill impairment review, management estimated the fair value of the Company's tangible and intangible net assets with the assistance of independent external service providers. Identified intangible assets were valued specifically for each reporting unit tested. The difference between the estimated fair value of each reporting unit and the sum of the fair value of the identified net assets results in the residual value of goodwill. Future impairment indicators, including further declines in the Company's market capitalization or changes in forecasted future cash flows, could require additional impairment charges. There was no goodwill impairment during the three and nine months ended September 30, 2005.

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In the nine months ended September 30, 2006, increases to goodwill are primarily related the distribution of \$15.1 million in cash for the resolution of certain indemnity obligations for the Redline Networks, Inc. (Redline) and Kagoor Networks, Inc. (Kagoor) acquisitions and the release of 0.8 million shares of common stock held in escrow with a total market value of \$10.3 million in conjunction with the resolution of certain indemnity obligations associated with the Peribit Networks, Inc. (Peribit) acquisition. The decrease in goodwill in the three months ended September 30, 2006 of \$2.2 million is primarily related to changes in the market value of the common stock related to the Peribit escrow between the resolution date and the release date. In the nine months ended September 30, 2005, increases to goodwill of \$5.4 million was primarily related to the resolution of certain earn-out obligations associated with the acquisition of NetScreen Technologies, Inc. (NetScreen).

Restated year end balances include \$6.0 million and \$18.5 million decreases in goodwill for 2005 and 2004, respectively, related to misclassified tax benefits from deductions from stock options assumed in acquisitions.

Purchased Intangible Assets

The following is a summary of the Company's purchased intangibles assets with definite lives (in millions):

	Gross	Accumulated Amortization	Net
As of September 30, 2006:			
Technologies and patents	\$ 379.6	\$ (221.5)	\$ 158.1
Other	68.9	(34.0)	34.9
Total	\$ 448.5	\$ (255.5)	\$ 193.0
As of December 31, 2005:			
Technologies and patents	\$ 382.4	\$ (156.3)	\$ 226.1
Other	69.5	(25.7)	43.8
Total	\$ 451.9	\$ (182.0)	\$ 269.9

For the nine months ended September 30, 2006, the Company recorded an impairment charge of \$3.4 million due to a significant decrease in forecasted cash flows associated with its stand-alone session border control (SBC) products in the second quarter of 2006. There were no impairment charges in the three months ended September 30, 2006.

There were no additions to purchased intangible assets during the three and nine months ended September 30, 2006. Amortization expense of purchased intangible assets of \$24.4 million and \$23.0 million were included in operating expenses and cost of product revenue for the three months ended September 30, 2006 and 2005, respectively, and \$73.5 million and \$61.4 million for the nine months ended September 30, 2006 and 2005, respectively.

The estimated future amortization expense of purchased intangible assets with definite lives for the next five years is as follows (in millions):

Year Ending December 31,	Amount
2006 (remaining three months)	\$ 24.4
2007	91.9
2008	45.2
2009	17.9
2010	4.1
Thereafter	9.5
Total	\$ 193.0

Table of Contents**Note 4. Other Financial Information*****Investments***

The following is a summary of the Company's available-for-sale investments, at fair value (in millions):

	September 30, 2006	As of December 31, 2005
Commercial paper	\$	\$ 8.0
Government securities	350.0	319.6
Corporate debt securities	637.2	700.7
Asset-backed securities and equity securities	92.7	95.5
Other	0.8	4.9
Total	\$ 1,080.7	\$ 1,128.7
Reported as:		
Short-term investments	\$ 514.2	\$ 510.4
Long-term investments	566.5	618.3
Total	\$ 1,080.7	\$ 1,128.7

Restricted Cash

Restricted cash as of September 30, 2006 and December 31, 2005 consisted of escrow accounts required by certain acquisitions and the Directors & Officers (D&O) trust. In the three months ended September 30, 2006, the Company reduced restricted cash by \$2.0 million related to the cash distribution for the partial resolution of certain indemnity obligations for the Kagoor acquisition. In the nine months ended September 30, 2006, the Company reduced restricted cash by \$20.8 million, of which \$5.9 million was related to the removal of deposit requirements for standby letters of credits issued for facility leases, and \$15.1 million was related to the cash distributions for the resolution of certain indemnity obligations for the Redline and Kagoor acquisitions. During the nine months ended September 30, 2005, the Company added \$20.0 million to restricted cash for the escrow accounts established in connection with the Kagoor and Redline acquisitions.

Minority Equity Investments

As of September 30, 2006 and December 31, 2005, the carrying values of the Company's minority equity investments in privately held companies of \$16.3 million and \$13.2 million, respectively, were included in other long-term assets in the condensed consolidated balance sheets. There was no additional minority equity investment in privately-held companies during the three months ended September 30, 2006. During the nine months ended September 30, 2006, the Company made minority equity investments of \$3.1 million in privately-held companies. During the three and nine months ended September 30, 2005, the Company invested \$10.0 million and \$11.0 million, respectively, in privately held companies and recognized a gain of \$1.7 million resulting from the sale of the one of the Company's portfolio companies with a cost basis of \$1.0 million. There was no gain or impairment against the Company's minority equity investments in the three and nine months ended September 30, 2006.

Warranties

As of September 30, 2006 and December 31, 2005, warranty reserve was \$34.1 million and \$35.3 million, respectively. Changes in the Company's warranty reserve are as follows (in millions):

Three Months Ended September 30,		Nine Months Ended September 30,	
2006	2005	2006	2005

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Beginning balance	\$	35.2	\$	36.1	\$	35.3	\$	38.9
Provisions made during the period		6.8		12.2		27.3		22.8
Changes in estimates		(1.5)		(1.3)		(4.7)		(2.5)
Actual costs incurred during the period		(6.4)		(9.3)		(23.8)		(21.5)
Ending balance	\$	34.1	\$	37.7	\$	34.1	\$	37.7

Reported as:

Current	\$	27.5	\$	30.9	\$	27.5	\$	30.9
Non-current (included in other long-term liabilities)		6.6		6.8		6.6		6.8
Ending balance	\$	34.1	\$	37.7	\$	34.1	\$	37.7

Deferred Revenue

Deferred revenue consists of the following (in millions):

		September 30, 2006	As of December 31, 2005
Service		\$ 267.2	\$ 201.7
Product		78.8	51.1
Total		\$ 346.0	\$ 252.8
Reported as:			
Current		\$ 282.5	\$ 213.5
Non-current		63.5	39.3
Total		\$ 346.0	\$ 252.8

Table of Contents***Other Charges***

Other charges recognized consist of the following (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Restructuring charges	\$	\$	\$ 0.6	\$
Acquisition related charges	1.4	(0.2)	4.1	(6.8)
Stock option investigation costs	11.4		13.9	
Tax related charges	2.5		2.5	
Total	\$ 15.3	\$ (0.2)	\$ 21.1	\$ (6.8)

Restructuring Charges

Restructuring charges were based on Juniper Networks' restructuring plans that were committed to by management. Any changes in the estimates of executing the approved plans will be reflected in the Company's results of operations.

2006 Restructuring Plan. In June 2006, the Company implemented a restructuring plan which provided for a reduction of 33 employees within the Infrastructure segment during the second and third quarters of 2006. Total accrual of \$0.7 million, consisting primarily of severance charges, was recognized as restructuring expense in the nine months ended September 30, 2006. In the three and nine months ended September 30, 2006, the Company paid \$0.5 million and \$0.6 million in severance payments, respectively. As of September 30, 2006, the Company had restructuring reserve of \$0.1 million, relating to facility charges, in short-term liabilities in its condensed consolidated balance sheet. In addition to the restructuring charges included in operating expense, the Company also recorded \$1.4 million of restructuring charges in cost of product revenue in 2006.

Pre-2006 Restructuring Plans. As of September 30, 2006, the Company had restructuring reserves of \$1.1 million and \$0.6 million pertaining to future facility charges accrued in connection with the discontinuance of the CMTS products and the acquisition of Unisphere Networks, Inc. (Unisphere), respectively. During the three and nine months ended September 30, 2006, the Company paid an immaterial amount for facility charges associated with its restructuring plans initiated prior to 2006. The Company expects to pay these obligations over the life of the related obligations, which extends through 2009.

Acquisition Related Charges

Acquisition related charges include acquisition related restructuring and bonus expenses. In conjunction with various acquisitions, the Company accrued for acquisition related restructuring charges primarily related to severance and facility charges. During the three months ended September 30, 2006, the Company paid \$0.4 million primarily for the facility related charges associated with its acquisition related restructuring reserves. As of September 30, 2006, approximately \$4.5 million of the Company's acquisition related restructuring reserves remained unpaid, of which \$2.7 million and \$1.8 million was recorded in other short-term liabilities and other long-term liabilities, respectively, in the condensed consolidated balance sheet. During the three and nine months ended September 30, 2005, the Company reversed its previously accrued acquisition related restructuring charges by \$0.2 million due to the additional facility sublease income for a former NetScreen Technologies, Inc. (NetScreen) facility and by \$6.8 million due primarily to the Company's re-occupation of the NetScreen building. As of December 31, 2005, approximately \$6.9 million of the Company's acquisition related restructuring reserves remained unpaid, of which \$3.6 million and \$3.3 million was recorded in other short-term liabilities and other long-term liabilities, respectively, in the condensed consolidated balance sheet.

During the three and nine months ended September 30, 2006, the Company recognized bonus and earn-out compensation expense of \$1.4 million and \$4.2 million, respectively, associated with its past acquisitions.

Stock Option Investigation Costs

In connection with the stock option investigation, the Company incurred legal and professional fees of \$11.4 million and \$13.9 million during the three and nine months ended September 30, 2006. As of September 30,

2006, the investigation was not complete and additional charges are expected in future periods.

Table of Contents*Tax Related Charges*

The Company recorded \$2.5 million in operating expense in the three and nine months ended September 30, 2006 in connection with certain tax related items. The Company expects to incur future charges to resolve the adverse tax consequences of incorrectly priced options.

Other Comprehensive Income

Other comprehensive income was as follows (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
		As Restated (1)		As Restated (1)
Net income (loss)	\$ 58.3	\$ 83.5	\$ (1,072.4)	\$ 245.8
Reclassification of net losses on investments realized and included in net income		0.2		0.7
Change in net unrealized gain (loss) on investments	6.3	(2.3)	4.3	3.6
Change in foreign currency translation adjustment	0.7	(0.3)	2.6	(2.8)
Total comprehensive income (loss)	\$ 65.3	\$ 81.1	\$ (1,065.5)	\$ 247.3

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

Derivatives

Derivatives used to mitigate transaction gains and losses generated by certain foreign currency denominated monetary assets and liabilities are carried at fair value with changes recorded in other expense. Changes in the fair value of these derivatives are largely offset by re-measurement of the underlying assets and liabilities. These foreign exchange forward contracts have maturities between one and two months.

Derivatives used to hedge certain forecasted foreign currency transactions relating to operating expenses are designated as cash flow hedges and have maturities of less than one year. The effective portion of the derivative's gain or loss is initially reported as a component of accumulated other comprehensive income and, upon occurrence of the forecasted transaction, is subsequently reclassified into the consolidated statements of operations line item to which the hedged transaction relates. The Company records any ineffectiveness of the hedging instruments, which was immaterial during the three and nine months ended September 30, 2006 and 2005, respectively, in interest and other expense in its condensed consolidated statements of operations.

Note 5. Net Income per Share

The calculation of basic and diluted net income per share is summarized as follows (in millions, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
		As Restated		As Restated
		(1)		(1)
Numerator:				
Net income (loss)	\$ 58.3	\$ 83.5	\$ (1,072.4)	\$ 245.8
Denominator:				
Weighted-average shares of common stock outstanding	568.6	561.8	566.9	550.5
Weighted-average shares subject to repurchase				(0.2)
Denominator for basic net income (loss) per share	568.6	561.8	566.9	550.3
Common stock equivalents	31.0	44.5		47.0
Denominator for diluted net income per share	599.6	606.3	566.9	597.3
Consolidated net income (loss) per share:				
Basic	\$ 0.10	\$ 0.15	\$ (1.89)	\$ 0.45
Diluted	\$ 0.10	\$ 0.14	\$ (1.89)	\$ 0.41

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

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Net income for the three and nine months ended September 30, 2006 included pre-tax stock-based compensation expense of \$22.9 million and \$69.1 million, respectively. These charges related to employee stock options, RSUs, employee stock purchases under the Company's Employee Stock Purchase Plan and acquisitions reflecting the fair value recognition provisions under SFAS 123R. Net income for the three and nine months ended September 30, 2005 included stock-based compensation expense of \$7.2 million and \$17.6 million, respectively, for employee stock-based compensation and stock options assumed from past acquisitions. No stock-based compensation expense related to the Company's Employee Stock Purchase Plan was included in the results of operations in the three and nine months ended September 30, 2005 as the Company adopted SFAS 123R using the modified prospective method and, therefore, did not restate its operating results prior to 2006 as if SFAS 123R were applied to the earlier periods. See Note 6 for additional information.

For the three and nine months ended September 30, 2006, approximately 58.8 million and 85.2 million common stock equivalents were not included in the computation of diluted earnings per share because the effect would have been anti-dilutive. For the three and nine months ended September 30, 2005, approximately 29.2 million and 28.2 million common stock equivalents were not included in the computation of diluted earnings per share because the effect would have been anti-dilutive.

Note 6. Stockholders' Equity***Stock Repurchase Activities***

In July 2004, the Company's Board of Directors (the Board) authorized a stock repurchase program. This program authorized repurchases of up to \$250.0 million of the Company's common stock. In the nine months ended September 30, 2006, the Company repurchased 10,071,100 common shares at an average price of \$18.51 per share as part of this stock repurchase program. No shares were repurchased in the second and third quarters of 2006. As of September 30, 2006, a total of 12,939,700 common shares had been repurchased and retired since the inception of the program, equating to approximately \$250.0 million at an average price of \$19.32 per share. The purchase price of \$186.4 million for the shares of the Company's stock repurchased in 2006 was reflected as a reduction to retained earnings.

In July 2006, the Company's Board approved a new stock repurchase program authorizing the Company to repurchase up to \$1.0 billion of Juniper Networks' common stock under this program. In February 2007, the Company's Board approved an increase of \$1.0 billion under this new stock repurchase program. Coupled with the prior authorization of \$1.0 billion announced in July 2006, the Company is authorized to repurchase up to a total of \$2.0 billion of its common stock. Purchases under this plan will be subject to a review of the circumstances in place at the time. Acquisitions under the share repurchase program will be made from time to time as permitted by securities laws and other legal requirements. The program may be discontinued at any time.

Stock Option Plans***Amended and Restated 1996 Stock Plan***

The Company's Amended and Restated 1996 Stock Plan (the 1996 Plan) provided for the granting of incentive stock options to employees and non-statutory stock options to employees, directors and consultants. On November 3, 2005, the Board adopted an amendment to the 1996 Plan to add the ability to issue RSUs under the 1996 Plan. RSUs represent an obligation of the Company to issue unrestricted shares of common stock to the grantee only when and to the extent that the vesting criteria of the award are satisfied. In the case of RSUs, vesting criteria can be based on time or other conditions specified by the Board or an authorized committee of the Board. However, until vesting occurs, the grantee is not entitled to any stockholder rights with respect to the unvested shares. The Company had authorized 164,623,039 shares of common stock for issuance under the 1996 Plan. Effective May 18, 2006, additional equity awards under the 1996 Plan have been discontinued and new equity awards are being granted under the 2006 Equity Incentive Plan (the 2006 Plan). Remaining authorized shares under the 1996 Plan that were not subject to outstanding awards as of May 18, 2006 were canceled on May 18, 2006. The 1996 Plan will remain in effect as to outstanding equity awards granted under the plan prior to May 18, 2006.

Under the 1996 Plan, incentive stock options may not be granted at an exercise price less than the fair market value per share of the common stock on the date of grant. The Company has not granted incentive stock options since June 1999. Non-statutory stock

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options may be granted under the terms of the plan at an exercise price determined by the Board of Directors or a committee authorized by the Board of Directors. See Note 2, Restatement of Condensed Consolidated Financial Statements. Vesting and exercise provisions were permitted to be determined under the terms of the plan by the Board of Directors or a committee authorized by the Board. Options granted under the 1996 Plan generally become exercisable over a four-year period beginning on the date of grant and have a maximum term of ten years. Options granted to consultants were in consideration for the fair value of services previously rendered, are not contingent upon future events and were expensed in the period of grant. See Note 2, Restatement of Condensed Consolidated Financial Statements.

The 1996 Plan also provided for the sale of restricted shares of common stock or RSUs to employees and consultants. Shares issued to consultants were for the fair value of services previously rendered and were not contingent upon future events. Shares sold to employees were made pursuant to restricted stock purchase agreements containing provisions established by the Board or a committee authorized by the Board. These provisions give Juniper Networks the right to repurchase the shares at the original sales price upon termination of the employee. This right expires at a rate determined by the Board, generally at the rate of 25% after one year and 2.0833% per month thereafter.

2000 Nonstatutory Stock Option Plan

In July 2000, the Board adopted the Juniper Networks 2000 Nonstatutory Stock Option Plan (the 2000 Plan).

The 2000 Plan provided for the granting of non-statutory stock options to employees, directors and consultants. Non-statutory stock options may be granted under the terms of the plan at an exercise price determined by the Board or a committee authorized by the Board. See Note 2, Restatement of Condensed Consolidated Financial Statements. Vesting and exercise provisions were permitted to be determined under the terms of the plan by the Board or an authorized committee of the Board. Options granted under the 2000 Plan generally become exercisable over a four-year period beginning on the date of grant and have a maximum term of ten years. Options granted to consultants were in consideration for the fair value of services previously rendered, were not contingent upon future events and were expensed in the period of grant. The Company had authorized 90,901,437 shares of common stock for issuance under the 2000 Plan. Effective May 18, 2006, additional equity awards under the 2000 Plan have been discontinued and new equity awards are being granted under the 2006 Plan. Remaining authorized shares under the 2000 Plan that were not subject to outstanding awards as of May 18, 2006 were canceled on May 18, 2006. The 2000 Plan will remain in effect as to outstanding equity awards granted under the plan prior to May 18, 2006.

2006 Equity Incentive Plan

On May 18, 2006, the Company's stockholders adopted the 2006 Plan to enable the granting of incentive stock options, non-statutory stock options, RSUs, restricted stock, stock appreciation rights, performance shares, performance units, deferred stock units or dividend equivalents to the employees and consultants of the Company. The 2006 Plan also provides for the automatic, non-discretionary award of nonstatutory stock options to the Company's non-employee members of the Board (outside directors).

The maximum aggregate number of shares authorized under the 2006 Plan is 64,500,000 shares of common stock, plus the addition of any shares subject to outstanding options under the 1996 Plan and 2000 Plan that subsequently expired unexercised after May 18, 2006 up to a maximum of 75,000,000 additional shares of the common stock. Restricted stock or RSUs with a per share or unit purchase price lower than 100% of market price of the Company's common stock on the day of the grant shall be counted as two and one-tenth shares for every one share. To the extent a 2006 Plan award is settled in cash rather than stock, such cash payment shall not reduce the number of shares available for issuance under the 2006 Plan. No restricted stock, stock appreciation right, performance share, performance unit, deferred stock unit or dividend equivalent has been issued as of September 30, 2006. In the case of a restricted stock or performance share award, the entire number of shares subject to such award would be issued at the time of grant. Such shares could be subject to vesting provisions based on time or other conditions specified by the Board or an authorized committee of the Board. The Company would have the right to repurchase unvested shares subject to a restricted stock or performance share award if the grantee's service to the Company terminated prior to full vesting of the award. Until repurchased, such unvested shares would be considered outstanding for dividend, voting and other purposes.

Incentive stock options are granted at an exercise price of not less than the fair market value of the Company's common stock on the date such option is granted. The exercise price of an incentive stock option granted to a 10% or greater stockholder may not be less than 110% of the fair market value of the common stock on the grant date. Vesting and exercise provisions are determined by the Board, or an authorized committee of the Board. Stock options granted under the 2006 Plan generally vest and become exercisable over a four year period. Restricted stock, performance shares, RSUs or deferred stock units that vest solely based on continuing

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employment or provision of services will vest in full no earlier than the three year anniversary of the grant date. In the event vesting is based on factors other than continued future provision of services, such awards will vest in full no earlier than the one year anniversary of the grant date. Options granted under the 2006 Plan have a maximum term of seven years from the grant date while incentive stock options granted to a 10% or greater stockholder have a maximum term of five years from the grant date.

The 2006 Plan provides each outside director an automatic grant of an option to purchase 50,000 shares of common stock upon the date on which such individual first becomes an outside director, whether through election by the stockholders of the Company or appointment by the Board to fill a vacancy (the *First Option*). In addition, at each of the Company's annual stockholder meetings (i) each outside director who was an outside director on the date of the prior year's annual stockholder meeting shall be automatically granted an option to purchase 20,000 shares of common stock, and (ii) each outside director who was not an outside director on the date of the prior year's annual stockholder meeting shall receive an option to purchase a pro-rata portion of the 20,000 shares of the common stock determined by the time elapsed since the individual's First Option grant (the *Annual Option*). The First Option vests monthly over approximately three years from the grant date subject to the outside director's continuous service on the Board. The Annual Option shall vest monthly over approximately one year from the grant date subject to the outsider director's continuous service on the Board. Under the 2006 Plan, options granted to outside directors have a maximum term of seven years.

Plans Assumed Upon Acquisition

In connection with past acquisitions, the Company assumed options and restricted stock under the stock plans of the acquired companies. The Company exchanged those options and restricted stock for Juniper Networks' options and, in the case of the options, authorized the appropriate number of shares of common stock for issuance pursuant to those options. During the nine months ended September 30, 2006, 333 shares of restricted common stock were repurchased at an average price of \$0.35 per share in connection with employee terminations. No restricted stock was repurchased in the three months ended September 30, 2006. There were zero shares of restricted stock subject to repurchase as of September 30, 2006.

