MORGAN STANLEY
Form 424B2
April 16, 2019

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities Offered	*Maximum Aggregate Offering Price*	*Amount of Registration Fee*
Dual Directional Trigger Participation Securities due 2020	$2,263,150	$274.29

April 2019

Pricing Supplement No. 1,804

Registration Statement Nos. 333-221595; 333-221595-01

Dated April 12, 2019

Filed pursuant to Rule 424(b)(2)

Morgan Stanley Finance LLC

Structured Investments

Opportunities in U.S. Equities

Dual Directional Trigger Participation Securities Based on the Performance of the S&P 500® Index due June 3, 2020

Fully and Unconditionally Guaranteed by Morgan Stanley

Principal at Risk Securities

The Dual Directional Trigger Participation Securities (the "securities") are unsecured obligations of Morgan Stanley Finance LLC ("MSFL") and are fully and unconditionally guaranteed by Morgan Stanley. The securities will pay no interest, do not guarantee any return of principal at maturity and have the terms described in the accompanying product supplement for Participation Securities, index supplement and prospectus, as supplemented or modified by this document. At maturity, if the S&P 500® Index, which we refer to as the underlying index, has **appreciated** in value, investors will receive the stated principal amount of their investment plus unleveraged upside performance of the underlying index, subject to the maximum upside payment at maturity. If the underlying index has **depreciated** in value but by no more than 10%, investors will receive the stated principal amount of their investment plus an unleveraged positive return equal to the absolute value of the percentage decline, which will effectively be limited to a positive 10% return. However, if the underlying index has **depreciated** in value by more than 10%, investors will be negatively exposed to the full amount of the percentage decline in the underlying index and will lose 1% of the stated principal amount for every 1% of decline, without any buffer. The securities are for investors who seek an equity index-based return and who are willing to risk their principal and forgo current income and upside above the maximum upside payment at maturity in exchange for the absolute return feature that applies to a limited range of performance of the underlying index. **Investors may lose their entire initial investment in the securities.** The securities are notes issued as part of MSFL's Series A Global Medium-Term Notes program.

The securities differ from the Participation Securities described in the accompanying product supplement for Participation Securities in that the securities offer the potential for a positive return at maturity if the underlying index depreciates by up to 10%. The securities are not the Buffered Participation Securities described in the accompanying product supplement for Participation Securities. Unlike the Buffered Participation Securities, the securities do not provide any protection if the underlying index depreciates by more than 10%.

All payments are subject to our credit risk. If we default on our obligations, you could lose some or all of your investment. These securities are not secured obligations and you will not have any security interest in, or otherwise have any access to, any underlying reference asset or assets.

FINAL TERMS

Issuer:	Morgan Stanley Finance LLC
Guarantor:	Morgan Stanley
Maturity date:	June 3, 2020
Valuation date:	May 29, 2020, subject to postponement for non-index business days and certain market disruption events
Underlying index:	S&P 500® Index
Aggregate principal amount:	$2,263,150
Payment at maturity:	If the final index value is *greater than* the initial index value: $10 + ($10 x index percent change), subject to the maximum upside payment at maturity If the final index value is *less than or equal to* the initial index value but is *greater than or equal to* the trigger level: $10 + ($10 x absolute index return) *In this scenario, you will receive a 1% positive return on the securities for each 1% negative return on the underlying index. In no event will this amount exceed the stated principal amount plus $1.00.* If the final index value is *less than* the trigger level: $10 × index performance factor *Under these circumstances, the payment at maturity will be less than the stated principal amount of $10, and will represent a loss of more than 10%, and possibly all, of your investment.*
Maximum upside payment at maturity:	$11.025 per security (110.25% of the stated principal amount)
Index percent change:	(final index value – initial index value) / initial index value
Absolute index return:	The absolute value of the index percent change. For example, a –5% index percent change will result in a +5% absolute index return.
Index performance factor:	final index value / initial index value
Initial index value:	2,907.41, which is the index closing value on the pricing date
Final index value:	The index closing value on the valuation date
Trigger level:	2,616.669, which is 90% of the initial index value
Stated principal amount / Issue price:	$10 per security (see “Commissions and issue price” below)
Pricing date:	April 12, 2019

Original issue date:	April 17, 2019 (3 business days after the pricing date)
CUSIP / ISIN:	61768X762 / US61768X7628
Listing:	The securities will not be listed on any securities exchange.
Agent:	Morgan Stanley & Co. LLC ("MS & Co."), a wholly owned subsidiary of Morgan Stanley and an affiliate of MSFL. See "Supplemental information regarding plan of distribution; conflicts of interest."
Estimated value on the pricing date:	$9.746 per security. See "Investment Summary" on page 2.

Commissions and issue price:	**Price to public**	**Agent's commissions and fees**	**Proceeds to us[3]**
Per security	$10	$0.175[1]	
		$0.05[2]	$9.775
Total	$2,263,150	$50,920.88	$2,212,229.12

(1) Selected dealers, including Morgan Stanley Wealth Management (an affiliate of the agent), and their financial advisors will collectively receive from the agent, MS & Co., a fixed sales commission of $0.175 for each security they sell. See "Supplemental information regarding plan of distribution; conflicts of interest." For additional information, see "Plan of Distribution (Conflicts of Interest)" in the accompanying product supplement for Participation Securities.

(2) Reflects a structuring fee payable to Morgan Stanley Wealth Management by the agent or its affiliates of $0.05 for each security.

(3) See "Use of proceeds and hedging" on page 14.

The securities involve risks not associated with an investment in ordinary debt securities. See "Risk Factors" beginning on page 6.