Equity Award Activity

In the three and nine months ended September 30, 2006, the Company granted 0.2 million and 3.2 million RSUs, respectively, to its employees under the 1996 Plan and the 2006 Plan. Such awards generally vest over a period of three or four years from the date of grant. RSUs do not have the voting rights of common stock and the shares underlying the RSUs are not considered issued and outstanding until vested. The Company expenses the cost of the RSUs, which is determined to be the fair market value of the shares of the Company's common stock at the date of grant, ratably over the period during which the restrictions lapse. The Company granted 3.2 million and 13.4 million of RSUs and employee stock options, respectively, under the 1996 Plan and the 2006 Plan during the three and nine months ended September 30, 2006, respectively. The total weighted-average grant date fair value was \$20.5 million and \$230.8 million for the RSUs and stock option awards granted during the three and nine months ended September 30, 2006, respectively.

The Company's award activities and related information as of and for the nine months ended September 30, 2006 are summarized as follows (share data presented in thousands):

Shares Available For Grant(1) (In thousands)	Number of Shares (In thousands)	Outstanding Options		Aggregate Intrinsic Value (In thousands)
		Weighted- Average Exercise Price (in dollars)	Weighted Average Remaining Contractual Term (In years)	

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Balance at January 1, 2006	78,478	85,153	\$	17.79		
RSUs granted(4)	(3,579)					
Options granted	(13,362)	13,362		17.27		
RSUs canceled	93					
Options canceled(2)	2,277	(3,699)		16.45		
Options expired(2)	3,496	(3,654)		25.56		
Shares discontinued(3)	(70,242)					
Shares authorized under the 2006 Plan	64,500					
Options exercised		(9,312)		6.91		
Balance at September 30, 2006	61,661	81,850	\$	18.66	6.5	\$ 250,180

(1) Shares available for grant under the 1996 Plan, the 2000 Plan and the 2006 Plan, as applicable.

(2) Canceled or expired options under the 1996 Plan, the 2000 Plan and the stock plans of the acquired companies are no longer available for future grant under such plans, except for shares subject to outstanding options under the 1996 Plan and the 2000 Plan that subsequently expired unexercised after May 18, 2006, up to a maximum of 75,000,000 additional shares of common stock,

become
available for
grant under the
2006 Plan.

- (3) Authorized
shares not
subject to
outstanding
awards under
the 1996 Plan
and the 2000
Plan as of
May 18, 2006
were canceled.
- (4) RSUs granted
under the 2006
Plan are counted
as two and
one-tenth shares
of common
stock for each
share subject to
such RSU.

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The Company's vested or expected to vest stock and exercisable options as of September 30, 2006 are summarized as follows:

	Number of Shares (In thousands)	Weighted- Average Exercise Price (In dollars)	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Vested or expected to vest options	78,768	\$ 18.70	5.9	\$ 246,475
Exercisable options	61,940	19.00	6.4	223,089

Aggregate intrinsic value represents the difference between the Company's closing stock price on the last trading day of the fiscal period, which was \$17.28 as of September 30, 2006, and the exercise price multiplied by the number of related options. The pre-tax intrinsic value of options exercised was \$9.2 million and \$107.8 million for the three and nine months ended September 30, 2006, respectively. This intrinsic value represents the difference between the fair market value of the Company's common stock on the date of the exercise and the exercise price of each option.

The following schedule summarizes information about stock options outstanding under all option plans as of September 30, 2006:

Range of Exercise Price	Options Outstanding			Options Exercisable	
	Number Outstanding (In thousands)	Weighted-Average Remaining Contractual Life (In years)	Weighted- Average Exercise Price (In dollars)	Number Exercisable (In thousands)	Weighted- Average Exercise Price (In dollars)
\$0.07 - \$5.69	10,656	4.6	\$ 4.15	10,225	\$ 4.25
\$5.70 - \$10.31	10,656	5.8	9.68	10,216	9.76
\$10.54 - \$15.32	9,863	6.9	14.55	4,252	14.55
\$15.41 - \$18.96	11,342	6.2	17.92	2,840	17.23
\$19.03 - \$22.59	9,187	8.0	21.82	5,277	22.27
\$22.97 - \$24.02	6,451	8.9	23.51	6,289	23.49
\$24.14 - \$24.14	8,785	8.0	24.14	8,683	24.14
\$24.53 - \$29.19	8,945	7.3	26.99	8,193	26.92
\$29.93 - \$115.48	5,953	3.3	37.84	5,953	37.84
\$183.06 - \$183.06	12	4.0	183.06	12	183.06
\$0.07 - \$183.06	81,850	6.5	\$ 18.66	61,940	\$ 19.00

In addition to the 81.8 million outstanding stock options, the Company also had 3.0 million RSUs outstanding as of September 30, 2006.

The following schedule summarizes information about the Company's RSUs as of September 30, 2006:

	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value
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	Shares (In thousands)	Price (In dollars)	Term (In years)	Value (In thousands)
Outstanding RSUs	2,975		2.0	\$ 51,407
Vested and expected to vest RSUs	2,320		1.9	40,081

None of the outstanding RSUs were vested as of September 30, 2006. These RSUs have been deducted from the shares available for grant under the Company's stock option plans.

Total fair value of options vested during the three and nine months ended September 30, 2006 was \$23.2 million and \$84.7 million, respectively. As of September 30, 2006, approximately \$121 million of total unrecognized compensation cost related to stock options and RSUs is expected to be vested and recognized over a weighted-average period of 1.4 years and 2.0 years.

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No non-vested restricted stock was granted during the three and nine months ended September 30, 2006 and 2005. Forfeitures and vesting of the non-vested restricted stock were immaterial during the three and nine months ended September 30, 2006 and 2005. Total non-vested restricted stock outstanding at September 30, 2006 was immaterial.

Extension of Stock Option Exercise Periods for Former Employees

The Company cannot issue any securities under its registration statements on Form S-8 during the period it is not current in its SEC reporting obligations for filing its periodic reports on the Securities Exchange Act of 1934. As a result, options vested and held by the Company's former employees cannot be exercised until the completion of the Company's stock option investigation and the Company's public filings obligations have been met (the trading black-out period). During 2006, approximately 400,000 such options were due to expire. The Company extended the expiration date of these stock options to the end of a 30 day period subsequent to the Company's filing of its required regulatory reports. As a result of the modification, the fair value of such stock options have been reclassified to current liabilities subsequent to the modification and are subject to mark-to-market provisions at the end of each reporting period until final settlement. The Company measured the fair value of these stock options using the Black-Scholes-Merton option valuation model and recorded an aggregate fair value of approximately \$1.4 million under current liabilities as of September 30, 2006. Any changes to the fair values of these options in future periods until settlement will be expensed in the Company's consolidated statements of operations in the period of change.

Employee Stock Purchase Plan

In April 1999, the Board approved the adoption of Juniper Networks' 1999 Employee Stock Purchase Plan (the ESPP). The ESPP permits eligible employees to acquire shares of the Company's common stock through periodic payroll deductions of up to 10% of base compensation. Each employee may purchase no more than 6,000 shares in any twelve-month period, and in no event, may an employee purchase more than \$25,000 worth of stock, determined at the fair market value of the shares at the time such option is granted, in one calendar year. The ESPP is implemented in a series of offering periods, each six months in duration, or a shorter period as determined by the Board. The price at which the common stock may be purchased is 85% of the lesser of the fair market value of the Company's common stock on the first day of the respective offering period or on the last day of the applicable offering period. On December 16, 2005, the Board amended the Company's ESPP to eliminate the ability of a participant under the ESPP to increase the rate of his/her payroll deductions during any offering period (as defined in the ESPP). This change was effective beginning with the offering period commencing on February 1, 2006. The Company issued 716,125 shares and 1,031,704 shares of its common stock under the ESPP in January 2006 and July 2006, respectively. For the three and nine months ended September 30, 2006, pre-tax compensation expense related to the common stock issued under the ESPP was \$1.4 million and \$6.6 million, respectively. Compensation expense for ESPP in the same 2005 periods was only required as a footnote disclosure prior to the adoption of SFAS 123R. As a result of the Company's failure to file its Quarterly Reports on Form 10-Q for the second and third quarters of 2006, the Company has suspended its employee payroll withholdings for the purchase of its common stock under the ESPP from August 2006 through the filing of all its required regulatory reports. In January 2007, the Board of Directors approved a delay of the start of next offering period from February 1, 2007 to April 1, 2007 (such offering period will end on July 31, 2007).

Valuation of Stock-Based Compensation

SFAS No. 123R requires the use of a valuation model to calculate the fair value of stock-based awards. The Company has elected to use the Black-Scholes-Merton option-pricing model, which incorporates various assumptions including volatility, expected term, and risk-free interest rates. The expected volatility is based on the historical volatility of the Company's common stock over the most recent period commensurate with the estimated expected term of the Company's stock options, adjusted for other relevant factors including implied volatility of market traded options on the Company's common stock. The expected term of an award is based on historical experience and on the terms and conditions of the stock awards granted to employees, as well as the potential effect from options that had not been exercised at the time.

In 2006, the Company began granting stock option awards that have a contractual life of seven years from the date of grant. Prior to 2006, stock option awards generally had a ten year contractual life from the date of grant. As a result, the expected term assumption used in the three and nine months ended September 30, 2006 reflects the shorter

contractual life of the new option awards granted during the period.

The assumptions used and the resulting estimates of weighted-average fair value per share of options granted and for employee stock purchases under the ESPP during those periods are summarized as follows:

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
		As Restated (1)		As Restated (1)
Employee Stock Options:				
Dividend yield				
Volatility factor	41%	41%	39%	41%
Risk-free interest rate	4.9%	4.2%	4.8%	3.9%
Expected life (years)	3.5	4.4	3.5	4.4
Weighted-average fair value of options granted during the periods	\$ 5.2	\$ 9.2	\$ 6.0	\$ 9.2
Employee Stock Purchase Plan:				
Dividend yield				
Volatility factor	35%	40%	33%	35%
Risk-free interest rate	4.6%	2.8%	4.2%	3.3%
Expected life (years)	0.5	0.5	0.5	0.5
Weighted-average fair value of employee stock purchases during the periods	\$ 4.7	\$ 6.6	\$ 5.2	\$ 6.2
Weighted-average fair value of RSUs granted during the periods	\$14.1	\$	\$18.5	\$

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

Note 7. Operating Segments

The Company's chief operating decision maker (CODM) and senior management team (together management) allocate resources and assess performance based on financial information by categories of products and by service.

The Infrastructure segment includes products from the E-, M- and T-series router product families as well as the circuit-to-packet products and SBC products. Prior to 2006, SBC products were included in the SLT segment which includes security products and application acceleration reporting units. Beginning in 2007, the Company no longer segregates the two reporting units within the SLT segment. The SLT segment consists primarily of firewall and virtual private network (VPN) systems and appliances, secure sockets layer VPN appliances, intrusion detection and prevention appliances (IDP), application front end platforms, the J-series router product family, Odyssey products and wide area network (WAN) optimization platforms. The Service segment delivers world-wide services to customers of the Infrastructure and the SLT segments.

The primary financial measure used by the management in assessing performance and allocating resources to the segments is management operating income, which includes certain cost of revenues, research and development expenses, sales and marketing expenses, and general and administrative expenses. Direct costs, such as standard costs, research and development, and product marketing expenses, are generally applied directly to each operating segment.

Indirect costs, such as manufacturing overhead and other cost of sales, are allocated based on standard costs. Indirect operating expenses, such as sales, marketing, business development, and general and administrative expenses are generally allocated to each operating segment based on factors including headcount and revenue.

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Financial information for each operating segment used by management to make financial decisions and allocate resources is summarized as follows (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
		As Restated(1)		As Restated(1)
Net Revenues:				
Infrastructure	\$ 345.6	\$ 358.4	\$ 1,060.8	\$ 994.3
Service Layer Technologies	121.7	108.1	349.4	288.1
Service	106.3	79.9	297.6	206.1
Total net revenues	\$ 573.6	\$ 546.4	\$ 1,707.8	\$ 1,488.5
Operating income (loss):				
Management operating income (loss):				
Infrastructure	\$ 94.2	\$ 128.6	\$ 321.1	\$ 353.2
Service Layer Technologies	(1.4)	2.7	(9.4)	10.4
Service	28.9	20.2	76.7	49.7
Total management operating income	121.7	151.5	388.4	413.3
Amortization of purchased intangible assets(2)	(24.4)	(23.0)	(73.5)	(61.4)
Stock-based compensation expense	(22.9)	(7.2)	(69.1)	(17.5)
In-process research and development		(3.8)		(5.7)
Impairment of goodwill and intangibles			(1,283.4)	
Other charges, net(3)	(16.7)	(9.5)	(22.5)	(3.1)
Total operating income (loss)	57.7	108.0	(1,060.1)	325.6
Interest and other income	28.6	15.6	73.3	40.0
Interest and other expense	(0.8)	(0.9)	(2.7)	(2.7)
Gain on investment		1.7		1.7
Income (loss) before income taxes	\$ 85.5	\$ 124.4	\$ (989.5)	\$ 364.6

(1) Stock-based compensation expense for the 2005 periods has been restated as a result of the stock option investigation. In addition, prior period amounts

have been reclassified to reflect the reorganization of certain research and development activities and changes in allocation methodologies.

- (2) Amount includes amortization expense of purchased intangible assets in operating expenses and in costs of revenues.
- (3) Other expense for 2006 includes charges such as restructuring, acquisition related charges, stock option investigation costs and tax related charges, as well as certain restructuring costs that were included in cost of revenues. Other expense for 2005 includes charges such as restructuring, acquisition related charges and patent related charges.

The Company attributes sales to geographic region based on the customer's ship-to location. The following table shows net revenue by geographic region (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Americas:				
United States	\$ 228.3	\$ 227.1	\$ 709.0	\$ 616.1
Other	17.8	10.7	60.9	44.6
Total Americas	246.1	237.8	769.9	660.7
Europe, Middle East and Africa	194.1	175.4	588.5	430.1
Asia Pacific:				
Japan	37.2	53.0	118.5	170.4
Other	96.2	80.2	230.9	227.3
Total Asia Pacific	133.4	133.2	349.4	397.7
Total	\$ 573.6	\$ 546.4	\$ 1,707.8	\$ 1,488.5

Siemens AG and Ericsson Telekom A.B. individually accounted for 13% and 11% of the Company's net revenues for the three months ended September 30, 2006, respectively. Siemens individually accounted for 15% of the Company's net revenues for the nine months ended September 30, 2006 as well as 12% and 14% of the Company's net revenues for the three and nine months ended September 30, 2005, respectively. The revenue attributed to these customers was derived from the sale of products and services in all three operating segments.

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The Company tracks assets by physical location. The majority of the Company's assets, including property and equipment, were attributable to its U.S. operations as of September 30, 2006 and 2005. The CODM does not review asset information on a segment basis in order to assess performance and allocate resources. The accounting policies of the reportable segments are the same as those applied to the consolidated financial statements.

Note 8. Income Taxes

The Company recorded tax provisions of \$27.2 million and \$40.9 million for the three months ended September 30, 2006 and 2005, or effective tax rates of 32% and 33%, respectively. The Company recorded tax provisions of \$82.9 million and \$118.7 million for the nine months ended September 30, 2006 and 2005, or effective tax rates of -8% and 33%, respectively. The 2006 rates differ from the federal statutory rate as well as from the rates used in 2005 primarily due to the inability to benefit from a substantial portion of the goodwill impairment charge recorded in the second quarter of 2006. The Company's income taxes currently payable for federal and state purposes have been reduced by the tax benefit from employee stock option transactions. These benefits totaled \$9.1 million and \$17.5 million for the three and nine months ended September 30, 2006, respectively, and were reflected as an increase to additional paid-in capital. See Note 2, Restatement of Condensed Consolidated Financial Statements.

Note 9. Commitments and Contingencies***Commitments***

The following table summarizes the Company's principal contractual obligations as of September 30, 2006 (in millions):

	Total	2006	2007	2008	2009	2010	Thereafter
Operating leases, net of committed subleases	\$ 187.5	\$ 9.8	\$ 39.6	\$ 32.6	\$ 26.3	\$ 24.7	\$ 54.5
Senior notes	399.9			399.9			
Purchase commitments	221.5	221.5					
Other contractual obligations	27.4	7.1	20.3				
Total	\$ 836.3	\$ 238.4	\$ 59.9	\$ 432.5	\$ 26.3	\$ 24.7	\$ 54.5

Operating Leases

Juniper Networks leases its facilities under operating leases that expire at various times, the longest of which expires in 2016. Rent and related expenses paid to a related party was \$1.2 million and \$0.7 million for the three months ended September 30, 2006 and 2005, respectively, and \$3.8 million and \$2.9 million for the nine months ended September 30, 2006 and 2005, respectively.

Senior Notes

As of September 30, 2006, the Company's Zero Coupon Convertible Senior Notes (Senior Notes), due on June 15, 2008, had a carrying value of \$399.9 million. Due to the stock option investigation, the Company did not file its quarterly reports on Form 10-Q for the quarters ended June 30, 2006 and September 30, 2006 by the respective due dates. The Company received a Notice of Default on August 25, 2006 from the Trustee of the Senior Notes alleging that the Company was in violation of certain provisions of the Indenture relating to the Senior Notes as a result of its failure to file and was given a 60-day cure period to file its quarterly reports. The holders of the Senior Notes may have had the right to accelerate the Senior Notes by sending the Company a valid Notice of Acceleration in accordance with the terms of the Indenture so long as the Event of Default was continuing. As of the filing of this report, the Company had not received a Notice of Acceleration. Upon the filing of the Company's Quarterly Reports on Form 10-Q for the periods ended June 30, 2006 and September 30, 2006 the alleged default and Event of Default relating to the late filings of these reports is no longer continuing.

Purchase Commitments

The Company does not have firm purchase commitments with its contract manufacturers. In order to reduce manufacturing lead times and ensure adequate component supply, the contract manufacturers place non-cancelable,

non-returnable (NCNR) orders, which were valued at \$221.5 million as of September 30, 2006, based on the Company's build forecasts. The Company does not take ownership of the components and the NCNR orders do not represent firm purchase commitments pursuant to Juniper Networks' agreements with the contract manufacturers. The components are used by the contract manufacturers to build products based on

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purchase orders the Company has received from its customers or its forecast. The Company may incur a liability for products built by the contract manufacturer if the components go unused for specified periods of time and, in the meantime, the Company may be assessed carrying charges. As of September 30, 2006, the Company had accrued \$23.0 million included in other accrued liabilities in the condensed consolidated balance sheet based on its estimate of such charges.

Other Contractual Obligations

As of September 30, 2006, other contractual obligations consisted primarily of the escrow amount of \$19.2 million in connection with past acquisitions to secure certain indemnity obligations expiring between October 2006 and June 2007. Earn-out and bonus obligations of \$8.2 million will be payable to certain employees of acquired companies through the fourth quarter of 2007 and, to the extent paid, will be recorded as compensation expense ratably over the periods in which the payouts are measured. The Company had accrued \$4.8 million for its earn-out and bonus obligations as of September 30, 2006.

In addition, 0.8 million shares of the Company's common stock with a fair value of \$17.6 million, established as of the acquisition date, are held in escrow to secure certain indemnity obligations associated with the Peribit Networks, Inc. (Peribit) acquisition. These escrow shares are not included in the preceding table for contractual obligations. One-half of the indemnity obligations expired in July 2006 and the remaining one-half expired in January 2007. The release of common shares will be recorded at the current market value upon settlement of the escrow.

Legal Proceedings

The Company is subject to legal claims and litigation arising in the ordinary course of business, such as employment or intellectual property claims, including, but not limited to, the matters described below. The outcome of any such matters is currently not determinable. Although the Company does not expect that any such legal claims or litigation will ultimately have a material adverse effect on its consolidated financial position or results of operations, however, an adverse result in one or more matters could negatively affect the Company's results in the period in which they occur.

Stock Option Lawsuits***Federal Derivative Lawsuits***

Between May 24, 2006 and August 17, 2006, seven purported shareholder derivative actions were filed in the United States District Court for the Northern District of California against the Company and certain of the Company's current and former officers and directors. The lawsuits allege that the Company's officers and directors either participated in illegal back-dating of stock option grants or allowed it to happen. The lawsuits assert causes of action for violations of federal securities laws, violations of California securities laws, breaches of fiduciary duty, aiding and abetting breaches of fiduciary duty, abuse of control, corporate waste, breach of contract, unjust enrichment, gross mismanagement, insider selling and constructive fraud. The actions also demand an accounting and rescission of allegedly improper stock option grants. On October 19, 2006, the Court ordered the consolidation of these actions as *In Re Juniper Derivative Actions*, No. 06-03396, and appointed as lead plaintiffs Timothy Hill, Employer-Teamsters Local Nos. 175 & 505 Pension Trust Fund, and Indiana State District Council of Laborers and HOD Carriers Pension Fund. The Court ordered lead plaintiffs to file a consolidated complaint no later than January 12, 2007. On February 14, 2007, the parties agreed to extend the deadline for plaintiffs to file a consolidated complaint until thirty days after the Company completes the filing of its restated financial statements with the Securities Exchange Commission and the court approved the stipulation on February 15, 2007.

State Derivative Lawsuits – California

On May 24, 2006 and June 2, 2006, two purported shareholder derivative actions were filed in the Santa Clara County Superior Court in the State of California against the Company and certain of the Company's current and former officers and directors. These two actions were consolidated as *In re Juniper Networks Derivative Litigation*, No. 1:06CV064294, by order dated June 20, 2006. A consolidated complaint was filed on July 17, 2006. The consolidated complaint alleges that certain of the Company's current and former officers and directors either participated in illegal back-dating of stock options or allowed it to happen. The complaint asserts causes of action for unjust enrichment, breach of fiduciary duty, abuse of control, gross mismanagement, waste, and violations of California securities laws for insider selling. Plaintiffs also demand an accounting and rescission of allegedly

improper stock options grants. On July 28, 2006, the defendants filed a motion to stay all discovery in this action. On August 16, 2006, the defendants filed a motion to dismiss or stay this action in favor of the federal derivative actions pending in the Northern District of California. Plaintiffs have not yet filed their oppositions to those two motions. On November 6, 2006, the parties stipulated that the plaintiffs could file a

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motion to amend their complaint and a motion to compel responses to discovery no later than thirty days after the Company completes the filing of its restated financial statements, and that the hearing on the defendants' two pending motions will be heard on the same date as the plaintiffs' two contemplated motions.

Federal Securities Class Actions

On July 14, 2006, a purported class action complaint styled *Garber v. Juniper Networks, Inc., et al.*, No. C-06-4327 MJJ, was filed in the Northern District of California against the Company and certain of the Company's officers and directors. The plaintiff filed a Corrected Complaint on July 28, 2006. The *Garber* class action is brought on behalf of all purchasers of the Company's common stock between September 1, 2003 and May 22, 2006. On August 29, 2006, another purported class action complaint styled *Peters v. Juniper Networks, Inc., et al.*, No. C 06 5303 JW, was filed in the Northern District of California against the Company and certain of its officers and directors. The *Peters* class action is brought on behalf of all purchasers of the Company's common stock between April 10, 2003 and August 10, 2006. Both of these purported class actions allege that the Company and certain of the Company's officers and directors violated federal securities laws by manipulating stock option grant dates to coincide with low stock prices and issuing false and misleading statements including, among others, incorrect financial statements due to the improper accounting of stock option grants. On November 20, 2006, the Court appointed the New York City Pension Funds as lead plaintiffs. The lead plaintiffs filed a Consolidated Class Action Complaint on January 12, 2007. The Consolidated Complaint asserts claims on behalf of all purchasers of, or those who otherwise acquired, the Company's publicly traded securities from April 10, 2003 through and including August 20, 2006. The Consolidated Complaint alleges violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 by the Company and certain of the Company's current and former officers and directors. On February 15, 2007, the parties agreed that plaintiffs may file an Amended Consolidated Complaint within thirty days after the Company files its restated financial statements with the Securities Exchange Commission and the court approved the stipulation on February 16, 2007.

Other Matters

IPO Allocation Case

In December 2001, a class action complaint was filed in the United States District Court for the Southern District of New York against the Goldman Sachs Group, Inc., Credit Suisse First Boston Corporation, FleetBoston Robertson Stephens, Inc., Royal Bank of Canada (Dain Rauscher Wessels), SG Cowen Securities Corporation, UBS Warburg LLC (Warburg Dillon Read LLC), Chase (Hambrecht & Quist LLC), J.P. Morgan Chase & Co., Lehman Brothers, Inc., Salomon Smith Barney, Inc., Merrill Lynch, Pierce, Fenner & Smith, Incorporated (collectively, the

Underwriters), the Company and certain of the Company's officers. This action was brought on behalf of purchasers of the Company's common stock in the Company's initial public offering in June 1999 and its secondary offering in September 1999.

Specifically, among other things, this complaint alleged that the prospectus pursuant to which shares of common stock were sold in the Company's initial public offering and its subsequent secondary offering contained certain false and misleading statements or omissions regarding the practices of the Underwriters with respect to their allocation of shares of common stock in these offerings and their receipt of commissions from customers related to such allocations. Various plaintiffs have filed actions asserting similar allegations concerning the initial public offerings of approximately 300 other issuers. These various cases pending in the Southern District of New York have been coordinated for pretrial proceedings as *In re Initial Public Offering Securities Litigation*, 21 MC 92. In April 2002, plaintiffs filed a consolidated amended complaint in the action against the Company, alleging violations of the Securities Act of 1933 and the Securities Exchange Act of 1934. Defendants in the coordinated proceeding filed motions to dismiss. In October 2002, the Company's officers were dismissed from the case without prejudice pursuant to a stipulation. On February 19, 2003, the court granted in part and denied in part the motion to dismiss, but declined to dismiss the claims against the Company.

In June 2004, a stipulation for the settlement and release of claims against the issuers, including the Company, was submitted to the Court for preliminary approval. The terms of the settlement, if approved, would dismiss and release all claims against participating defendants (including the Company). In exchange for this dismissal, Directors and Officers insurance carriers would agree to guarantee a recovery by the plaintiffs from the underwriter defendants of at

least \$1.0 billion, and the issuer defendants would agree to an assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. On August 31, 2005, the Court granted preliminary approval of the settlement. On April 24, 2006, the Court held a fairness hearing in connection with the motion for final approval of the settlement. The Court did not issue a ruling on the motion for final approval at the fairness hearing. The settlement remains subject to a number of conditions, including final court approval. On December 5, 2006, the Court of Appeals for the Second Circuit reversed the Court's October 2004 order certifying a class in the case against the Company, which

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along with five other issuers, was selected as a test case by the underwriter defendants and plaintiffs in the coordinated proceeding. It is unclear what impact this will have on the settlement and the case against the Company.

Toshiba Patent Infringement Litigation

On November 13, 2003, Toshiba Corporation filed suit in the United States District Court in Delaware against the Company, alleging that certain of the Company's products infringe four Toshiba patents, and seeking an injunction and unspecified damages. A Markman hearing was held in April 2006, and a ruling favorable to the Company was issued on June 28, 2006. Toshiba stipulated to non-infringement of the four patents and filed a notice of appeal with the Court of Appeals for the Federal Circuit. The Delaware court has removed the trial, previously scheduled for August 2006, from its calendar, pending resolution of the appeal. The Company expects the appeal will not be heard before July 2007.

IRS Notices of Proposed Adjustments

The IRS has concluded an audit of the Company's federal income tax returns for fiscal years 1999 and 2000. During 2004, the Company received a Notice of Proposed Adjustment (NOPA) from the IRS. While the final resolution of the issues raised in the NOPA is uncertain, the Company does not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position or results of operations. The Company is also under routine examination by certain state and non-US tax authorities. The Company believes that it has adequately provided for any reasonably foreseeable outcome related to these audits.

In conjunction with the IRS income tax audit, certain of the Company's US payroll tax returns are currently under examination for fiscal years 1999–2001, and the Company received a second NOPA in the amount of \$11.7 million for employment tax assessments primarily related to the timing of tax deposits related to employee stock option exercises. The Company responded to this NOPA in February 2005, and intends to dispute this assessment with the IRS. An initial appeals conference was held on January 31, 2006 and October 3, 2006. The appeals process available to the Company has not been concluded. In the event that this issue is resolved unfavorably to the Company, there exists the possibility of a material adverse impact on the Company's results of operations.

Note 10. Related Party Transactions

The Company reimburses its CEO, Mr. Scott Kriens, for ordinary operating costs relating to his use of a personal aircraft for business purposes up to a maximum amount per year. Reimbursements incurred were \$0.2 million and \$0.3 million for the three and nine months ended September 30, 2006, respectively, and \$0.1 million and \$0.4 million for the three and nine months ended September 30, 2005, respectively.

Note 11. Subsequent Events

Stock Repurchase Program

In July 2006, the Company's Board approved a new stock repurchase program authorizing the Company to repurchase up to \$1.0 billion of Juniper Networks' common stock under this program. In February 2007, the Company's Board approved an increase of \$1.0 billion under this new stock repurchase program. Coupled with the prior authorization of \$1.0 billion announced in July 2006, the Company is now authorized to repurchase up to a total of \$2.0 billion of its common stock. Purchases under this plan will be subject to a review of the circumstances in place at the time. Acquisitions under the share repurchase program will be made from time to time as permitted by securities laws and other legal requirements. The program may be discontinued at any time.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

This Quarterly Report on Form 10-Q (Report), including the Management's Discussion and Analysis of Financial Condition and Results of Operations , contains forward-looking statements regarding future events and the future results of the Company that are based on current expectations, estimates, forecasts, and projections about the industry in which the Company operates and the beliefs and assumptions of the management of the Company. Words such as expects, anticipates, targets, goals, projects, intends, plans, believes, seeks, estimates, variations similar expressions are intended to identify such forward-looking statements. These forward-looking statements are only predictions and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in this Report under the section entitled Risk Factors in Item 1A of Part II and elsewhere, and in other reports the Company files with the Securities and Exchange Commission (SEC). The following discussion should be read in conjunction with the 2006 Form 10-K to be filed with the SEC (the 2006 Form 10-K) and the condensed consolidated financial statements and notes thereto included elsewhere in this Form 10-Q. The Company undertakes no obligation to revise or update publicly any forward-looking statements for any reason, except as required by law.

The information below has been adjusted to reflect the restatement of our financial results which is more fully described in the Explanatory Note immediately preceding Part I, Item 1 and in Note 2, Restatement of Condensed Consolidated Financial Statements, in Notes to Condensed Consolidated Financial Statements of this Form 10-Q.

The following discussion is based upon our Condensed Consolidated Financial Statements included elsewhere in this report, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingencies. In the course of operating our business, we routinely make decisions as to the timing of the payment of invoices, the collection of receivables, the manufacturing and shipment of products, the fulfillment of orders, the purchase of supplies, and the building of inventory and spare parts, among other matters. Each of these decisions has some impact on the financial results for any given period. In making these decisions, we consider various factors including contractual obligations, customer satisfaction, competition, internal and external financial targets and expectations, and financial planning objectives. On an on-going basis, we evaluate our estimates, including those related to sales returns, pricing credits, warranty costs, allowance for doubtful accounts, impairment of long-term assets, especially goodwill and intangible assets, contract manufacturer exposures for carrying and obsolete material charges, assumptions used in the valuation of stock-based compensation, and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Overview of the Results of Operations

To aid in understanding our operating results for the three and nine months ended September 30, 2006 and 2005, we believe a business overview and a discussion of the nature of our revenue and operating expenses is helpful.

Business Overview

We design and sell products and services that together provide our customers with high performance Internet Protocol (IP) networking solutions. Our purpose-built, high performance IP platforms enable customers to support many different services and applications at scale. Service providers, enterprises, governments and research and education institutions worldwide rely on Juniper Networks to deliver products for building networks that are tailored to the specific needs of their users, services and applications. Our portfolio of networking and security solutions supports the complex scale, security and performance requirements of many of the world's most demanding networks. We sell our products and services through our direct sales organization, value-added resellers and distributors to end-users in the service provider and enterprise markets.

Our operations are organized into three operating segments:

Infrastructure: Our Infrastructure segment primarily offers scalable router products that are used to control and direct network traffic. This control is made more important by the fact that the size and complexity of IP

networks are increasing at a time when service providers are looking to differentiate themselves through value-added service offerings. The

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Infrastructure segment includes products from the E-, M- and T-series router product families as well as the circuit-to-packet (CTP) products and session border control (SBC) products.

Service Layer Technologies (SLT): Our SLT segment offers solutions that meet a broad array of our customers priorities, from protecting the network itself, and protecting data on the network, to maximizing existing bandwidth and acceleration of applications across a distributed network. Together, our secure networking solutions help enable our customers to convert networks that provide commoditized, best efforts services into more valuable assets that provide differentiation and value and increased reliability and security to end users. The SLT segment includes firewall and virtual private network (VPN) systems and appliances, secure sockets layer (SSL) VPN appliances, Unified Access Control (UAC) products, Steel Belted Radius products, Odyssey products, intrusion detection and prevention appliances (IDP), application front end platforms, the J-series router product family and wide area network optimization platforms.

Service: Our Service segment delivers world-wide services, including technical support and professional services, as well as a number of education and training programs, to customers of the Infrastructure and SLT segments.

We continue to focus on our customers, product innovation and the delivery of product portfolio in order to capture the potential opportunities in the marketplace. During the first nine months of 2006, new infrastructure products announced included an intelligent multi-service edge product in the M-series installed base product family and part of our Ethernet strategy providing high density, low cost Ethernet to existing M- and T-series routing platforms. New SLT products included the Secure Services Gateway (SSG) Series, a new line of high-performance firewall/VPN platforms with integrated local-area and wide-area network routing interfaces, our next generation IDP platform as well as the new security management software which enhances application visibility and control across the network.

Nature of Revenues and Expenses

Of the total net revenues for the three and nine months ended September 30, 2006, 60% and 62% was attributed to Infrastructure products, respectively, 21% and 21% to SLT products, respectively, and 19% and 17% to Service, respectively. From a geographic perspective, in the three and nine months ended September 30, 2006, 43% and 45% of the total revenues was generated in the Americas region, respectively, 34% and 34% in the Europe, Middle East and Africa (EMEA) region, respectively, and 23% and 21% in the Asia Pacific (APAC) region, respectively.

We have direct sales forces and an extensive distribution channel that we use to increase sales and target new customers in the service provider and the enterprise markets.

Most of our manufacturing, repair and supply chain operations are outsourced to independent contract manufacturers. Accordingly, most of our costs of revenues consist of payments to our independent contract manufacturers for product costs. The independent contract manufacturers produce our products using design specifications, quality assurance programs and standards that we establish. Controls around manufacturing, engineering and documentation are conducted primarily at our facilities in Sunnyvale, California and Westford, Massachusetts. Our independent contract manufacturers have facilities primarily in Canada, China, Malaysia and the United States. We generally do not own the components, and title to products transfers from the contract manufacturers to us and then immediately to our customers upon shipment.

The contract manufacturers procure components based on our build forecasts and if actual component usage is lower than our forecasts, we may be, and have been in the past, liable for carrying or obsolete material charges.

Employee related costs have historically been the primary driver of our operating expenses and we expect this trend to continue. Employee related costs include items such as wages, stock-based compensation, commissions, bonuses, vacation, benefits and travel. We increased our headcount from 3,784 employees as of September 30, 2005 to 4,613 employees as of September 30, 2006 mainly due to product innovation efforts, sales force expansions and the growth of our Service business. In addition, the acquisitions completed in the fourth quarter of 2005 added approximately 150 individuals to our headcount.

Facility and information technology departmental costs are allocated to other departments based on factors including headcount. These departmental costs have increased in 2006 due to increases in headcount and facility

leases resulting from past acquisitions as well as additional infrastructure and systems to support our growth. Our capital spending increased by \$10.9 million in the nine months ended September 30, 2006 compared to the same period in 2005 due primarily to additional investment in our test equipment

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and internal infrastructure. We expect our capital spending to increase in the future as we continue to support our product development efforts and revenue growth.

Research and development expenses include employee related costs of developing our products from components to prototypes to finished products, outside services such as certifications of new products and expenditures associated with equipment used for testing. We expense our research and development costs as they are incurred. Several components of our research and development efforts require significant expenditures, such as the development of new components and the purchase of prototype equipment, the timing of which can cause quarterly variability in our expenses. Future research and development expenses are expected to increase in absolute dollars and as a percentage of revenue during the remainder of 2006 and part of 2007 as we plan to continue our investment in research and development efforts to further advance our competitive advantage.

Sales and marketing expenses include employee related costs as well as costs for promoting our products and services, such as demonstration equipment and advertisements. These costs vary quarter-to-quarter depending on revenues, product launches and marketing initiatives. We have made substantial investments in our distribution channel and in our direct sales force in 2005 and 2006 in an effort to expand and grow our presence in new markets, serving both private and public networks with a full portfolio of networking products. Future sales and marketing expenses are expected to increase in absolute dollars but slightly decrease as a percentage of revenue.

General and administrative expenses include employee related costs as well as professional fees, bad debt provisions and other corporate expenses. Professional fees include legal, audit, tax, accounting and certain corporate strategic services. Future general and administrative expenses are expected to be relatively consistent as a percentage of revenue.

Intangible assets amortization expense includes the amortization of intangible assets acquired from past acquisitions and, to a lesser extent, purchased patents.

Other operating expenses include in-process research and development, restructuring, acquisition related costs, impairment, stock option review and other expenses.

Significant Events in 2006

Restatement of Previously Issued Financial Statements

In this Form 10-Q, we are restating our condensed consolidated balance sheet as of December 31, 2005, the related consolidated statements of operations for the three and nine months ended September 30, 2005, and the related consolidated statement of cash flows for the nine months ended September 30, 2005 as a result of an independent stock option investigation commenced by our Board of Directors and Audit Committee. This restatement is more fully described in Note 2, Restatement of Condensed Consolidated Financial Statements, in Notes to Condensed Consolidated Financial Statements. In our Form 10-K for the year ended December 31, 2006 to be filed with the SEC (the 2006 Form 10-K), we are restating our audited consolidated financial statements and related disclosures for the years ended December 31, 2005 and 2004, and our consolidated statement of operations and consolidated balance sheet data for the years ended December 31, 2005, 2004, 2003 and 2002. In addition, we are restating our unaudited quarterly financial information and financial statements for interim periods of 2005, and unaudited condensed financial statements for the three months ended March 31, 2006.

Financial information included in the reports on Form 10-K, Form 10-Q and Form 8-K filed by us prior to August 10, 2006, and the related opinions of our independent registered public accounting firm, and all earnings press releases and similar communications issued by us, prior to August 10, 2006 should not be relied upon and are superseded in their entirety by this Report and other reports on Form 10-Q and Form 8-K filed by us with the Securities and Exchange Commission on or after August 10, 2006.

Stock Option Investigation

On May 22, 2006, we issued a press release and Form 8-K announcing that we had received a request for information relating to our stock option granting practices from the U.S. Attorney's Office for the Eastern District of New York. In the same press release and Form 8-K, we announced that our Board of Directors (the Board) had directed the Board's Audit Committee, comprised of outside directors, to conduct a review of our stock option granting practices. On May 24, 2006, we received a letter from the SEC indicating that the SEC was conducting an inquiry regarding Juniper Networks.

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The investigation was conducted with the assistance of independent counsel and forensic accountants (collectively the Investigative Team). The investigation focused on all stock option grants made to all employees, officers, directors and consultants during the period following our initial public offering (IPO) on June 24, 1999 to May 23, 2006 (the relevant period). In addition, the Audit Committee investigation involved testing and analyses of our hiring, termination, leave of absence, grant notification and exercise practices regarding stock options and certain issues regarding grants made before the IPO. The scope of the investigation did not include a review of options granted by companies acquired by us. All of the companies acquired by us, with one exception, were privately held companies. None of the acquisitions was accounted for as a pooling of interests. All of the acquisitions were accounted for under the purchase method as provided by Statement of Financial Standards No. 141, *Business Combinations* and its predecessor Accounting Principles Board Opinion No. 16, *Business Combinations*.

In connection with the investigation, more than 785,000 physical and electronic documents were reviewed and 35 current and former directors, officers, employees and agents were interviewed.

On December 20, 2006, we announced key findings of the Audit Committee. Key findings of the Audit Committee are:

There were numerous instances in which grant dates were chosen with the benefit of hindsight as to the price of our stock, so as to give favourable exercise prices. In this regard, the Audit Committee identified serious concerns regarding the actions of certain former management in connection with the stock option granting process

Formal documentation of stock option grants often lagged the referenced grant date

Grants were made by persons or committees who did not have the proper authority to make the grants in question

Management failed to exercise sufficient responsibility for the stock option granting process

Our CEO, Scott Kriens, received two stock option awards whose measurement dates for financial accounting purposes differ from the recorded grant dates for such awards. However, both options were exchanged and cancelled unexercised in 2001 as part of a company-wide option re-pricing program. Mr. Kriens has not exercised any stock options since 1998, approximately nine months before our IPO

There were substantial changes to our granting procedures after June 9, 2003 and again in 2005. No grants subsequent to 2004 required new measurement dates

There was no improper conduct by our Compensation Committee or Board of Directors regarding the granting of stock options by those bodies

Our Audit Committee expressed their continuing confidence in Scott Kriens and the current management of the Company

Consistent with the accounting literature and recent guidance from the SEC, we have organized the grants during the relevant period into categories based on grant type and the process by which the grant was finalized. We analyzed the evidence from the Audit Committee's investigation related to each category including, but not limited to, physical documents, electronic documents, underlying electronic data about documents, and witness interviews. Based on the relevant facts and circumstances, we applied the then appropriate accounting standards to determine, for every grant within each category, the proper measurement date. If the measurement date is not the originally assigned grant date, accounting adjustments were made as required, resulting in stock-based compensation expense and related tax effects.

Grants made by our Board of Directors or Compensation Committee to Officers or Directors

We have concluded that the measurement dates of several grants to executive officers who were reporting persons as that term is defined under Section 16 of the Securities Exchange Act of 1934, as amended, (Officers) and members of the Board of Directors made between June 1999 and June 2003 were incorrect. In general, during the relevant period, the Board or the Compensation Committee of the Board made grants to Officers and directors. Grants were

sometimes approved at meetings of these bodies or by action by unanimous written consent. There were several instances in which grants to Officers or directors were given grant dates (and corresponding exercise prices) prior to the date on which formal corporate action making the grant was taken. In general, this appears to have been done to make the grant date coincide with either a specific event, such as the appointment or re-election of a director or with the purported date options were granted to non-Officers. In these cases, we have determined that the correct measurement date is the date on which our Board or Compensation Committee took the action to approve the grant. We also identified instances in which grants to Officers were granted effective upon a future event, such as the commencement of employment or closing of an acquisition. In these cases, we have determined that the date of the future event is the correct measurement date for such grants. We also identified instances where grants to Officers were made by a body not authorized by our Board to make grants to Officers and were subsequently ratified by our Board. In those instances, we determined that the correct measurement date is the date on which such ratification

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occurred. In connection with the application of these measurement principles, and after accounting for forfeitures, we have adjusted the measurement of compensation cost for options covering 5.6 million shares of common stock resulting in an incremental stock-based compensation expense of \$80.3 million on a pre-tax basis over the respective awards' vesting terms.

In addition, there was one other grant to an Officer where approval of such grant was not reflected in minutes of a meeting or an action by unanimous written consent of our Board of Directors or the Compensation Committee. For that grant, the measurement date was determined based on the terms of the Officer's offer letter and the date his employment commenced. With respect to that grant, we have adjusted the measurement of compensation cost for options covering 1.5 million shares of common stock resulting in an incremental stock-based compensation expense of \$6.5 million on a pre-tax basis over the award's vesting terms after accounting for forfeitures.

Grants to Non-Officers

We have concluded that the measurement dates of a large number of grants to non-Officers during the period between June 1999 and December 2004 were incorrect. Our practice has been to grant stock options, except where prohibited, to nearly all full-time employees in connection with joining us. To facilitate the granting of options to our rapidly growing workforce, the Board of Directors established a Stock Option Committee to grant options to non-Officer employees. Between June 1999 and June 2003, the dates for a large number of grants made by our Stock Option Committee were chosen with the benefit of hindsight as to the price of our stock, so as to give favorable exercise prices. Moreover, our Stock Option Committee's process for finalizing and documenting these grants was often completed after the originally assigned grant date. Beginning with grants dated June 20, 2003, we implemented a number of new procedures and policies regarding the granting of options to non-Officer employees. After that, we have concluded that the pattern of consciously looking back for the most favorable dates for the employees ceased. However, the documentation and written approvals of grant dates still generally trailed the recorded grant dates. Based on all available facts and circumstances, the originally recorded measurement dates for the grants made by our Stock Option Committee during the period from July 1999 through December 2004 can not be relied upon in isolation as the correct measurement dates. In 2005, we made additional changes to our procedures. No grants in 2005 and 2006 required new measurement dates.

APB 25 defines the measurement date for determining stock-based compensation expense as the first date on which both (1) the number of shares that an individual employee is entitled to receive and (2) the option or purchase price, are known. Throughout the relevant period, the Company's stock administration department entered the option grant information for grants made by the Stock Option Committee into its Equity Edge stock administration system. This system was used to monitor and administer our stock option program. The data in Equity Edge were sent on a regular basis to designated brokers, allowing grantees to view their options information in their accounts via the Internet.

For grants made by the Stock Option Committee between June 1999 and December 2004, where there is no other reliable objective evidence pointing to an earlier single specific date that the number of shares and the individuals entitled to receive them and the price had become final, we have determined the Equity Edge entry date to be the most reliable measurement date for calculating additional stock-based compensation expense under APB 25. Using this measurement date, and after accounting for forfeitures, we have adjusted the measurement of compensation cost for options covering 74.2 million shares of common stock resulting in an incremental stock-based compensation expense of \$636.7 million on a pre-tax basis over the respective awards' vesting terms.

In many of the cases where the Equity Edge entry date was used as the measurement date, the formal Stock Option Committee granting documentation (consisting of unanimous written consents or minutes and related lists of recipients, amounts and types of awards) was not created or completed until a later date. Because the awards listed in the formal granting documentation did not differ from the grants entered into Equity Edge, the notice of the awards was made available to employees prior to the creation or completion of the granting documents, and because the completion of the documentation was treated as perfunctory, we determined that the Equity Edge entry date was the proper measurement date under APB 25 rather than the date the Stock Option Committee granting documentation was completed.

In a number of cases, there was reliable objective evidence pointing to a single specific date that the number of shares and the individuals entitled to receive them and the price had become final. Such evidence primarily consisted of electronic data indicating that the granting instrument and schedule were created prior to the Equity Edge entry date. We also relied on other evidence such as emails or written agreements to determine the date certain options became final. Such evidence was used to determine the measurement dates for options for which we have adjusted the measurement of compensation cost for options covering 27.9 million shares of common stock resulting in incremental stock-based compensation expense of \$141.2 million on a pre-tax basis over the respective awards' vesting terms.

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We also concluded that there were instances in which clerical errors or omissions regarding the persons to receive an award or the number of options to be granted were corrected after the date of award. In the case of most additions made to correct omissions and other corrections that were not reflected on the grant documentation at the time of the applicable grant date or in documentation existing at the time of grant, we have determined that a new measurement date should be established. We considered whether certain of such changes or additions should give rise to variable accounting treatment and concluded that such treatment was not appropriate because the grants represented independent decisions or events rather than a continuation or modification of the other grants. We believe that the correct measurement date for these grants is the date Stock Administration entered the correction or addition into Equity Edge, except where objective evidence identifies an earlier date on which the correction was approved. After accounting for forfeitures, we have adjusted the measurement of compensation cost for options covering 1.3 million shares of common stock resulting in incremental stock-based compensation of \$11.9 million on a pre-tax basis over the respective awards' vesting terms.

Stock Option Grant Modifications Connected with Terminations or Leaves of Absences and Other Matters

Compensation expense was also recognized as a result of modifications that were made to certain employee option grant awards in connection with certain employees' terminations or leaves of absence. Typically such modifications related to extensions of the time employees could exercise options following their termination of employment or that enabled the employee to vest in additional shares in relation to a leave of absence. For example, in connection with reductions in work force in 2001 and 2002, we increased the period for affected employees to exercise their options from 30 days to 90 days. We have incremental stock-based compensation expense associated with such terminations or leaves of absence of \$20.0 million on a pre-tax basis in the period of modification.

Compensation expense of \$0.2 million on a pre-tax basis was also recognized as a result of non-employee grants to consultants in exchange for services and other matters.

Judgment

In light of the significant judgment used in establishing revised measurement dates, alternate approaches to those used by us could have resulted in different compensation expense charges than those recorded by us in the restatement. We considered various alternative approaches. For example, in those cases where the formal documentation of a grant was completed after the date the grant was entered in Equity Edge, an alternative measurement date to using the Equity Edge entry date could be the creation date of the documentation. Changing the measurement dates for grants made by our Stock Option Committee from the Equity Edge entry date to the later of the electronic data creation date of the unanimous written consent or the related schedule of grants would cause the pre-tax compensation charges of \$636.7 million discussed above to increase by approximately \$10.6 million. Conversely, where we established a new measurement date prior to the Equity Edge entry date for grants made by our Stock Option Committee to non-Officers based on other evidence, such as the electronic data indicating the initial creation date of the granting instrument and schedule, an alternative measurement date could be the Equity Edge entry date. Changing the measurement dates for these grants by the Stock Option Committee from a date prior to Equity Edge entry date to the Equity Edge entry date would increase the \$141.2 million of the pre-tax compensation charges discussed above by approximately \$37.7 million. We believe that the approaches we used were the most appropriate under the circumstances.

Summary of Stock-Based Compensation Adjustments

We adjusted the measurement dates for options covering a total of 110.5 million, or 76%, of the 146.0 million shares of common stock covered by options granted during the relevant period.

The incremental impact from on the condensed consolidated statement of operations from recognizing stock-based compensation expense through December 31, 2005 resulting from the investigation is summarized as follows (in millions):

Fiscal Year	Pre-Tax Expense	After Tax Expense
1998	\$	\$
1999	15.3	15.3

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2000	283.3	201.6
2001	513.1	488.1
2002	48.0	48.0
2003	19.4	8.6
2004	10.9	7.5
2005	4.7	3.3
Total	\$ 894.7	\$ 772.4

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In addition to the \$894.7 million recognized through fiscal 2005, \$2.1 million of unamortized deferred compensation remained as of December 31, 2005, bringing the total incremental impact from the investigation to approximately \$896.8 million. As required by SFAS 123R, which was adopted on January 1, 2006, the unamortized deferred compensation of \$2.1 million has been reclassified to additional paid-in capital, along with the unamortized deferred compensation for stock options assumed from past acquisitions, in our consolidated balance sheet. Beginning in 2006, the incremental amortization resulting from the investigation is included in stock-based compensation expense under the provisions of SFAS 123R. The incremental expense from the restatement of employee stock options is insignificant for the three and nine months ended September 30, 2006.

Other Matters

After considering all available evidence, primarily the then current 2005 operating projections of future income, which remain appropriate, we have concluded that the previously recorded valuation allowance related to the tax benefit of stock options deductions should have been reversed in the fourth quarter of 2005. Accordingly, we decreased the valuation allowance as of December 31, 2005 by \$158.0 million with a corresponding credit to additional paid in capital. The remaining valuation allowance balance of \$40.6 million relates to capital losses which will carry forward to offset future capital gains.

Additionally, we misclassified the tax benefit from deductions from stock options assumed in acquisitions. Accordingly, we have reduced additional paid-in capital for the years ended December 31, 2005 and 2004 by \$6.0 million and \$18.5 million, respectively, with a corresponding decrease to goodwill. The total reduction to both additional paid-in capital and goodwill as of December 31, 2005 was \$24.5 million.

Because virtually all holders of options issued by us were not involved in or aware of the incorrect pricing, we have taken and intend to take actions to deal with certain adverse tax consequences that may be incurred by the holders of certain incorrectly priced options. The primary adverse tax consequence is that incorrectly priced stock options vesting after December 31, 2004 may subject the option holder to a penalty tax under IRC Section 409A (and, as applicable, similar penalty taxes under California and other state tax laws). We expect to incur future charges to resolve the adverse tax consequences of incorrectly priced options.

We misclassified the gains and losses from the retirement of our treasury shares in fiscal 2004. Accordingly, we reduced our retained earnings (accumulated deficit) as of December 31, 2004 and 2005 by \$63.6 million with a corresponding increase to additional paid-in capital.

The effect of restatement adjustments on each component of stockholders' equity at the end of each year is summarized as follows (in millions):

Fiscal Year	Common Stock & Additional Paid-In Capital	Deferred Stock Compensation	Accumulated Deficit	Net Impact to Stockholders Equity
1998	\$	\$	\$	\$
1999	215.3	(200.0)	(15.3)	
2000	479.6	(278.0)	(201.6)	
2001	74.9	413.2	(488.1)	
2002	21.5	26.5	(48.0)	
2003	(10.6)	19.2	(8.6)	
2004	41.3	11.3	(71.1)	(18.5)
2005	204.6	5.7	(3.3)	207.0
Total	\$ 1,026.6	\$ (2.1)	\$ (836.0)	\$ 188.5

NASDAQ Listing Status

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In August 2006, we received a NASDAQ Staff Determination letter stating that, as a result of the delayed filing of our quarterly report on Form 10-Q for the quarter ended June 30, 2006 (the Second Quarter Form 10-Q), we were not in compliance with the filing requirements for continued listing as set forth in Marketplace Rule 4310(c)(14) and were therefore subject to delisting from the NASDAQ Global Select Market. In November 2006, we received an additional letter from NASDAQ of similar substance related to our Form 10-Q for the quarter ended September 30, 2006 (the

Third Quarter Form 10-Q). In December 2006, the NASDAQ Listing Qualifications Panel granted our request for continued listing, provided that we file a written summary of our audit committee's findings with NASDAQ as well as the Second Quarter Form 10-Q, the Third Quarter Form 10-Q and any required restatements with

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the SEC on or before February 12, 2007. In January 2007, we received a notice from the NASDAQ Listing and Hearings Review Council which advised us that any delisting determination by the NASDAQ Listing Qualifications Panel has been stayed pending further review by the Review Council. We have been given until March 30, 2007 to submit additional information to assist the Review Council in their assessment of our listing status. On February 20, 2007, we filed a written summary of our Audit Committee's findings with NASDAQ. In addition, on March 9, 2007, we filed the Second Quarter Form 10-Q and the Third Quarter Form 10-Q with the SEC. We consider that the filing of these materials has remedied our non-compliance with Marketplace Rule 4310(c)(14), subject to NASDAQ's affirmative completion of its compliance protocols and its notification to us accordingly. However, if NASDAQ disagrees with our position or if the SEC disagrees with the manner in which we have accounted for and reported, or not reported, the financial impact of past stock option grants, there could be further delays in filing subsequent SEC reports or other actions that might result in delisting of our common stock from the NASDAQ Global Select Market.

Impairment of Goodwill

We recorded a \$1,280.0 million non-cash goodwill impairment charge in the second quarter of 2006 within the SLT segment to adjust the estimated carrying value of our goodwill for the nine months ended September 30, 2006. The impairment of goodwill was primarily attributable to the decline in the Company's market capitalization that occurred over a period of approximately six months prior to the impairment review and, to a lesser extent, a decrease in the forecasted future cash flows used in the income approach. Future impairment indicators, including further declines in our market capitalization or a decrease in revenue or profitability levels, could require additional impairment charges to be recorded.

Stock-Based Compensation

We adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R) effective January 1, 2006, using the modified prospective transition method and, therefore, have not revised prior periods' results. During the first six months of 2006, we issued stock options to the members of our Board (outside directors) and stock options, restricted stock units (RSUs) and shares of common stock pursuant to equity incentive plans. Prior to the adoption of SFAS 123R, our Board of Directors approved the acceleration of the vesting of certain unvested and out-of-the-money stock options that had an exercise price per share equal to or greater than \$22.00, all of which were previously granted under our stock option plans and that were outstanding on December 16, 2005. The options accelerated excluded options previously granted to certain employees, including all of the executive officers and the Board of Directors of Juniper Networks. Under SFAS 123R, we recorded stock-based compensation expense of \$22.8 million and \$69.1 million for the three and nine months ended September 30, 2006, respectively, compared to \$7.2 and \$17.5 million for the same periods in 2005, respectively.

Beginning in May 2006, we have adopted the 2006 Equity Incentive Plan (2006 Plan) which provides for a maximum term of seven years from the grant date for non-statutory stock options and for incentive stock options (except that the maximum term is five years from the grant date for incentive stock options granted to a holder of more than 10% of the Company's stock). The 2006 Plan also provides for a defined option granting schedule for our outside directors. Details of the 2006 Plan are described in Note 6, *Stockholders' Equity*, in Notes to Condensed Consolidated Financial Statements of this Form 10-Q.

Stock Repurchase Activities

In July 2004, our Board of Directors authorized a stock repurchase program. This program authorized repurchases of up to \$250.0 million of our common stock. In the first quarter of 2006, we repurchased and retired 10,071,100 shares of common stock at an average price of \$18.51 per share as part of our Common Stock Repurchase Program. No shares were repurchased after the three months ended March 31, 2006. As of September 30, 2006, a total of 12,939,700 common shares had been repurchased and retired since the inception of the program, equating to approximately \$250.0 million at an average price of \$19.32 per share.

In July 2006, our Board authorized a new stock repurchase program under which we are authorized to repurchase up to \$1.0 billion of our Company's common stock. In February 2007, our Board approved an increase of \$1.0 billion under this new share repurchase program. Coupled with the original \$1.0 billion approved in July 2006, we are now authorized to repurchase up to \$2.0 billion of our common stock. Purchases under this plan will be subject to a review

of the circumstances in place at the time. Acquisitions under the share repurchase program will be made from time to time as permitted by securities laws and other legal requirements. The program may be discontinued at any time.

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Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of net revenue and expenses in the reporting period. We regularly evaluate our estimates and assumptions. We base our estimates and assumptions on current facts and historical experience that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Our actual results may differ materially and adversely from our estimates. To the extent there are material differences between our estimates and the actual results, our future operating results will be affected.

We believe the following critical accounting policies require us to make significant judgments and estimates in the preparation of our consolidated financial statements:

Revenue Recognition;

Allowance for Doubtful Accounts;

Contract Manufacturer Liabilities;

Warranty Reserve;

Goodwill and Purchased Intangible Assets;

Stock-Based Compensation;

Income Taxes;

Litigation and Settlement Costs; and

Loss Contingencies.

We believe that, other than the adoption of SFAS 123R, there have been no significant changes to our critical accounting policies and estimates during the nine months ended September 30, 2006. Note 1 of the Notes to Consolidated Financial Statements in our 2006 Form 10-K, which is to be filed with the SEC, describes the significant accounting policies and methods used in the preparation of our consolidated financial statements.

Stock-Based Compensation Expense

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS 123R, using the modified prospective transition method, and therefore have not restated prior periods' results in our Condensed Consolidated Financial Statements. In accordance with SFAS 123R, we recognize compensation expense, net of estimated forfeitures, for all stock-based awards, including stock options and Restricted Stock Units (RSUs) as well as common stock issued under our Employee Stock Purchase Plan (ESPP), granted after January 1, 2006 and prior to but not vested as of January 1, 2006.

Under SFAS 123R, stock-based compensation cost for stock options is estimated at the grant date based on the award's fair value as calculated by the Black-Scholes-Merton option-pricing model and is recognized as expense, net of estimated forfeitures, ratably over the requisite service period. The Black-Scholes-Merton model requires various highly judgmental assumptions including expected option life and volatility. In anticipation of adopting SFAS 123R, we refined the methodology of estimating the expected term to be more representative of future exercise patterns in 2005. We also refined our computation of expected volatility by considering the volatility of publicly traded options to purchase our common stock and their historical stock volatility.

If any of the assumptions used in the Black-Scholes-Merton model or the estimated forfeiture rate changes significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period. Given our employee stock options have certain characteristics that are significantly different from traded

options and, because changes in the subjective assumptions can materially affect the estimated value, in our opinion, the existing valuation models may not provide an accurate measure of the fair value of our employee stock options. Although we determine the fair value of employee stock options in accordance with SFAS 123R and SAB 107 using the Black-Scholes-Merton option-pricing model, that value may not be indicative of the fair value observed between a willing buyer and a willing seller in a market transaction.

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In addition to stock options, we also granted RSUs during 2006. Stock-based compensation cost for RSUs is estimated at the grant date based on the market price of our common stock and is recognized as expense, net of estimated forfeitures, ratably over the requisite service period.

During 2005, in anticipation of adopting SFAS 123R, our Board of Directors approved the acceleration of the vesting of certain unvested and out-of-the-money stock options that had an exercise price per share equal to or greater than \$22.00, all of which were previously granted under Juniper Networks stock option plans and that were outstanding on December 16, 2005 were accelerated. The options accelerated excluded options previously granted to certain employees, including all of the executive officers and the Board of Directors of Juniper Networks.

Results of Operations

The following table illustrates certain statement of operations data expressed as a percentage of net revenues for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
		Restated (1)		Restated (1)
Net revenues	100%	100%	100%	100%
Cost of revenues	33%	31%	33%	32%
Gross margin	67%	69%	67%	68%
Operating expenses:				
Research and development	22%	17%	21%	17%
Sales and marketing	24%	22%	24%	21%
General and administrative	4%	5%	4%	4%
Amortization of purchased intangible assets	4%	4%	4%	4%
Impairment of goodwill and intangible assets			75%	
In-process research and development		1%		
Other charges, net	3%		1%	
Total operating expenses	57%	49%	129%	46%
Income (loss) from operations	10%	20%	(62%)	22%

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

Net revenues, in absolute dollars, for the three months ended September 30, 2006 increased compared to the same period in 2005 due to revenue increases in the SLT and Service revenues. Net revenues, in absolute dollars, for the nine months ended September 30, 2006 increased, compared to the same period in 2005, due to revenue increases across all three segments. The inclusion of net revenues from the companies acquired in 2005 also contributed, in part, to the revenue increases in the 2006 periods. The increases in cost of revenues were primarily due to additional

product and service costs driven by volume increases. Gross margin percentages decreased primarily due to changes in geographic mix and product mix. Increases in operating expenses were primarily attributable to headcount increase, additional stock-based compensation expense from the adoption of SFAS 123R, restructuring charges, stock option review and related expenses as well as the inclusion of the operating results from the 2005 acquisitions. During the nine months ended September 30, 2006, we incurred non-cash impairment charges as we wrote down our existing goodwill and intangible assets.

Net Revenues

The following table illustrates net product and service revenues (in millions except percentages):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2006	% of Net Revenues	2005	% of Net Revenues	2006	% of Net Revenues	2005	% of Net Revenues
Net revenues:								
Product	\$ 467.3	81%	\$ 466.5	85%	\$ 1,410.2	83%	\$ 1,282.4	86%
Service	106.3	19%	79.9	15%	297.6	17%	206.1	14%
Total net revenues	\$ 573.6	100%	\$ 546.4	100%	\$ 1,707.8	100%	\$ 1,488.5	100%

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Net Product Revenues. Net product revenues increased \$0.8 million and \$127.8 million in the three and nine months ended September 30, 2006, respectively, compared to the corresponding periods in 2005. Net revenues from Infrastructure products were \$345.6 million and \$1,060.8 million for the three and nine months ended September 30, 2006, respectively. Net revenues from SLT products were \$121.7 million and \$349.4 million for the three and nine months ended September 30, 2006, respectively. Revenue in the third quarter of 2006 increased compared to a year ago primarily due to the increases in the SLT product revenue, partially offset by the decreases in Infrastructure product revenue during the third quarter of 2006. For the nine months ended September 30, 2006, net product revenues increased compared to the same 2005 period due primarily to higher Infrastructure and SLT product revenues driven by the adoption and expansion of secure IP networks and Next Generation Network (NGN) build-outs by our customers. For the three months ended September 30, 2006, Infrastructure net revenue decreased \$12.8 million compared to the 2005 period as a result of the timing of our revenue deferrals, delayed purchasing decisions by customers in certain NGN build-outs and timing of our new products in the edge routing market. For the nine months ended September 30, 2006, Infrastructure net revenues increased \$66.5 million compared to the same 2005 period due primarily to the sales of higher-end products and increased penetration of our router portfolio. SLT net revenues increased \$13.6 million and \$61.2 million compared to the same periods in 2005, respectively, primarily due to a growing demand and brand recognition for our Security products from large enterprises and the U.S. Federal Government and to a lesser extent the addition of certain SLT product families through our 2005 acquisitions. An analysis of the change in revenue by Infrastructure and SLT segments and the change in product units, can be found below in the section titled Segment Information.

Net Service Revenues. Net service revenues increased \$26.4 million and \$91.5 million in the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005 primarily due to the growth in support services business and increases in professional service revenue. A majority of our service revenue is earned from customers who purchase our products and enter into service contracts. Support service revenue, representing 90% and 89% of the net service revenues for the three and nine months ended September 30, 2006, respectively, increased by \$23.2 million and \$79.3 million in the three and nine months ended September 30, 2006, respectively, compared to the comparable 2005 periods. The increases in support service revenue in the 2006 periods were primarily due to the additional technical support service contract initiations associated with higher product sales, which have resulted in increased renewal and a larger installed base of equipment being serviced. These contracts are typically for one-year renewable periods for services such as 24-hour customer support, non-specified updates and hardware repairs. We recognize revenue from service contracts as the services are completed or ratably over the period of the obligation. Professional service revenue also increased, to a lesser extent, for the nine months ended September 30, 2006 compared to the 2005 periods due primarily to maintenance related on-site engineering services as well as additional consulting projects in 2006. In addition to support services and professional services, we also provide educational services.

Total Net Revenues by Geographic Region and Principal Customers. The following table shows total net revenues by geographic region (in millions, except percentages):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2006		2005*		2006		2005*	
Americas:								
United States	\$ 228.3	40%	\$ 227.1	42%	\$ 709.0	42%	\$ 616.1	41%
Other	17.8	3%	10.7	2%	60.9	3%	44.6	3%
Total Americas	246.1	43%	237.8	44%	769.9	45%	660.7	44%
EMEA	194.1	34%	175.4	32%	588.5	34%	430.1	29%
APAC:								
Japan	37.2	6%	53.0	10%	118.5	7%	170.4	11%
Other	96.2	17%	80.2	14%	230.9	14%	227.3	16%

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Total APAC	133.4	23%	133.2	24%	349.4	21%	397.7	27%
Total	\$ 573.6	100%	\$ 546.4	100%	\$ 1,707.8	100%	\$ 1,488.5	100%

* During the three and nine months ended September 30, 2005, sales rebates included in the net revenues in the United States were reclassified to net revenues in other Americas countries to conform to the current periods presentation.

During the three months ended September 30, 2006, net revenues in Americas increased in absolute dollars compared to the same period in 2005. This was primarily due to strength in the Service segment and the SLT segment, partially offset by Infrastructure product revenue decreases due largely to delayed purchasing decisions by customers in certain NGN build-outs and the timing of our new products in the edge routing market. Net revenues in the Americas region as a percentage of total revenue decreased in the third quarter of 2006 compared to the third quarter of 2005 due primarily to the relative strength in EMEA in the 2006 period. For the nine months ended September 30, 2006, net revenues in Americas increased, in dollars and as a percentage of revenue, compared to the same period last year was due to strength across all three segments as our customers continue to focus on increasing network

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performance, reliability, security and scale. The inclusion of companies acquired in 2005 also contributed to the higher net revenue in the Americas region during the three and nine months ended September 30, 2006.

Net revenues in EMEA as a percentage of total net revenues increased in the three months ended September 30, 2006 compared to the same period in 2005 primarily due to strength across the region in the SLT segment. Net revenues in EMEA for the nine months ended September 30, 2006 increased compared to the 2005 period due mainly to strength across the region in all three segments which was largely driven by growing importance of secure networks, Internet Protocol Television (IPTV) demands and NGN build-outs.

Net revenues in APAC as a percentage of total net revenues decreased in the three and nine months ended September 30, 2006 compared to the same periods in 2005 primarily due to a pause in the build out of certain NGNs and associated purchase decisions, particularly in Japan, as major carriers prepare for the next stage of bandwidth and services expansion. In absolute dollars, net revenue in APAC increased slightly for the third quarter of 2006 compared to the same period in 2005 due largely to increased build-out demands in China, partially offset by a decline in the net revenue in Japan resulting from the NGN pause.

Siemens AG and Ericsson Telekom A.B. individually accounted for 13% and 11% of the Company's net revenues for the three months ended September 30, 2006, respectively. Siemens individually accounted for 15% of the Company's net revenues for the nine months ended September 30, 2006 as well as 11% and 13% of the Company's net revenues for the three and nine months ended September 30, 2005, respectively. Revenue attributed to these significant customers was derived from the sale of products and services in all three operating segments.

Cost of Revenues

The following table shows cost of product and service revenues and the related gross margin (GM) percentages (in millions, except percentages):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	GM		GM		GM		GM	
	2006	%	2005 As Restated (1)	%	2006	%	2005 As Restated (1)	%
Cost of revenues:								
Product	\$ 140.8	70%	\$ 132.2	72%	\$ 421.2	70%	\$ 366.4	71%
Service	49.4	54%	39.5	51%	142.8	52%	105.0	49%
Total cost of revenues	\$ 190.2	67%	\$ 171.7	69%	\$ 564.0	67%	\$ 471.4	68%

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

Cost of Product Revenues. Cost of product revenues increased \$8.6 million and \$54.8 million in the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005. The higher product costs were primarily attributable to increases in the material and production costs incurred by our contract manufacturers in

connection with higher product revenues. Also included in product costs for the three and nine months ended September 30, 2006 were the amortization of purchased technologies of \$1.4 million and \$4.1 million, respectively, stock-based compensation expense of \$0.5 million and \$1.5 million, respectively, and a \$1.4 million and \$1.4 million, respectively, restructuring charges related to a payment to our contract manufacturer discontinuation of the stand-alone SBC products. Stock-based compensation expense increased \$0.2 million and \$0.8 million in the three and nine months ended September 30, 2006, respectively, compared to the same 2005 periods primarily due to the adoption of SFAS 123R in 2006.

Product gross margin percentage for the three and nine months ended September 30, 2006 fell compared to the same 2005 periods, which was primarily attributable to the timing of new product introductions and product mix. In addition, the incremental stock-based compensation expense from the adoption of SFAS 123R also contributed, in part, to the decline in product gross margin percentages during the 2006 periods. As we have expanded our market share and entered more markets, we have experienced increased competition. Despite the decreases in total product gross margin percentage, SLT product gross margin percentage for the nine months ended September 30, 2006 increased compared to the same 2005 periods due primarily to the sales of higher end products particularly during the third quarter of 2006. Product gross margin increased in absolute dollars due to product volume and increased headcount, partially offset by our focus on decreasing sales and reducing manufacturing related costs. As of September 30, 2006 and 2005, we employed 146 and 127 people, respectively, in our manufacturing and operations organization who primarily manage relationships with our contract manufacturers, manage our supply chain, and monitor and manage product testing and quality.

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Cost of Service Revenues. Cost of service revenues increased \$9.9 million and \$37.8 million in the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005 due primarily to increases in personnel related expenses, outside services expense, spares expense and stock-based compensation expense. Personnel related expenses, consisting primarily of salaries, wages, bonuses and fringe benefits, increased \$5.6 million and \$15.3 million for the three and nine months ended September 30, 2006, respectively, compared to the 2005 periods, due to increases in service related headcount from 430 to 560 people. The increase in headcount was attributable primarily to growth in the service business due to the additional service contracts driven by increased installed base and demands for on-site engineering support and, in part, to the acquisitions completed in 2005. Outside services expense increased by \$0.8 million and \$5.2 million for the three and nine months ended September 30, 2006, respectively, due to increases in customer service and logistic demands resulting from additional service contracts. Spares expense decreased by \$0.7 million and increased by \$5.8 million for the three and nine months ended September 30, 2006, respectively, compared to the same 2005 periods, to support the additional service contracts. The adoption of SFAS 123R in 2006 resulted in additional stock-based compensation expense of \$1.3 million and \$3.3 million in the three and nine months ended September 30, 2006, respectively, compared to the same 2005 periods. Stock-based compensation for the three and nine months ended September 30, 2006 was \$1.6 million and \$4.5 million, respectively, compared to \$0.4 million and \$1.2 million for the three and nine months ended September 30, 2005, respectively. Service gross margin increased three percentage points for the three and nine months ended September 30, 2006 compared to the corresponding 2005 periods due primarily to achieving improved economies of scale despite the increased operating costs in absolute dollars.

Operating Expenses

Operating expenses were as follows (in millions, except percentages):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2006	% of Net Revenues	2005 As Restated (1)	% of Net Revenues	2006	% of Net Revenues	2005 As Restated (1)	% of Net Revenues
Research and development	\$ 123.4	22%	\$ 94.7	17%	\$ 353.3	21%	\$ 257.6	17%
Sales and marketing	139.4	24%	118.2	22%	404.8	24%	314.9	21%
General and administrative	24.5	4%	27.2	5%	71.8	4%	58.6	4%
Amortization of purchased intangible assets	23.0	4%	23.0	4%	69.4	4%	61.4	4%
Impairment of goodwill and intangibles					1,283.4	75%		
In-process research and development			3.8	1%			5.7	
Other charges, net	15.3	3%	(0.2)		21.1	1%	(6.8)	

(1) See Note 2, Restatement of Condensed Consolidated Financial Statements, in

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Research and Development Expenses. Research and development expenses increased by \$28.7 million and \$95.7 million in the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005 due mainly to increases in personnel related expenses, test equipment expense and stock-based compensation expense. Personnel related charges, consisting of salaries, bonuses, and fringe benefits expenses, increased \$14.9 million and \$46.8 million in the three and nine months ended September 30, 2006, respectively, compared to the corresponding 2005 periods, due primarily to an increase in headcount from 1,566 to 1,930 people in the engineering organization across the Infrastructure segment and the SLT segment. The headcount increase was attributable to product innovation efforts in areas including routers security and integration in order to capture potential future NGN infrastructure growth and other opportunities in the enterprise and the service provider markets. The increase in headcount was also attributable, in part, to the acquisitions in 2005. To a lesser extent, the increases in personnel expenses were attributable to merit-based salary increases beginning in April 2006. Additionally, engineering project expenses, facilities, information technology, depreciation and equipment expenses increased \$6.6 million and \$25.1 million for the three and nine months ended September 30, 2006, respectively, to support our product innovation efforts. Consulting expenses increased \$1.3 million and \$3.4 million for the three and nine months ended September 30, 2006, respectively, primarily for the development of future product roadmaps. The adoption of SFAS 123R in 2006 resulted in stock-based compensation expense of \$9.4 million and \$28.8 million for the three and nine months ended September 30, 2006, respectively, compared to \$4.2 million and \$9.8 million for the three and nine months ended September 30, 2005, respectively.

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Sales and Marketing Expenses. Sales and marketing expenses increased \$21.2 million and \$89.9 million in the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005 primarily due to increases in personnel related expenses, marketing related expenses and stock-based compensation expense. Personnel related charges, consisting of salaries, commissions, bonuses, and fringe benefits expenses, increased \$13.4 million and \$39.9 million for the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005, due mainly to an increase in headcount, from 1,308 to 1,576 people in our worldwide sales and marketing organizations, to support additional products, customers and countries. The increase in headcount was also attributable to our sales force expansion in the enterprise and the service provider markets, especially in emerging countries, and to the acquisitions in 2005. Travel, marketing and related expenses increased \$3.0 million and \$15.7 million for the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005, as we focused on introducing new products, increasing brand awareness and expanding our presence in the enterprise market. The adoption of SFAS 123R in 2006 resulted in stock-based compensation expense for sales and marketing of \$8.1 million and \$24.2 million in the three and nine month periods ended September 30, 2006, respectively, compared to \$1.9 million and \$4.9 million for the three and nine months ended September 30, 2005, respectively.

General and Administrative Expenses. General and administrative expenses decreased \$2.6 million and increased \$13.2 million in the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005. The decreases in the third quarter of 2006 were due primarily to a one-time \$10.0 million patent related expense in the third quarter of 2005, partially offset by the \$1.5 million increases in personnel related expenses, the \$3.5 million increases in outside professional services related expenses and the \$2.9 million increase in stock-based compensation expense in the 2006 period. The increases in the first nine months of 2006 were due primarily to increases in personnel related expenses, outside professional services and stock-based compensation expense. Personnel related charges, consisting of salaries, bonuses, and fringe benefits expenses, increased \$1.5 million and \$4.4 million for the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005, due to an increase in headcount, from 197 to 230 people in our worldwide general and administrative functions, to support the overall growth in the business. The increase in headcount was also attributable, in part, to the acquisitions in 2005. Outside professional services, which include accounting, tax, and legal fees, increased in the three and nine months ended September 30, 2006, compared to the same 2005 periods, primarily as a result of patent application and litigation expenses. The adoption of SFAS 123R in 2006 resulted in general and administrative related stock-based compensation expense of \$3.3 million and \$10.2 million in the three and nine months ended September 30, 2006, respectively, compared to \$0.4 million and \$0.9 million for the three and nine months ended September 30, 2005, respectively.

Amortization of Intangible Assets. Amortization of intangible assets remained consistent in the third quarter of 2006 and increased \$8.0 million in the nine months ended September 30, 2006 compared to the corresponding 2005 periods. The increase in the first nine months of 2006 was due to the additional intangible assets acquired from acquisitions completed in 2005, partially offset by the impairment related write-down during the second quarter of 2006.

Impairment of Goodwill and Intangible Assets. Impairment of goodwill and intangibles was zero and \$1,283.4 million in the three and nine months ended September 30, 2006, respectively. Due primarily to the decline in the Company's market capitalization that occurred over a period of approximately six months prior to the impairment review and, to a lesser extent, a decrease in the forecasted future cash flows used in the income approach, we evaluated the carrying value of our goodwill and reduced the goodwill within the SLT segment by \$1,280.0 million. In addition, we recorded a \$3.4 million impairment expense pertaining to a write-down of intangible assets as a result of a decrease in forecasted revenue for the SBC stand-alone products during the second quarter of 2006. There were no impairment charges in the three and nine months ended September 30, 2005. Future impairment indicators, including further declines in our market capitalization, could cause additional impairment charges.

In-Process Research and Development Expense. There was no in-process research and development expense during the three and nine months ended September 30, 2006 as we had no new acquisitions in the 2006 periods. During the three and nine months ended September 30, 2005, we completed three acquisitions and wrote off

in-process research and development of \$3.8 million and \$5.7 million, respectively.

Other Charges. Other charges in the three and nine months ended September 30, 2006 include the following:

§ *Acquisition Related Charges.* Acquisition related charges for the three and nine months ended September 30, 2006 were \$1.4 million and \$4.2 million, respectively, which pertained primarily to the accrual of acquisition related bonus and earn-out payments as well as adjustments to the acquisition related restructuring reserves. During the three and nine months ended September 30, 2005, we reduced our acquisition related restructuring accruals by \$0.2 million and \$6.8 million, respectively. We adjusted this accrual due to additional sublease income for the former NetScreen Technologies, Inc.

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(NetScreen) facility. Additionally, we re-occupied a portion of the former NetScreen facility that was previously included in the restructuring reserve as a result of our growth from the acquisitions in 2005.

- § *Restructuring Charges.* Restructuring charges primarily relating to severance costs of zero and \$0.7 million were recorded in the three and nine months ended September 30, 2006, respectively, due to a reorganization plan initiated in June 2006 associated with the discontinuation of certain stand-alone SBC products.
- § *Stock Option Review Expense.* Stock option investigation costs of \$11.4 million and \$13.9 million in the three and nine months ended September 30, 2006, respectively, were incurred in connection with our audit committee's independent review of our stock option practices initiated in May 2006. Expenses incurred during the 2006 periods were primarily for legal and other professional services. As of September 30, 2006, the investigation was not completed and we incurred additional costs of \$6.6 million in the remainder of 2006.
- § *Tax Related Charges.* We accrued \$2.5 million in operating expense for the three and nine months ended September 30, 2006 in connection with tax related items. We expect to incur future charges to resolve the adverse tax consequences of incorrectly priced options.

Other Income and Expenses

The following table shows other income and expenses (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Interest and other income	\$28.6	\$15.6	\$73.4	\$40.1
Interest and other expenses	\$ (0.8)	\$ (0.9)	\$ (2.7)	\$ (2.7)
Gain on investment	\$	\$ 1.7	\$	\$ 1.7

Interest and Other Income. Interest and other income increased by \$13.0 million and \$33.3 million in the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005 as a result of higher cash, cash equivalents and investment balances compared to a year ago. Multiple interest rate increases during 2006 and 2005 also contributed to the interest income increases in 2006.

Interest and Other Expenses. Interest and other expenses decreased slightly in the three months ended September 30, 2006, compared to the same 2005 period, due primarily to decreases in foreign exchange losses and in other expenses such as portfolio management fees during the third quarter of 2006. Interest and other expenses remained consistent for the nine months ended September 30, 2006 compared to the same period in 2005.

Provision for Income Taxes

We recorded tax provisions of \$27.2 million and \$40.9 million for the three months ended September 30, 2006 and 2005, or effective tax rates of 32% and 33%, respectively. We recorded tax provisions of \$82.9 million and \$118.7 million for the nine months ended September 30, 2006 and 2005, or effective tax rates of -8% and 33%, respectively. The 2006 rates differ from the federal statutory rate as well as from the rates used in 2005 primarily due to the inability to benefit from a substantial portion of the goodwill impairment charge recorded in the second quarter of 2006.

Table of Contents**Segment Information**

We track financial information by our three operating segments as our chief operating decision maker (CODM) and senior management team (together management team) measure the business based on product and service profitability. During 2006, we re-aligned our SBC products from the SLT segment to the Infrastructure segment. Financial information for each operating segment used by our management team to make financial decisions and allocate resources is as follows (in millions):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
		As		As
		Restated(1)		Restated(1)
Net Revenues:				
Infrastructure	\$ 345.6	\$ 358.4	\$ 1,060.8	\$ 994.3
Service Layer Technologies	121.7	108.1	349.4	288.1
Service	106.3	79.9	297.6	206.1
Total net revenues	\$ 573.6	\$ 546.4	\$ 1,707.8	\$ 1,488.5
Operating income (loss):				
Management operating income (loss):				
Infrastructure	\$ 94.2	\$ 128.6	\$ 321.1	\$ 353.2
Service Layer Technologies	(1.4)	2.7	(9.4)	10.4
Service	28.9	20.2	76.7	49.7
Total management operating income	121.7	151.5	388.4	413.3
Amortization of purchased intangible assets (2)	(24.4)	(23.0)	(73.5)	(61.4)
Stock-based compensation expense	(22.9)	(7.2)	(69.1)	(17.5)
In-process research and development		(3.8)		(5.7)
Impairment of goodwill and intangibles			(1,283.4)	
Other charges, net (3)	(16.7)	(9.5)	(22.5)	(3.1)
Total operating income (loss)	57.7	108.0	(1,060.1)	325.6
Interest and other income	28.6	15.6	73.3	40.0
Interest and other expense	(0.8)	(0.9)	(2.7)	(2.7)
Gain on investment		1.7		1.7
Income (loss) before income taxes	\$ 85.5	\$ 124.4	\$ (989.5)	\$ 364.6

(1) Stock-based compensation expense for the 2005 periods has been restated as a result of the

stock option investigation. In addition, prior period amounts have been reclassified to reflect the reorganization of certain research and development activities and changes in allocation methodologies.

- (2) Amount includes amortization expense of purchased intangible assets in operating expenses and in costs of revenues.
- (3) Other expense for 2006 includes charges such as restructuring, acquisition related charges, stock option investigation costs and tax related charges, as well as certain restructuring costs that were included in cost of revenues. Other expense for 2005 includes charges such as restructuring, acquisition related charges

and patent
related charges.

Infrastructure Operating Segment

Infrastructure net revenues decreased \$12.8 million and increased \$66.5 million in the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005. The decrease in the third quarter of 2006 was due primarily to the additional deferred revenue, delayed purchasing decisions by our customers in certain NGN build-outs especially in Japan and the timing of our new products in the edge router market. The revenue increases in the first nine months of 2006 were due primarily to increases in revenue from higher-end infrastructure chassis products and increased penetration of our router portfolio. We track infrastructure chassis revenue units and number of ports shipped to analyze customer trends and indicate areas of potential network growth. Our infrastructure product platforms are essentially modular, with the chassis serving as the base of the platform. Each chassis has a certain number of slots that are available to be populated with components we refer to as modules or interfaces. The modules are the components through which the router receives incoming packets of data from a variety of transmission media. The physical connection between a transmission medium and a module is referred to as a port. The number of ports on a module varies widely depending on the functionality and throughput offered by the module. Chassis revenue units represent the number of chassis on which revenue was recognized during the period. The following table shows infrastructure revenue units and ports shipped:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Infrastructure chassis revenue units	2,791	2,377	7,759	7,185
Infrastructure ports shipped	46,398	34,797	120,992	112,580
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Chassis revenue units increased in the three and months ended September 30, 2006 compared to the same 2005 periods due primarily to the sales of higher-end T-series and M-series products and the inclusion of the chassis units related to a 2005 acquisition, partially offset by decreases in sales of lower-end E-series and M-series products. Sales of higher-end chassis units increased as our customers continued to adopt and expand IP networks in order to reduce total operating costs and to be able to offer multiple services over a single network. Port shipment units increased in the three and months ended September 30, 2006 as compared to the same 2005 periods primarily due to the increase in port demands driven by the larger expansion capacity in the higher-end chassis revenue units shipped during 2006, partially offset by the lower port capacity in CTP-series chassis revenue units.

Gross margin percentages for the Infrastructure segment in the third quarter of 2006 fell compared to that in the same 2005 period due primarily to the product mix in the edge router market. Additionally, we experienced higher Infrastructure gross margin percentage for the third quarter of 2005 as compared to other quarters. Gross margin in the nine months ended September 30, 2006 fell by less than one percentage point compared to that in the same 2005 period as the higher gross margin percentage from higher-end units sales throughout the first and second quarters of 2006 partially offset the gross margin percentage decline in the third quarter of 2006 due to the timing of product release. Infrastructure management operating income decreased during the three and nine months ended September 30, 2006, respectively, compared to that in the 2005 periods, due primarily to higher personnel related costs associated with our investments in product innovation for next generation core and edge infrastructure products as well as increased operating expenses associated with marketing related efforts and improvements to our internal infrastructure, partially offset by savings in sales expense during the 2006 periods as we increasingly leveraged our existing distribution channel.

SLT Operating Segment

The SLT operating segment consists of security products and application acceleration products. The following table shows SLT revenue units recognized:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Service Layer Technologies revenue units	45,300	54,000	134,500	127,000

SLT net revenues increased \$13.6 million and \$61.2 million for the three and nine months ended September 30, 2006, respectively, compared to the 2005 periods. SLT revenue units decreased in the three months ended September 30, 2006 due primarily to sales of higher-end larger-capacity products. Despite a decline in revenue units, SLT revenue increased in the third quarter of 2006 primarily attributable to increases in revenue from higher-end firewalls and SSL products in both the enterprise and service provider markets. During the first nine months of 2006, revenue increased as sales increased across various SLT product families including firewalls, IDP products, J-series products, DX products and SSL products. Additionally, the inclusion of the WX products from the acquisitions completed in 2005 also contributed, in part, to the SLT revenue increases in the three and nine months ended September 30, 2006.

Gross margin percentages for the SLT segment increased in the three months ended September 30, 2006 and declined in the first nine months of 2006, as compared to the same 2005 periods. The gross margin percentage increase in the third quarter of 2006 was due largely to the sales of higher-end products while the decrease in the first nine months in 2006 was due primarily to product mix prior to the introduction of the new integrated products. SLT management operating income decreased in the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005, primarily due to higher personnel related costs despite the higher SLT net revenues and gross margin. Increases in personnel related costs were primarily related to headcount growth in order to support product innovation, new products sales and a larger customer base. Personnel related costs primarily related to the headcount growth in order to support product innovation, product sales and a larger customer base.

Service Operating Segment

Net service revenues increased \$26.4 million and \$91.5 million in the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005 due primarily to the growth in support services, and to a

lesser extent, the growth in professional services. The growth in support services was largely due to increased technical support service contracts associated with higher product sales, which have resulted in our growing installed base of equipment being serviced. The growth in professional services was mainly due to resident engineering professional services and consulting projects in the first nine months of 2006. Service gross margin percentages as well as service management operating income increased in the three and nine months ended September 30, 2006, respectively, compared to the same 2005 periods due primarily to improved economies of scale achieved by faster revenue growth through the Infrastructure products and the SLT products relative to the increases in operating costs. In absolute dollars, employee related expenses increased in the 2006 periods as a result of increased service related headcount. Expenses associated with spare components also increased in 2006 as a result of revenue growth.

Table of Contents**Liquidity and Capital Resources*****Overview***

We have funded our business by issuing securities and through our operating activities. The following table shows our capital resources (in millions):

	September 30, 2006	December 31, 2005
Working capital	\$ 1,604.3	\$ 1,261.4
Cash and cash equivalents	\$ 1,333.3	\$ 918.4
Short-term available-for-sale investments	514.2	510.4
Long-term available-for-sale investments	566.5	618.3
Total cash, cash equivalents and available-for-sale investments	\$ 2,414.0	\$ 2,047.1

Working capital increased in the nine months ended September 30, 2006 primarily due to cash provided by operations as well as the issuance of common stock through employee stock option exercises and through our Employee Stock Purchase Plan. The significant components of our working capital are cash and cash equivalents, short-term investments and accounts receivable, reduced by accounts payable, income taxes payable, accrued liabilities and deferred revenue.

Based on past performance and current expectations, we believe that our existing cash and cash equivalents, short-term and long-term investments, together with cash generated from operations and from the exercise of employee stock options and the purchase of common stock through our employee stock purchase plan, will satisfy our working capital needs, capital expenditures, commitments, repurchases of our common stock, and other liquidity requirements associated with our existing operations through at least the next 12 months. However, it is possible that we may need to raise additional funds to finance our activities beyond the next 12 months or to consummate acquisitions of other businesses, assets, products or technologies. We could raise such funds by selling equity or debt securities to the public or to selected investors, or by borrowing money from financial institutions. In addition, even though we may not need additional funds, we may still elect to sell additional equity or debt securities or obtain credit facilities for other reasons.

There are no transactions, arrangements, and other relationships with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of our requirements for capital resources, except the \$2.0 billion stock repurchase program approved by the Board of Directors as described below. If we were to purchase \$2.0 billion of our common stock, we would significantly reduce our working capital and we may elect to obtain additional debt or credit facilities to fund the repurchases.

Our future capital requirements may vary materially from those now planned depending on many factors, including:

- the overall levels of sales of our products and gross profit margins;
- our business, product, capital expenditure and research and development plans;
- the market acceptance of our products;
- repurchase of our common stock;
- issuance and repayment of debt;

litigation expenses, settlements and judgments;

volume price discounts and customer rebates;

the levels of accounts receivable that we maintain;

acquisitions of other businesses, assets, products or technologies;

changes in our compensation policies;

capital improvements for new and existing facilities;

technological advances;

our competitors' responses to our products;

our relationships with suppliers and customers;

expenses related to our future restructuring plans, if any;

legal and professional service fees associated with our stock option investigation activities;

tax expense associated with stock-based awards;

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issuance of stock-based awards and the related payment in cash for withholding taxes in the current year and possibly during future years;

the level of exercises of stock options and stock purchases under our Employee Stock Purchase Plan; and

general economic conditions and specific conditions in our industry and markets, including the effects of recent international conflicts and related uncertainties.

Cash Requirements

In July 2006, our Board authorized a new stock repurchase program under which we are authorized to repurchase up to \$1.0 billion of our Company's common stock. In February 2007, our Board approved an increase of \$1.0 billion under this new share repurchase program. Coupled with the original \$1.0 billion approved in July 2006, we are now authorized to repurchase up to \$2.0 billion of our common stock. Purchases under this plan will be subject to a review of the circumstances in place at the time. Acquisitions under the share repurchase program will be made from time to time as permitted by securities laws and other legal requirements. The program may be discontinued at any time.

In May 2006, our audit committee commenced an independent review of our stock option practices and related accounting. The audit committee was assisted by independent legal counsel and accounting experts. We recognized \$20.5 million of expense for legal and other professional services associated with this stock option investigation through December 31, 2006. In addition, we incurred tax related charges of \$10.1 million in the third and fourth quarters of 2006. We expect to incur additional fees and other costs in 2007.

Contractual Obligations

Our principal commitments consist of obligations outstanding under operating leases, the Zero Coupon Convertible Senior Notes due June 15, 2008 (Senior Notes), purchase commitments, escrow payments, bonus and earn-out obligations.

Our contractual obligations under operating leases, which extend through 2016, primarily pertain to our facilities. Future minimum payments under our non-cancelable operating leases totaled \$187.5 million as of September 30, 2006.

The Senior Notes were issued in June 2003 and are senior unsecured obligations, rank on parity in right of payment with all of our existing and future senior unsecured debt, and rank senior to all of our existing and future debt that expressly provides that it is subordinated to the notes. The Senior Notes bear no interest, but are convertible into shares of our common stock, subject to certain conditions, at any time prior to maturity on June 15, 2008, or their prior repurchase by Juniper Networks. The conversion rate is 49.6512 shares per each \$1,000 principal amount of convertible notes, subject to adjustment in certain circumstances. This is equivalent to a conversion price of approximately \$20.14 per share. As of September 30, 2006, the carrying value of the Senior Notes was \$399.9 million. Due to the stock option investigation, the Company did not file its quarterly reports on Form 10-Q for the quarters ended June 30, 2006 and September 30, 2006 by the respective due dates. The Company received a Notice of Default on August 25, 2006 from the Trustee of the Senior Notes alleging that the Company was in violation of certain provisions of the Indenture relating to the Senior Notes as a result of its failure to file and was given a 60-day cure period to file its quarterly reports. The holders of the Senior Notes may have had the right to accelerate the Senior Notes by sending the Company a valid Notice of Acceleration in accordance with the terms of the Indenture so long as the Event of Default was continuing. As of the filing of this report, the Company had not received a Notice of Acceleration. Upon the filing of the Company's Quarterly Reports on Form 10-Q for the periods ended June 30, 2006 and September 30, 2006 the alleged default and Event of Default relating to the late filings of these reports is no longer continuing.

We do not have firm purchase commitments with our contract manufacturers. In order to reduce manufacturing lead times and ensure adequate component supply, our contract manufacturers place non-cancelable, non-returnable (NCNR) orders, which were valued at \$221.5 million as of September 30, 2006, based on our build forecasts. We do not take ownership of the components and the NCNR orders do not represent firm purchase commitments pursuant to our agreements with the contract manufacturers. The components are used by the contract manufacturers to build products based on purchase orders we have received from our customers or our forecast. We may incur a liability for

products built by the contract manufacturer if the components go unused for specified periods of time and, in the meantime, we may be assessed carrying charges. As of September 30, 2006, we had accrued a total of \$23.0 million based on our estimate of such charges.

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Other Contractual obligations consist of the following:

As of September 30, 2006, other contractual obligations consisted primarily of the escrow obligations of \$20.1 million in connection with past acquisitions for indemnity obligations expiring between October 2006 and June 2007. Earn-out and bonus obligations of \$8.2 million may be payable to certain employees from our past acquisitions through the fourth quarter of 2007 and recorded as compensation expense ratably over the periods in which the payouts are measured.

- § Escrow amount of \$12.7 million related to the Funk acquisition to secure certain indemnity obligations. One-half of the escrow expired in January 2007 and the remaining one-half will expire in June 2007. Also included is a contingent bonus payable, based on certain milestones, of \$5.0 million, which was earned over a one year period ending in 2006.
- § Escrow amount of \$1.6 million related to the Acorn acquisition to secure certain indemnity obligations. The escrow period will expire in May 2007. Also included is a contingent earn-out payable to former Acorn stockholders, based on certain milestones, of up to \$2.2 million, and a contingent bonus payable to employees related to continued employment of up to \$1.0 million. The earn-out and bonus amounts will be paid, to the extent earned, in 2007 and 2008.
- § Escrow amount related to the Redline and Kagoor acquisitions of \$0.7 million and \$5.1 million, respectively, to secure certain indemnity obligations.

In addition, 1.6 million shares of the Company's common stock with a fair value of \$35.2 million, established as of the acquisition date, were held in escrow associated with indemnity obligations for the Peribit acquisition. One-half of the indemnity obligations expired in July 2006 and the remaining one-half expired in January 2007. The escrow shares less amounts necessary to satisfy claims, if any, will be issued at the current market price upon settlement of the escrow.

Summary of Cash Activities

In the first nine months of 2006, we generated net cash flows of \$521.4 million from our operations as compared to \$445.4 million for the nine months ended September 30, 2005. Cash provided by operating activities was partially offset by the \$15.0 million and \$91.5 million used in investing activities and financing activities, respectively. Positive operating cash flows during the 2006 period were primarily attributable to our increased revenue and accounts receivable collections, partially offset by the additional stock option investigation costs associated with our stock option investigation and bonus payments in the period.

Operating Activities

Net cash generated from operating activities increased by \$76.0 million in the 2006 period compared to the same period a year ago. Increases in cash provided by operating activities were driven by our net income adjusted by non-cash charges as well as changes in operating assets and liabilities:

Non-cash charges of \$1,474.9 million and \$217.0 million for the nine months ended September 30, 2006 and 2005, respectively, which were attributable to impairment charges, depreciation and amortization expenses, stock-based compensation and amortization of debt issuance costs. Non-cash charges in the nine months ended September 30, 2005 also included \$94.3 million of tax benefit from employee stock options, which was not included in operating cash flows for the nine months ended September 30, 2006. As a result of the adoption of SFAS 123R, gross tax benefits of \$7.8 million from tax deductions in excess of the stock-based compensation expense recognized for the six months ended June 30, 2006 were presented as a financing activity and the operating cash flows for the same period were reduced by the corresponding amount in the condensed consolidated statements of cash flows.

Changes in operating assets and liabilities of \$118.9 million and \$(17.4) million for the nine months ended September 30, 2006 and 2005, respectively, which were generated in the normal course of business. Net cash increased in the 2006 period which was primarily attributable to increases in deferred revenue of \$93.1 million due primarily to payments from customers, decreases in other current assets and long-term assets of

\$27.1 million and increases in income taxes payable and other accrued liabilities of \$37.8 million, which were partially offset by increases in accounts receivable of \$15.6 million, decreases in accrued compensation of \$16.0 million, and decreases in accounts payable of \$6.2 million. Increases in accounts receivable were due primarily to shipments being made toward the end of the quarter. Decreases in long-term assets were due to reduced deferred tax assets. Increases in income taxes payable and accrued liabilities were due to the increase of tax liabilities. Net cash used during the nine months ended September 30, 2005 was primarily attributable to increases in prepaid expenses and other assets of

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\$37.2 million and decreases in other accrued liabilities of \$16.2 million, increases in accounts receivable of \$43.5 million, decreases in accrued compensation of \$12.1 million, partially offset by the increases in deferred revenue of \$57.5 million and the increases in accounts payable of \$35.5 million.

Investing Activities

Net cash used in investing activities was \$15.0 million and \$373.3 million for the nine months ended September 30, 2006 and 2005, respectively. Investing activities included purchases, sales and maturities of available-for-sale securities, capital expenditures, purchase and sales of minority equity investments, changes in restricted cash requirements and acquisition of businesses. Net cash used in available-for-sale investments decreased by \$150.7 million in the first nine months ended September 30, 2006, compared to the 2005 period, as funds were converted from available-for-sale securities to cash or cash equivalents given the interest rate increases. Capital expenditures increased by \$10.9 million in the first nine months of 2006 compared to the same 2005 period mainly due to increases in equipment purchases during 2006 to support product development efforts and growth of the business. Restricted cash decreased by \$20.7 million in the first nine months of 2006 primarily due to the \$13.1 million and the \$2.0 million escrow payments associated with the Redline Networks, Inc. (Redline) acquisition and the Kagoor Networks, Inc. (Kagoor) acquisition, respectively. Another contributing factor to the decrease in restricted cash in 2006 was the reduction in deposit requirements of \$5.9 million pertaining to letters of credit for facility leases. Additionally, \$3.1 million was invested in the minority equity of privately held companies. In the first nine months of 2005, we paid \$199.1 million in cash for the Kagoor, Peribit and Redline acquisitions.

Financing Activities

Net cash used in financing activities was \$91.5 million for the nine months ended September 30, 2006 while net cash provided by financing activities was \$103.1 million for the same period in 2005. Net cash used in financing activities increased in the 2006 period as compared to the same 2005 period primarily due to the common stock repurchases and the decreases in total cash proceeds from common stock issuance due partly to the employee trading black-out period as a result of our failure to file the Quarterly Reports on Form 10-Q as of and for the periods ended June 30, 2006 and September 30, 2006, partially offset by the inclusion of excess tax benefits of \$7.8 million related to employee stock options. In the nine months ended September 30, 2006, we used \$186.4 million to repurchase 10,071,000 shares of our common stock at an average price of \$18.51 per share. Common stock issued in relation to employee stock option exercises and our Employee Stock Purchase Plan generated total cash proceeds of \$87.1 million during the 2006 period. Total tax benefits of \$7.8 million from tax deductions in excess of the expense recognized for employee stock options was presented as financing cash flows due to the adoption of SFAS 123R beginning on January 1, 2006. Tax deductions associated with the expense recognized for employee stock options were previously included in operating cash flows prior to 2006. In the nine months ended September 30, 2005, common stock issued in relation to employee option exercises and our Employee Stock Purchase Plan generated total cash proceeds of \$103.1 million.

Factors That May Affect Future Results

A description of risk factors associated with our business is included under Risk Factors in Item 1A of Part II of this report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our market risk profile has not changed significantly during the nine months ended September 30, 2006. The following discussion should be read in conjunction with the 2006 Form 10-K to be filed with the SEC and the condensed consolidated financial statements and notes thereto included elsewhere in this Form 10-Q.

Interest Rate Risk

We maintain an investment portfolio of various holdings, types and maturities. These securities are generally classified as available-for-sale and, consequently, are recorded on the condensed consolidated balance sheet at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income (loss).

At any time, a rise in interest rates could have a material adverse impact on the fair value of our investment portfolio. Conversely, declines in interest rates could have a material impact on interest earnings of our investment portfolio. We do not currently hedge these interest rate exposures. We recognized no material net gains or losses

related to the sales of our investments during the three and nine months ended September 30, 2006 and 2005.

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Foreign Currency Risk and Foreign Exchange Forward Contracts

It is our policy to use derivatives to partially offset our market exposure to fluctuations in foreign currencies. We do not enter into derivatives for speculative or trading purposes.

We use foreign currency forward contracts to mitigate transaction gains and losses generated by certain foreign currency denominated monetary assets and liabilities. These derivatives are carried at fair value with changes recorded in other income (expense). Changes in the fair value of these derivatives are largely offset by re-measurement of the underlying assets and liabilities. These foreign exchange contracts have maturities between one and two months.

Periodically, we use foreign currency forward and/or option contracts to hedge certain forecasted foreign currency transactions relating to operating expenses. These derivatives are designated as cash flow hedges and have maturities of less than one year. The effective portion of the derivative's gain or loss is initially reported as a component of accumulated other comprehensive income and, upon occurrence of the forecasted transaction, is subsequently reclassified into the consolidated statements of operations line item to which the hedged transaction relates. We record any ineffectiveness of the hedging instruments, which was immaterial during the three and nine months ended September 30, 2006 and 2005, in other income (expense) on our condensed consolidated statements of operations.

Investments In Privately Held Companies

From time to time, we make minority equity investments in privately held companies. These investments are strategic in nature and are typically made in companies that are in their early stages of development. As such, these investments carry the risk associated with new ventures. We monitor the progress of these companies and their financial viability on a quarterly basis and ascertain if there is any impairment to our carrying cost of these investments.

As of September 30, 2006 and December 31, 2005, the carrying value of our minority equity investments in privately held companies was \$16.3 million and \$13.2 million, respectively. There were no impairment charges against our minority equity investments in the three and nine months ended September 30, 2006. During the three and nine months ended September 30, 2006, we made minority investments of zero and \$3.1 million, respectively, in privately-held companies.

Item 4. Controls and Procedures

Stock Option Grant Practices and Restatement

As discussed in Note 2 in Notes to the Condensed Consolidated Financial Statements of this Form 10-Q, during 2006, an independent investigation related to our historical stock option granting practices was carried out by the Audit Committee and the Board of Directors. As a result of the investigation, we reached a conclusion that incorrect measurement dates were used for financial accounting purposes for certain stock option grants made in prior periods. Therefore, we have recorded additional non-cash stock-based compensation expense and related tax effects with regard to past stock option grants, substantially all of which relate to options granted between June 9, 1999 and December 31, 2003. We are restating previously filed financial statements in the quarterly reports on Form 10-Q for June 30, 2006 and September 30, 2006 and in the annual report on Form 10-K for the year ended December 31, 2006.

Remediation of Past Material Weaknesses in Internal Control Over Financial Reporting

As a result of this investigation, we identified certain material weaknesses in our internal control over financial reporting related to our stock option granting practices and the related accounting in periods ending prior to June 30, 2006.

Before 2003, we did not have sufficient safeguards in place to monitor our control practices regarding stock option pricing and related financial reporting, the result of which is discussed in Item 1, Note 2 of this report. From 2003 through 2006 we implemented improvements to procedures, processes, and systems to provide additional safeguards and greater internal control over our financial reporting processes including, but not limited to, the stock option granting and administration function, in compliance with the Sarbanes-Oxley Act (SOX) and evolving accounting guidance. These improvements included, but were not limited to:

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- § In response to the requirements of the Sarbanes-Oxley Act of 2002, documenting accounting policies, processes and procedures; and assessing the design and operation effectiveness of internal controls over financial reporting. These efforts led to segregating responsibilities, adding reviews and reconciliations, and redefining roles and responsibilities.
- § Implementing the practice of using the receipt of the final Board of Directors, Compensation Committee or Stock Option Committee approval as the grant and measurement date for stock option grants.
- § Also in response to the requirements of the Sarbanes-Oxley Act of 2002, establishing a confidential hotline for use by employees to report actual or suspected wrongdoing and to answer questions about business conduct. Reports may be made anonymously, and all reports are investigated. Information about this hotline is available on our internal websites.
- § Additionally in response to certain of the reporting requirements of the Sarbanes-Oxley Act of 2002, which requires executive officers to report stock option grants within two business days, implementing new procedures for stock option grants that were designed to provide reasonable assurance that stock options were priced on the actual grant date.
- § Effective January 1, 2006, adopting SFAS No. 123R and added controls in our stock administration, human resources and finance functions to ensure that stock-based compensation expenses are recorded correctly.
- § Obtaining additional resources with responsibilities for financial reporting, internal controls, compliance and stock accounting and administration.
- § Upgrading systems and system controls that support the stock option granting processes.
- § Establishing in 2003 an internal audit function that reports functionally to the Audit Committee. The internal audit function is chartered with evaluating the adequacy of risk management, control, and governance processes and determining whether these processes are functioning in a manner to ensure our financial statements are accurate, reliable and fairly presented.

We believe that these changes remediated the past material weaknesses in our internal control over financial reporting related to our stock option granting practices and the related accounting.

In addition to the significant improvements implemented between 2003 and 2006 discussed above, we will adopt other measures identified by the Board of Directors to enhance the oversight of the stock option granting and administration function and the review and preparation of financial statements, including, but not limited to, the following:

- § We will develop an equity award granting process to provide a more regular schedule for when grants are made.
- § Our Compensation Committee will perform periodic reviews of our equity award granting policies.
- § The Stock Option Committee will be expanded to include the Chief Executive Officer (CEO), Chief Financial Officer (CFO) and a non-management member of the Board of Directors.
- § The authority of the Stock Option Committee to approve equity awards will be limited to a maximum number of shares per recipient.
- § The Stock Option Committee will deliver quarterly reports summarizing granting activity to the Board of Directors.

§ We will implement cross-functional training for persons involved in the equity award process and accounting.

§ We will introduce additional controls related to the equity award granting and administration process where necessary.

Evaluation of Disclosure Controls and Procedures

Attached as exhibits to this report are certifications of our CEO and CFO, which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended. This Controls and Procedures section includes information concerning the controls and controls evaluation referred to in the certifications, and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

We carried out an evaluation, under the supervision and with the participation of our management, including the CEO and CFO, of the effectiveness of the design and operation of 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. Based upon that evaluation, the CEO and CFO concluded that, as of the end of the period covered in this report, our disclosure controls and procedures were effective to ensure that information required to be disclosed by the company in reports that it files under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that material information relating to our consolidated operations is made known to our management, including the CEO and CFO, particularly during the period when our periodic reports are being prepared.

Table of Contents**Changes in Internal Controls**

There was no change in our internal control over financial reporting that occurred during the third quarter of 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION**Item 1. Legal Proceedings**

We are subject to legal claims and litigation arising in the ordinary course of business, such as employment or intellectual property claims, including the matters described below. The outcome of any such matters is currently not determinable. Although we do not expect that such legal claims and litigation will ultimately have a material adverse effect on our consolidated financial position or results of operations, an adverse result in one or more matters could negatively affect our results in the period in which they occur.

Stock Option Lawsuits***Federal Derivative Lawsuits***

Between May 24, 2006 and August 17, 2006, seven purported shareholder derivative actions were filed in the United States District Court for the Northern District of California against us and certain of our current and former officers and directors. The lawsuits allege that our officers and directors either participated in illegal back-dating of stock option grants or allowed it to happen. The lawsuits assert causes of action for violations of federal securities laws, violations of California securities laws, breaches of fiduciary duty, aiding and abetting breaches of fiduciary duty, abuse of control, corporate waste, breach of contract, unjust enrichment, gross mismanagement, insider selling and constructive fraud. The actions also demand an accounting and rescission of allegedly improper stock option grants. On October 19, 2006, the Court ordered the consolidation of these actions as *In Re Juniper Derivative Actions*, No. 06-03396, and appointed as the lead plaintiffs Timothy Hill, Employer-Teamsters Local Nos. 175 & 505 Pension Trust Fund, and Indiana State District Council of Laborers and HOD Carriers Pension Fund. The Court ordered lead plaintiffs to file a consolidated complaint no later than January 12, 2007. On February 14, 2007, the parties agreed to extend the deadline for plaintiffs to file a consolidated complaint until thirty days after we complete the filing of our restated financial statements with the Securities Exchange Commission and the court approved the stipulation on February 15, 2007.

State Derivative Lawsuits California

On May 24, 2006 and June 2, 2006, two purported shareholder derivative actions were filed in the Santa Clara County Superior Court in the State of California against us and certain of our current and former officers and directors. These two actions were consolidated as *In re Juniper Networks Derivative Litigation*, No. 1:06CV064294, by order dated June 20, 2006. A consolidated complaint was filed on July 17, 2006. The consolidated complaint alleges that certain of our current and former officers and directors either participated in illegal back-dating of stock options or allowed it to happen. The complaint asserts causes of action for unjust enrichment, breach of fiduciary duty, abuse of control, gross mismanagement, waste, and violations of California securities laws for insider selling. Plaintiffs also demand an accounting and rescission of allegedly improper stock options grants. On July 28, 2006, the defendants filed a motion to stay all discovery in this action. On August 16, 2006, the defendants filed a motion to dismiss or stay this action in favor of the federal derivative actions pending in the Northern District of California. Plaintiffs have not yet filed their oppositions to those two motions. On November 6, 2006, the parties stipulated that the plaintiffs could file a motion to amend their complaint and a motion to compel responses to discovery no later than thirty days after we complete the filing of our restated financial statements, and that the hearing on the defendants' two pending motions will be heard on the same date as the plaintiffs' two contemplated motions.

Federal Securities Class Actions

On July 14, 2006, a purported class action complaint styled *Garber v. Juniper Networks, Inc., et al.*, No. C-06-4327 MJJ, was filed in the Northern District of California against us and certain of our officers and directors. The plaintiff filed a Corrected Complaint on July 28, 2006. The *Garber* class action is brought on behalf of all purchasers of Juniper Networks' common stock between September 1, 2003 and May 22, 2006. On August 29, 2006, another purported class action complaint styled *Peters v. Juniper Networks, Inc., et al.*, No. C 06 5303 JW, was filed in the Northern District of California against us and certain of our officers and directors. The *Peters* class action is brought on behalf of all purchasers of Juniper Networks' common stock between April 10, 2003 and August 10,

2006. Both of these purported class actions allege that we and certain of our officers and directors violated federal securities laws by

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manipulating stock option grant dates to coincide with low stock prices and issuing false and misleading statements including, among others, incorrect financial statements due to the improper accounting of stock option grants. On November 20, 2006, the Court appointed the New York City Pension Funds as lead plaintiffs. The lead plaintiffs filed a Consolidated Class Action Complaint on January 12, 2007. The Consolidated Complaint asserts claims on behalf of all purchasers of, or those who otherwise acquired, Juniper Networks' publicly traded securities from April 10, 2003 through and including August 20, 2006. The Consolidated Complaint alleges violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 by us and certain of our current and former officers and directors. On February 15, 2007, the parties agreed that plaintiffs may file an Amended Consolidated Complaint within thirty days after we file our restated financial statements with the Securities Exchange Commission and the court approved the stipulation on February 16, 2007.

Other Matters***IPO Allocation Case***

In December 2001, a class action complaint was filed in the United States District Court for the Southern District of New York against the Goldman Sachs Group, Inc., Credit Suisse First Boston Corporation, FleetBoston Robertson Stephens, Inc., Royal Bank of Canada (Dain Rauscher Wessels), SG Cowen Securities Corporation, UBS Warburg LLC (Warburg Dillon Read LLC), Chase (Hambrecht & Quist LLC), J.P. Morgan Chase & Co., Lehman Brothers, Inc., Salomon Smith Barney, Inc., Merrill Lynch, Pierce, Fenner & Smith, Incorporated (collectively, the Underwriters), our Company and certain of our officers. This action was brought on behalf of purchasers of our common stock in our initial public offering in June 1999 and our secondary offering in September 1999.

Specifically, among other things, this complaint alleged that the prospectus pursuant to which shares of common stock were sold in our initial public offering and our subsequent secondary offering contained certain false and misleading statements or omissions regarding the practices of the Underwriters with respect to their allocation of shares of common stock in these offerings and their receipt of commissions from customers related to such allocations. Various plaintiffs have filed actions asserting similar allegations concerning the initial public offerings of approximately 300 other issuers. These various cases pending in the Southern District of New York have been coordinated for pretrial proceedings as *In re Initial Public Offering Securities Litigation*, 21 MC 92. In April 2002, plaintiffs filed a consolidated amended complaint in the action against us, alleging violations of the Securities Act of 1933 and the Securities Exchange Act of 1934. Defendants in the coordinated proceeding filed motions to dismiss. In October 2002, our officers were dismissed from the case without prejudice pursuant to a stipulation. On February 19, 2003, the court granted in part and denied in part the motion to dismiss, but declined to dismiss the claims against us.

In June 2004, a stipulation for the settlement and release of claims against the issuer defendants, including us, was submitted to the Court for approval. The terms of the settlement, if approved, would dismiss and release all claims against participating defendants (including us). In exchange for this dismissal, Directors and Officers insurance carriers would agree to guarantee a recovery by the plaintiffs from the underwriter defendants of at least \$1.0 billion, and the issuer defendants would agree to an assignment or surrender to the plaintiffs of certain claims the issuer defendants may have against the underwriters. On August 31, 2005, the Court confirmed preliminary approval of the settlement. On April 24, 2006, the Court held a fairness hearing in connection with the motion for final approval of the settlement. The Court did not issue a ruling on the motion for final approval at the fairness hearing. The settlement remains subject to a number of conditions, including final court approval. On December 5, 2006, the Court of Appeals for the Second Circuit reversed the Court's October 2004 order certifying a class in the case against us, which along with five other issuers, was selected as a test case by the underwriter defendants and plaintiffs in the coordinated proceeding. It is unclear what impact this will have on the settlement and the case against us.

Toshiba Patent Infringement Litigation

On November 13, 2003, Toshiba Corporation filed suit in the United States District Court in Delaware against us, alleging that certain of our products infringe four Toshiba patents, and seeking an injunction and unspecified damages. A Markman hearing was held in April 2006, and a ruling favorable to us was issued on June 28, 2006. Toshiba stipulated to non-infringement of the four patents and filed a notice of appeal with the Court of Appeals for the Federal Circuit. The Delaware court has removed the trial, previously scheduled for August 2006, from its calendar, pending resolution of the appeal. We expect the appeal will not be heard before July 2007.

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IRS Notices of Proposed Adjustments

The Internal Revenue Service (IRS) has concluded an audit of our federal income tax returns for fiscal years 1999 and 2000. During 2004, we received a Notice of Proposed Adjustment (NOPA) from the IRS. While the final resolution of the issues raised in the NOPA is uncertain, we do not believe that the outcome of this matter will have a material adverse effect on our consolidated financial position or results of operations. We are also under routine examination by certain state and non-US tax authorities. We believe that we have adequately provided for any reasonably foreseeable outcome related to these audits.

In conjunction with the IRS income tax audit, certain of our US payroll tax returns are currently under examination for fiscal years 1999 – 2001, and we received a second NOPA in the amount of \$11.7 million for employment tax assessments primarily related to the timing of tax deposits related to employee stock option exercises. We responded to this NOPA in February 2005, and intend to dispute this assessment with the IRS. An initial appeals conference was held on January 31, 2006 and October 3, 2006. The appeal process available to us has not been concluded. In the event that this issue is resolved unfavorably to us, there exists the possibility of a material adverse impact on our results of operations.

Item 1A. Risk Factors

The risk factors included herein include any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in Item 1A to Part I of our 2005 Annual Report on Form 10-K.

Investments in equity securities of publicly traded companies involve significant risks. The market price of our stock reflects a higher multiple of expected future earnings than many other companies. Accordingly, even small changes in investor expectations for our future growth and earnings, whether as a result of actual or rumored financial or operating results, changes in the mix of the products and services sold, acquisitions, industry changes or other factors, could trigger significant fluctuations in the market price of our common stock. Investors in our securities should carefully consider all of the relevant factors, including, but not limited to, the following factors, that could affect our stock price.

Matters related to the investigation into our historical stock option granting practices and the restatement of our financial statements may result in additional litigation, regulatory proceedings and government enforcement actions.

Our historical stock option granting practices and the restatement of our financial statements have exposed us to greater risks associated with litigation, regulatory proceedings and government enforcement actions. For more information regarding our current litigation and related inquiries, please see Part II, Item 1- Legal Proceedings as well as the other risk factors related to litigation set forth in this section. We have provided the results of our internal review and independent investigation to the SEC and the United States Attorney's Office for the Northern District of California, and in that regard we have responded to formal and informal requests for documents and additional information. We intend to continue to cooperate with these governmental agencies. No assurance can be given regarding the outcomes from litigation, regulatory proceedings or government enforcement actions relating to our past stock option practices. The resolution of these matters will be time consuming, expensive, and may distract management from the conduct of our business. Furthermore, if we are subject to adverse findings in litigation, regulatory proceedings or government enforcement actions, we could be required to pay damages or penalties or have other remedies imposed, which could harm our business, financial condition, results of operations and cash flows.

In addition, while we believe that we have made appropriate judgments in determining the correct measurement dates for our stock option grants, the SEC may disagree with the manner in which we accounted for and reported, or not reported, the corresponding financial impact. Accordingly, there is a risk that we may have to further restate our prior financial statements, amend prior filings with the SEC, or take other actions not currently contemplated.

Also, in August 2006, we received a NASDAQ Staff Determination letter stating that, as a result of the delayed filing of our quarterly report on Form 10-Q for the quarter ended June 30, 2006 (the Second Quarter Form 10-Q), we were not in compliance with the filing requirements for continued listing as set forth in Marketplace Rule 4310(c)(14) and were therefore subject to delisting from the NASDAQ Global Select Market. In November 2006, we received an additional letter from NASDAQ of similar substance related to our Form 10-Q for the quarter ended September 30, 2006 (the Third Quarter Form 10-Q). In December 2006, the NASDAQ Listing Qualifications Panel granted our

request for continued listing, provided that we file a written summary of our audit committee's findings with NASDAQ as well as the Second Quarter Form 10-Q, the Third Quarter Form 10-Q and any required restatements with the SEC on or before February 12, 2007. In January, we received a notice from the NASDAQ Listing and Hearings Review Council which advised us that any delisting determination by the NASDAQ Listing Qualifications Panel has been stayed pending further review by the Review Council. We have been given until March 30, 2007 to submit additional information to assist the Review Council in their assessment of our listing status. On February 20, 2007, we filed a written summary of our audit

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committee's findings with NASDAQ. In addition, on March 9, 2007, we filed the Second Quarter Form 10-Q and the Third Quarter Form 10-Q with the SEC. We consider that the filing of these materials has remedied our non-compliance with Marketplace Rule 4310(c)(14), subject to NASDAQ's affirmative completion of its compliance protocols and its notification to us accordingly. However, if NASDAQ disagrees with our position or if the SEC disagrees with the manner in which we have accounted for and reported, or not reported, the financial impact of past stock option grants, there could be further delays in filing subsequent SEC reports or other actions that might result in delisting of our common stock from the NASDAQ Global Select Market.

Fluctuating economic conditions make it difficult to predict revenues for a particular period and a shortfall in revenues may harm our operating results.

Our revenues depend significantly on general economic conditions and the demand for products in the markets in which we compete. Economic weakness, customer financial difficulties and constrained spending on network expansion have previously resulted (for example, in 2001 and 2002), and may in the future result, in decreased revenues and earnings and could negatively impact our ability to forecast and manage our contract manufacturer relationships. Economic downturns may also lead to restructuring initiatives and associated expenses and impairment of investments. In addition, our operating expenses are largely based on anticipated revenue trends and a high percentage of our expenses are, and will continue to be, fixed in the short-term. Uncertainty about future economic conditions makes it difficult to forecast operating results and to make decisions about future investments. Future economic weakness, customer financial difficulties and reductions in spending on network expansion could have a material adverse effect on demand for our products and consequently on our results of operations and stock price.

Our quarterly results are inherently unpredictable and subject to substantial fluctuations and, as a result, we may fail to meet the expectations of securities analysts and investors, which could adversely affect the trading price of our common stock.

Our revenues and operating results may vary significantly from quarter to quarter due to a number of factors, many of which are outside of our control and any of which may cause our stock price to fluctuate.

The factors that may affect the unpredictability of our quarterly results include, but are not limited to, limited visibility into customer spending plans, changes in the mix of products sold, changing market conditions, including current and potential customer consolidation, competition, customer concentration, long sales and implementation cycles, regional economic and political conditions and seasonality. For example, many companies in our industry experience adverse seasonal fluctuations in customer spending patterns, particularly in the first and third quarters.

As a result, we believe that quarter-to-quarter comparisons of operating results are not necessarily a good indication of what our future performance will be. It is likely that in some future quarters, our operating results may be below the expectations of securities analysts or investors, in which case the price of our common stock may decline. Such a decline could occur, and has occurred in the past, even when we have met our publicly stated revenue and/or earnings guidance.

We sell our products to customers that use those products to build networks and IP infrastructure and, if the demand for network and IP systems does not continue to grow, then our business, operating results and financial condition could be adversely affected.

A substantial portion of our business and revenue depends on the growth of secure IP infrastructure and on the deployment of our products by customers that depend on the continued growth of IP services. As a result of changes in the economy and capital spending or the building of network capacity in excess of demand, all of which have in the past particularly affected telecommunications service providers, spending on IP infrastructure can vary, which could have a material adverse effect on our business and financial results. In addition, a number of our existing customers are evaluating the build out of their next generation network, or NGN. During the decision making period when the customers are determining the design of those networks and the selection of the equipment they will use in those networks, such customers may greatly reduce or suspend their spending on secure IP infrastructure. Such pauses in purchases can make it more difficult to predict revenues from such customers, can cause fluctuations in the level of spending by these customers and, even where our products are ultimately selected, can have a material adverse effect on our business and financial results.

Table of Contents***A limited number of our customers comprise a significant portion of our revenues and any decrease in revenue from these customers could have an adverse effect on our net revenues and operating results***

A substantial majority of our net revenues depend on sales to a limited number of customers and distribution partners. Siemens AG and Ericsson Telekom A.B. each accounted for greater than 10% of our net revenues during the three months ended September 30, 2006. Siemens also accounted for greater than 10% of our net revenues during the nine months ended September 30, 2006 and for greater than 10% of our net revenues during the three and nine months ended September 30, 2005. This customer concentration increases the risk of quarterly fluctuations in our revenues and operating results. Any downturn in the business of our key customers or potential new customers could significantly decrease sales to such customers, which could adversely affect our net revenues and results of operations. In addition, there has been and continues to be consolidation in the telecommunications industry (for example, the acquisitions of AT&T Inc., MCI, Inc. and BellSouth Corporation) and consolidation among the large vendors of telecommunications equipment and services (for example, the combination of Alcatel S.A. and Lucent Technologies Inc. and the acquisition of Redback Networks, Inc. by Ericsson). Such consolidation may cause our customers who are involved in these acquisitions to suspend or indefinitely reduce their purchases of our products or have other unforeseen consequences that could harm our business and operating results.

We rely on value-added resellers and distribution partners to sell our products, and disruptions to, or our failure to effectively develop and manage, our distribution channel and the processes and procedures that support it could adversely affect our ability to generate revenues from the sale of our products.

Our future success is highly dependent upon establishing and maintaining successful relationships with a variety of value-added reseller and distribution partners. The majority of our revenues are derived through value-added resellers and distributors, most of which also sell competitors' products. Our revenues depend in part on the performance of these partners. The loss of or reduction in sales to our value-added resellers or distributors could materially reduce our revenues. During 2006, Alcatel, a competitor of ours, acquired Lucent, one of our largest value-added resellers. In addition, our largest customer, Siemens, has announced that it will be transferring its telecommunications business to a joint venture between Siemens and Nokia. Our competitors may in some cases be effective in providing incentives to current or potential resellers and distributors to favor their products or to prevent or reduce sales of our products. If we fail to maintain relationships with our partners, fail to develop new relationships with value-added resellers and distributors in new markets or expand the number of distributors and resellers in existing markets, fail to manage, train or motivate existing value-added resellers and distributors effectively or if these partners are not successful in their sales efforts, sales of our products may decrease and our operating results would suffer.

In addition, we recognize a portion of our revenue based on a sell-through model using information provided by our distributors. If those distributors provide us with inaccurate or untimely information, the amount or timing of our revenues could be adversely impacted.

Further, in order to develop and expand our distribution channel, we must continue to scale and improve our processes and procedures that support it, and those processes and procedures may become increasingly complex and inherently difficult to manage. Our failure to successfully manage and develop our distribution channel and the processes and procedures that support it could adversely affect our ability to generate revenues from the sale of our products.

Traditional telecommunications companies and other large companies generally require more onerous terms and conditions of their vendors. As we seek to sell more products to such customers, we may be required to agree to terms and conditions that may have an adverse effect on our business or ability to recognize revenue.

Traditional telecommunications companies and other large companies, because of their size, generally have had greater purchasing power and, accordingly, have requested and received more favorable terms, which often translate into more onerous terms and conditions for their vendors. As we seek to sell more products to this class of customer, we may be required to agree to such terms and conditions, which may include terms that affect the timing of our ability to recognize revenue and have an adverse effect on our business and financial condition.

For example, many customers in this class have purchased products from other vendors who promised certain functionality and failed to deliver such functionality and/or had products that caused problems and outages in the networks of these customers. As a result, this class of customers may request additional features from us and require

substantial penalties for failure to deliver such features or may require substantial penalties for any network outages that may be caused by our products. These additional requests and penalties, if we are required to agree to them, would affect our ability to recognize the revenues from such sales, which may negatively affect our business and our financial condition. For example, in April 2006, we announced that we would be required to defer a large amount of revenue from a customer due to the contractual obligations required by that customer.

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For arrangements with multiple elements, vendor specific objective evidence of fair value is required in order to separate the components and to account for elements of the arrangement separately. Vendor specific objective evidence of fair value is based on the price charged when the element is sold separately. However, customers may require terms and conditions that make it more difficult or impossible for us to maintain vendor specific objective evidence of fair value for the undelivered elements to a similar group of customers, the result of which could cause us to defer the entire arrangement fees for a similar group of customers (product, maintenance, professional services, etc.) and recognize revenue only when the last element is delivered or if the only undelivered element is maintenance revenue would be recognized ratably over the contractual maintenance period which is generally one year.

We face intense competition that could reduce our revenues and adversely affect our financial results.

Competition is intense in the markets that we address. The IP infrastructure market has historically been dominated by Cisco Systems, Inc. with other companies such as Ericsson, Huawei, Alcatel-Lucent, and Nortel Networks Corporation providing products to a smaller segment of the market. In addition, a number of other small public and private companies have products or have announced plans for new products to address the same challenges that our products address.

In the service layer technologies market, we face intense competition from a broader group of companies including appliance vendors such as Cisco, Fortinet, Inc., F5 Networks, Inc., Nortel and Riverbed Technology, Inc. and software vendors such as CheckPoint Software Technologies, Ltd. In addition, a number of other small public and private companies have products or have announced plans for new products to address the same challenges that our products address.

In addition, actual or speculated consolidation among competitors, or the acquisition of our partners and resellers by competitors, can increase the competitive pressures faced by us. In this regard, Alcatel has recently combined with Lucent and Ericsson has recently acquired Redback. A number of our competitors have substantially greater resources and can offer a wider range of products and services for the overall network equipment market than we do. If we are unable to compete successfully against existing and future competitors on the basis of product offerings or price, we could experience a loss in market share and revenues and/or be required to reduce prices, which could reduce our gross margins, and which could materially and adversely affect our business, operating results and financial condition. ***If we do not successfully anticipate market needs and develop products and product enhancements that meet those needs, or if those products do not gain market acceptance, we may not be able to compete effectively and our ability to generate revenues will suffer.***

We cannot guarantee that we will be able to anticipate future market needs or be able to develop new products or product enhancements to meet such needs or to meet them in a timely manner. If we fail to anticipate the market requirements or to develop new products or product enhancements to meet those needs, such failure could substantially decrease market acceptance and sales of our present and future products, which would significantly harm our business and financial results. Even if we are able to anticipate, develop and commercially introduce new products and enhancements, there can be no assurance that new products or enhancements will achieve widespread market acceptance. Any failure of our products to achieve market acceptance could adversely affect our business and financial results.

We are a party to lawsuits, which are costly to investigate and defend and, if determined adversely to us, could require us to pay damages, any or all of which could harm our business and financial condition.

We and certain of our current and former officers and current and former members of our board of directors are subject to various lawsuits. For example, the SEC and U.S. Attorney's office have inquired regarding our stock option pricing practices, and we have been served with lawsuits related to the alleged backdating of stock options and other related matters, a description of which can be found above in Part II, Item 1- Legal Proceedings. There can be no assurance that these or any actions that have been or may be brought against us will be resolved in our favor. Regardless of whether they are resolved in our favor, these lawsuits are, and any future lawsuits to which we may become a party will likely be, expensive and time consuming to investigate, defend and/or resolve. Such costs of investigation and defense, as well as any losses resulting from these claims, could significantly increase our expenses and adversely affect our profitability and cash flow.

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Our ability to develop, market and sell products could be harmed if we are unable to retain or hire key personnel.

Our future success depends upon our ability to recruit and retain the services of key executive, engineering, sales, marketing and support personnel. The supply of highly qualified individuals, in particular engineers in very specialized technical areas, or sales people specializing in the service provider and enterprise markets, is limited and competition for such individuals is intense. None of our officers or key employees is bound by an employment agreement for any specific term. The loss of the services of any of our key employees, the inability to attract or retain key personnel in the future or delays in hiring required personnel, particularly engineers and sales people, and the complexity and time involved in replacing or training new employees, could delay the development and introduction of new products, and negatively impact our ability to market, sell or support our products.

Our reported financial results could suffer if there is an additional impairment of goodwill or other intangible assets with indefinite lives.

We are required to annually test, and review on an interim basis, our goodwill and intangible assets with indefinite lives, including the goodwill associated with past acquisitions and any future acquisitions, to determine if impairment has occurred. If such assets are deemed impaired, an impairment loss equal to the amount by which the carrying amount exceeds the fair value of the assets would be recognized. This would result in incremental expenses for that quarter which would reduce any earnings or increase any loss for the period in which the impairment was determined to have occurred. For example, such impairment could occur if the market value of our common stock falls below certain levels for a sustained period or if the portions of our business related to companies we have acquired fail to grow at expected rates or decline. In the second quarter of 2006, this impairment evaluation resulted in a reduction of \$1.3 billion to the carrying value of goodwill on our balance sheet for the SLT operating segment, primarily due to the decline in the Company's market capitalization that occurred over a period of approximately six months prior to the impairment review and, to a lesser extent, a decrease in the forecasted future cash flows used in the income approach. Further declines in our stock prices in the future as well as any marked decline in our level of revenues or gross margins increase the risk that goodwill and intangible assets may become impaired in future periods. We cannot accurately predict the amount and timing of any impairment of assets.

Litigation or claims regarding intellectual property rights may be time consuming, expensive and require a significant amount of resources to prosecute, defend or make our products non-infringing.

Third parties have asserted and may in the future assert claims or initiate litigation related to patent, copyright, trademark and other intellectual property rights to technologies and related standards that are relevant to our products. For example, in 2003, Toshiba Corporation filed a lawsuit against us, alleging that our products infringe certain Toshiba patents. The asserted claims and/or initiated litigation may include claims against us or our manufacturers, suppliers or customers, alleging infringement of their proprietary rights with respect to our products. Regardless of the merit of these claims, they can be time-consuming, result in costly litigation and may require us to develop non-infringing technologies or enter into license agreements. Furthermore, because of the potential for high awards of damages or injunctive relief that are not necessarily predictable, even arguably unmeritorious claims may be settled for significant amounts of money. If any infringement or other intellectual property claim made against us by any third party is successful, if we are required to settle litigation for significant amounts of money, or if we fail to develop non-infringing technology or license required proprietary rights on commercially reasonable terms and conditions, our business, operating results and financial condition could be materially and adversely affected.

The long sales and implementation cycles for our products, as well as our expectation that some customers will sporadically place large orders with short lead times, may cause our revenues and operating results to vary significantly from quarter to quarter.

A customer's decision to purchase certain of our products involves a significant commitment of its resources and a lengthy evaluation and product qualification process. As a result, the sales cycle may be lengthy. In particular, customers making critical decisions regarding the design and implementation of large or next-generation networks may engage in very lengthy procurement processes that may delay or impact expected future orders. Throughout the sales cycle, we may spend considerable time educating and providing information to prospective customers regarding the use and benefits of our products. Even after making the decision to purchase, customers may deploy our products slowly and deliberately. Timing of deployment can vary widely and depends on the skill set of the customer, the size

of the network deployment, the complexity of the customer's network environment and the degree of hardware and operating system configuration necessary to deploy the products. Customers with large networks usually expand their networks in large increments on a periodic basis. Accordingly, we may receive purchase orders for significant dollar amounts on an irregular basis. These long cycles, as well as our expectation that customers will tend to sporadically place large orders with short lead times, may cause revenues and operating results to vary significantly and unexpectedly from quarter to quarter.

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We are dependent on sole source and limited source suppliers for several key components, which makes us susceptible to shortages or price fluctuations in our supply chain and we may face increased challenges in supply chain management in the future.

With the current demand for electronic products, component shortages are possible and the predictability of the availability of such components may be limited. Growth in our business and the economy is likely to create greater pressures on us and our suppliers to accurately project overall component demand and to establish optimal component levels. If shortages or delays persist, the price of these components may increase, or the components may not be available at all. We may not be able to secure enough components at reasonable prices or of acceptable quality to build new products in a timely manner and our revenues and gross margins could suffer until other sources can be developed. For example, throughout the first quarter of 2006 we experienced component shortages that resulted in delays of shipments of product until late in the quarter and in an increase in our day sales outstanding. We currently purchase numerous key components, including application-specific integrated circuits (ASICs), from single or limited sources. The development of alternate sources for those components is time consuming, difficult and costly. In addition, the lead times associated with certain components are lengthy and preclude rapid changes in quantities and delivery schedules. In the event of a component shortage or supply interruption from these suppliers, we may not be able to develop alternate or second sources in a timely manner. If, as a result, we are unable to buy these components in quantities sufficient to meet our requirements on a timely basis, we will not be able to deliver product to our customers, which would seriously impact present and future sales, which would, in turn, adversely affect our business.

In addition, the development, licensing or acquisition of new products in the future may increase the complexity of supply chain management. Failure to effectively manage the supply of key components and products would adversely affect our business.

If we fail to accurately predict our manufacturing requirements, we could incur additional costs or experience manufacturing delays which would harm our business.

We provide demand forecasts to our contract manufacturers. If we overestimate our requirements, the contract manufacturers may assess charges or we may have liabilities for excess inventory, each of which could negatively affect our gross margins. Conversely, because lead times for required materials and components vary significantly and depend on factors such as the specific supplier, contract terms and the demand for each component at a given time, if we underestimate our requirements, the contract manufacturers may have inadequate time or materials and components required to produce our products, which could delay or interrupt manufacturing of our products and result in delays in shipments and deferral or loss of revenues.

We are dependent on contract manufacturers with whom we do not have long-term supply contracts, and changes to those relationships, expected or unexpected, may result in delays or disruptions that could cause us to lose revenue and damage our customer relationships.

We depend primarily on independent contract manufacturers (each of whom is a third party manufacturer for numerous companies) to manufacture our products. Although we have contracts with our contract manufacturers, those contracts do not require them to manufacture our products on a long-term basis in any specific quantity or at any specific price. In addition, it is time consuming and costly to qualify and implement additional contract manufacturer relationships. Therefore, if we should fail to effectively manage our contract manufacturer relationships or if one or more of them should experience delays, disruptions or quality control problems in our manufacturing operations, or if we had to change or add additional contract manufacturers or contract manufacturing sites, our ability to ship products to our customers could be delayed. Also, the addition of manufacturing locations or contract manufacturers would increase the complexity of our supply chain management. Moreover, an increasing portion of our manufacturing is performed in China and other countries and is therefore subject to risks associated with doing business in other countries. Each of these factors could adversely affect our business and financial results.

Integration of past acquisitions and future acquisitions could disrupt our business and harm our financial condition and stock price and may dilute the ownership of our stockholders.

We have made, and may continue to make, acquisitions in order to enhance our business. In 2005 we completed the acquisitions of Funk, Acorn, Peribit, Redline and Kagoor. Acquisitions involve numerous risks, including problems combining the purchased operations, technologies or products, unanticipated costs, diversion of

management's attention from our core businesses, adverse effects on existing business relationships with suppliers and customers, risks associated with entering markets in which we have no or limited prior experience and potential loss of key employees. There can be no assurance that we will be able to successfully integrate any businesses, products, technologies or personnel that we might acquire. The integration of businesses that we have acquired has

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been, and will continue to be, a complex, time consuming and expensive process. For example, although we completed the acquisition of NetScreen in April 2004, integration of the NetScreen products is a continuing activity and will be for the foreseeable future. Acquisitions may also require us to issue common stock that dilutes the ownership of our current stockholders, assume liabilities, record goodwill and non-amortizable intangible assets that will be subject to impairment testing on a regular basis and potential periodic impairment charges, incur amortization expenses related to certain intangible assets, and incur large and immediate write-offs and restructuring and other related expenses, all of which could harm our operating results and financial condition.

In addition, if we fail in our integration efforts with respect to any of our acquisitions and are unable to efficiently operate as a combined organization utilizing common information and communication systems, operating procedures, financial controls and human resources practices, our business and financial condition may be adversely affected.

We expect gross margin to vary over time and our recent level of product gross margin may not be sustainable.

Our product gross margins will vary from quarter to quarter and the recent level of gross margins may not be sustainable and may be adversely affected in the future by numerous factors, including product mix shifts, increased price competition in one or more of the markets in which we compete, increases in material or labor costs, excess product component or obsolescence charges from our contract manufacturers, increased costs due to changes in component pricing or charges incurred due to component holding periods if our forecasts do not accurately anticipate product demand, warranty related issues, or our introduction of new products or entry into new markets with different pricing and cost structures.

We are required to expense equity compensation given to our employees, which has reduced our reported earnings, will significantly harm our operating results in future periods and may reduce our stock price and our ability to effectively utilize equity compensation to attract and retain employees.

We historically have used stock options as a significant component of our employee compensation program in order to align employees' interests with the interests of our stockholders, encourage employee retention, and provide competitive compensation packages. The Financial Accounting Standards Board has adopted changes that require companies to record a charge to earnings for employee stock option grants and other equity incentives. We adopted this standard effective January 1, 2006. By causing us to record significantly increased compensation costs, such accounting changes have reduced, and will continue to reduce, our reported earnings, will significantly harm our operating results in future periods, and may require us to reduce the availability and amount of equity incentives provided to employees, which may make it more difficult for us to attract, retain and motivate key personnel. Moreover, if securities analysts, institutional investors and other investors adopt financial models that include stock option expense in their primary analysis of our financial results, our stock price could decline as a result of reliance on these models with higher expense calculations. Each of these results could materially and adversely affect our business.

Our ability to process orders and ship products is dependent in part on our business systems and upon interfaces with the systems of third parties such as our suppliers or other partners. If our systems, the systems of those third parties or the interfaces between them fail, our business processes could be impacted and our financial results could be harmed.

Some of our business processes depend upon our information technology systems and on interfaces with the systems of third parties. For example, our order entry system feeds information into the systems of our contract manufacturers, which enables them to build and ship our products. If those systems fail, our processes may function at a diminished level or not at all. This could negatively impact our ability to ship products or otherwise operate our business, and our financial results could be harmed. For example, although it did not adversely affect our shipments, an earthquake in late December of 2006 disrupted communications with China, where a significant part of our manufacturing occurs.

Our products are highly technical and if they contain undetected errors, our business could be adversely affected and we might have to defend lawsuits or pay damages in connection with any alleged or actual failure of our products and services.

Our products are highly technical and complex, are critical to the operation of many networks and, in the case of our security products, provide and monitor network security and may protect valuable information. Our products have

contained and may contain one or more undetected errors, defects or security vulnerabilities. Some errors in our products may only be discovered after a product has been installed and used by end customers. Any errors or security vulnerabilities discovered in our products after commercial release could result in loss of revenues or delay in revenue recognition, loss of customers and increased service and warranty cost, any of which could adversely affect our business and results of operations. In addition, we could face claims for product liability, tort or breach of warranty. Defending a lawsuit, regardless of its merit, is costly and may divert management's attention. In addition, if our

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business liability insurance coverage is inadequate or future coverage is unavailable on acceptable terms or at all, our financial condition could be harmed.

A breach of network security could harm public perception of our security products, which could cause us to lose revenues.

If an actual or perceived breach of network security occurs in the network of a customer of our security products, regardless of whether the breach is attributable to our products, the market perception of the effectiveness of our products could be harmed. This could cause us to lose current and potential end customers or cause us to lose current and potential value-added resellers and distributors. Because the techniques used by computer hackers to access or sabotage networks change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques.

If our products do not interoperate with our customers' networks, installations will be delayed or cancelled and could harm our business.

Our products are designed to interface with our customers' existing networks, each of which have different specifications and utilize multiple protocol standards and products from other vendors. Many of our customers' networks contain multiple generations of products that have been added over time as these networks have grown and evolved. Our products will be required to interoperate with many or all of the products within these networks as well as future products in order to meet our customers' requirements. If we find errors in the existing software or defects in the hardware used in our customers' networks, we may have to modify our software or hardware to fix or overcome these errors so that our products will interoperate and scale with the existing software and hardware, which could be costly and negatively impact our operating results. In addition, if our products do not interoperate with those of our customers' networks, demand for our products could be adversely affected, orders for our products could be cancelled or our products could be returned. This could hurt our operating results, damage our reputation and seriously harm our business and prospects.

Due to the global nature of our operations, economic or social conditions or changes in a particular country or region could adversely affect our sales or increase our costs and expenses, which could have a material adverse impact on our financial condition.

We conduct significant sales and customer support operations directly and indirectly through our distributors and value-added resellers in countries throughout the world and also depend on the operations of our contract manufacturers and suppliers that are located inside and outside of the United States. Accordingly, our future results could be materially adversely affected by a variety of uncontrollable and changing factors including, among others, political or social unrest, natural disasters, epidemic disease, war, or economic instability in a specific country or region, trade protection measures and other regulatory requirements which may affect our ability to import or export our products from various countries, service provider and government spending patterns affected by political considerations and difficulties in staffing and managing international operations. Any or all of these factors could have a material adverse impact on our revenue, costs, expenses, results of operations and financial condition.

We are exposed to fluctuations in currency exchange rates which could negatively affect our financial results and cash flows.

Because a majority of our business is conducted outside the United States, we face exposure to adverse movements in non-US currency exchange rates. These exposures may change over time as business practices evolve and could have a material adverse impact on our financial results and cash flows.

The majority of our revenues and expenses are transacted in US Dollars. We also have some transactions that are denominated in foreign currencies, primarily the Japanese Yen, Hong Kong Dollar, British Pound and the Euro, related to our sales and service operations outside of the United States. An increase in the value of the US Dollar could increase the real cost to our customers of our products in those markets outside the United States where we sell in US Dollars, and a weakened dollar could increase the cost of local operating expenses and procurement of raw materials to the extent we must purchase components in foreign currencies.

Currently, we hedge only those currency exposures associated with certain assets and liabilities denominated in nonfunctional currencies and periodically will hedge anticipated foreign currency cash flows. The hedging activities undertaken by us are intended to offset the impact of currency fluctuations on certain nonfunctional currency assets

and liabilities. If our attempts to hedge against these risks are not successful, our net income could be adversely impacted.

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Our products incorporate and rely upon licensed third-party technology and if licenses of third-party technology do not continue to be available to us or become very expensive, our revenues and ability to develop and introduce new products could be adversely affected.

We integrate licensed third-party technology into certain of our products. From time to time, we may be required to license additional technology from third parties to develop new products or product enhancements. Third-party licenses may not be available or continue to be available to us on commercially reasonable terms. Our inability to maintain or re-license any third-party licenses required in our products or our inability to obtain third-party licenses necessary to develop new products and product enhancements, could require us to obtain substitute technology of lower quality or performance standards or at a greater cost, any of which could harm our business, financial condition and results of operations.

Our success depends upon our ability to effectively plan and manage our resources and restructure our business through rapidly fluctuating economic and market conditions.

Our ability to successfully offer our products and services in a rapidly evolving market requires an effective planning, forecasting, and management process to enable us to effectively scale our business and adjust our business in response to fluctuating market opportunities and conditions. In periods of market expansion, we have increased investment in our business by, for example, increasing headcount and increasing our investment in research and development and other parts of our business. Conversely, during 2001 and 2002, in response to downward trending industry and market conditions, we restructured our business and reduced our workforce. Many of our expenses, such as real estate expenses, can not be rapidly or easily adjusted as a result of fluctuations in our business or numbers of employees. Moreover, rapid changes in the size of our workforce could adversely affect the ability to develop and deliver products and services as planned or impair our ability to realize our current or future business objectives.

If we fail to adequately evolve our financial and managerial control and reporting systems and processes, our ability to manage and grow our business will be negatively affected.

Our ability to successfully offer our products and implement our business plan in a rapidly evolving market depends upon an effective planning and management process. We will need to continue to improve our financial and managerial control and our reporting systems and procedures in order to manage our business effectively in the future. If we fail to continue to implement improved systems and processes, our ability to manage our business and results of operations may be negatively affected.

We are subject to risks arising from our international operations.

We derive a majority of our revenues from our international operations, and we plan to continue expanding our business in international markets in the future. As a result of our international operations, we are affected by economic, regulatory and political conditions in foreign countries, including changes in IT spending generally, the imposition of government controls, changes or limitations in trade protection laws, unfavorable changes in tax treaties or laws, natural disasters, labor unrest, earnings expatriation restrictions, misappropriation of intellectual property, acts of terrorism and continued unrest in many regions and other factors, which could have a material impact on our international revenues and operations. In particular, in some countries we may experience reduced intellectual property protection. Moreover, local laws and customs in many countries differ significantly from those in the United States. In many foreign countries, particularly in those with developing economies, it is common for others to engage in business practices that are prohibited by our internal policies and procedures or United States regulations applicable to us. Although we implement policies and procedures designed to ensure compliance with these laws and policies, there can be no assurance that all of our employees, contractors and agents will not take actions in violations of them. Violations of laws or key control policies by our employees, contractors or agents could result in financial reporting problems, fines, penalties, or prohibition on the importation or exportation of our products and could have a material adverse effect on our business.

While we believe that we currently have adequate internal control over financial reporting, we are exposed to risks from legislation requiring companies to evaluate those internal controls.

Section 404 of the Sarbanes-Oxley Act of 2002 requires our management to report on, and our independent auditors to attest to, the effectiveness of our internal control over financial reporting. We have an ongoing program to perform the system and process evaluation and testing necessary to comply with these requirements. We have and will

continue to incur significant expenses and devote management resources to Section 404 compliance on an ongoing basis. In the event that our chief executive officer, chief financial officer or independent registered public accounting firm determine in the future that our internal controls over financial

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reporting are not effective as defined under Section 404, investor perceptions may be adversely affected and could cause a decline in the market price of our stock.

Governmental regulations affecting the import or export of products could negatively affect our revenues.

The United States and various foreign governments have imposed controls, export license requirements and restrictions on the import or export of some technologies, especially encryption technology. In addition, from time to time, governmental agencies have proposed additional regulation of encryption technology, such as requiring the escrow and governmental recovery of private encryption keys. Governmental regulation of encryption technology and regulation of imports or exports, or our failure to obtain required import or export approval for our products, could harm our international and domestic sales and adversely affect our revenues.

Regulation of the telecommunications industry could harm our operating results and future prospects.

The telecommunications industry is highly regulated and our business and financial condition could be adversely affected by the changes in the regulations relating to the telecommunications industry. Currently, there are few laws or regulations that apply directly to access to or commerce on IP networks. We could be adversely affected by regulation of IP networks and commerce in any country where we operate. Such regulations could address matters such as voice over the Internet or using Internet Protocol, encryption technology, and access charges for service providers. In addition, regulations have been adopted with respect to environmental matters, such as the Waste Electrical and Electronic Equipment (WEEE) and Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS) regulations adopted by the European Union, as well as regulations prohibiting government entities from purchasing security products that do not meet specified local certification criteria. Compliance with such regulations may be costly and time-consuming for us and our suppliers and partners. The adoption and implementation of such regulations could decrease demand for our products, and at the same time could increase the cost of building and selling our products as well as impact our ability to ship products into affected areas and recognize revenue in a timely manner, which could have a material adverse effect on our business, operating results and financial condition.

Changes in effective tax rates or adverse outcomes resulting from examination of our income or other tax returns could adversely affect our results.

Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated earnings in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws or interpretations thereof. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse effect on our operating results and financial condition.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Description of Document
3.1	Juniper Networks, Inc. Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 27, 2001)
3.2	Amended and Restated Bylaws of Juniper Networks, Inc. (incorporated by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-Q filed with the Securities and Exchange Commission on November 14, 2003)
31.1	

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Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934

32.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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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.

Juniper Networks, Inc.

March 9, 2007

By: /s/ Robert R. B. Dykes
Robert R. B. Dykes
Chief Financial Officer (Duly
Authorized Officer and Principal
Financial and Accounting Officer)

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