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities, or determined if this document or the accompanying product supplement, index supplement and prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The securities are not deposits or savings accounts and are not insured by the Federal Deposit Insurance Corporation or any other governmental agency or instrumentality, nor are they obligations of, or guaranteed by, a bank.

You should read this document together with the related product supplement, index supplement and prospectus, each of which can be accessed via the hyperlinks below. Please also see "Additional Terms of the Securities" and "Additional Information About the Securities" at the end of this document.

References to "we," "us" and "our" refer to Morgan Stanley or MSFL, or Morgan Stanley and MSFL collectively, as the context requires.

Product Supplement for Participation Securities dated November 16, 2017 **Index Supplement dated November 16, 2017**

Prospectus dated November 16, 2017

Morgan Stanley Finance LLC

Dual Directional Trigger Participation Securities Based on the Performance of the S&P 500® Index due June 3, 2020

Principal at Risk Securities

Investment Summary

Dual Directional Trigger Participation Securities

Principal at Risk Securities

The Dual Directional Trigger Participation Securities Based on the Performance of the S&P 500® Index due June 3, 2020 (the "securities") can be used:

§ To achieve similar levels of upside exposure to the underlying index as a direct investment, subject to the maximum upside payment at maturity

§ To obtain an unleveraged positive return for a limited range of negative performance of the underlying index

§ To provide limited protection against a loss of principal in the event of a decline of the underlying index as of the valuation date but only if the final index value **is greater than or equal to** the trigger level

Maturity:	Approximately 13 months
Maximum upside payment at maturity:	$11.025 per security (110.25% of the stated principal amount)
Minimum payment at maturity:	None. Investors may lose their entire initial investment in the securities.
Trigger level:	90% of the initial index value
Coupon:	None
Listing:	The securities will not be listed on any securities exchange

The original issue price of each security is $10. This price includes costs associated with issuing, selling, structuring and hedging the securities, which are borne by you, and, consequently, the estimated value of the securities on the pricing date is less than $10. We estimate that the value of each security on the pricing date is $9.746.

What goes into the estimated value on the pricing date?

In valuing the securities on the pricing date, we take into account that the securities comprise both a debt component and a performance-based component linked to the underlying index. The estimated value of the securities is determined using our own pricing and valuation models, market inputs and assumptions relating to the underlying index, instruments based on the underlying index, volatility and other factors including current and expected interest rates, as well as an interest rate related to our secondary market credit spread, which is the implied interest rate at which our conventional fixed rate debt trades in the secondary market.

What determines the economic terms of the securities?

In determining the economic terms of the securities, including the trigger level and the maximum upside payment at maturity, we use an internal funding rate, which is likely to be lower than our secondary market credit spreads and therefore advantageous to us. If the issuing, selling, structuring and hedging costs borne by you were lower or if the internal funding rate were higher, one or more of the economic terms of the securities would be more favorable to you.

What is the relationship between the estimated value on the pricing date and the secondary market price of the securities?

The price at which MS & Co. purchases the securities in the secondary market, absent changes in market conditions, including those related to the underlying index, may vary from, and be lower than, the estimated value on the pricing date, because the secondary market price takes into account our secondary market credit spread as well as the bid-offer spread that MS & Co. would charge in a secondary market transaction of this type and other factors. However, because the costs associated with issuing, selling, structuring and hedging the securities are not fully deducted upon issuance, for a period of up to 6 months following the issue date, to the extent that MS & Co. may buy or sell the securities in the secondary market, absent changes in market conditions, including those related to the underlying index, and to our secondary market credit spreads, it would do so based on values higher than the estimated value. We expect that those higher values will also be reflected in your brokerage account statements.

MS & Co. may, but is not obligated to, make a market in the securities, and, if it once chooses to make a market, may cease doing so at any time.

Morgan Stanley Finance LLC

Dual Directional Trigger Participation Securities Based on the Performance of the S&P 500® Index due June 3, 2020

Principal at Risk Securities

Key Investment Rationale

The securities offer the potential for a positive return at maturity based on the absolute value of a limited range of percentage changes of the underlying index. At maturity, if the underlying index has **appreciated** in value, investors will receive the stated principal amount of their investment plus unleveraged upside performance of the underlying index, subject to the maximum upside payment at maturity. If the underlying index has **depreciated** in value but by no more than 10%, investors will receive the stated principal amount of their investment plus an unleveraged positive return equal to the absolute value of the percentage decline, which will effectively be limited to a positive 10% return. However, if the underlying index has **depreciated** in value by more than 10%, investors will be negatively exposed to the full amount of the percentage decline in the underlying index and will lose 1% of the stated principal amount for every 1% of decline, without any buffer. **Investors may lose their entire initial investment in the securities.** All payments on the securities are subject to our credit risk.

Absolute Return Feature	The securities enable investors to obtain an unleveraged positive return if the final index value is less than the initial index value **but** is greater than or equal to the trigger level.
Upside Scenario if the Underlying Index Appreciates	The final index value is greater than the initial index value, and, at maturity, you receive a full return of principal as well as 100% of the increase in the value of the underlying index, subject to the maximum upside payment at maturity. For example, if the final index value is 5% greater than the initial index value, the securities will provide a total return of 5% at maturity. If the final index value is 40% greater than the initial index value, the securities will provide a total return of only 10.25% at maturity, due to the maximum upside payment at maturity.
Absolute Return Scenario	The final index value is less than or equal to the initial index value but is greater than or equal to the trigger level, which is 90% of the initial index value. In this case, you receive a 1% positive return on the securities for each 1% negative return on the underlying index. For example, if the final index value is 8% less than the initial index value, the securities will provide a total positive return of 8% at maturity. The maximum return you may receive in this scenario is a positive 10% return at maturity.
Downside Scenario	The final index value is less than the trigger level. In this case, the securities redeem for at least 10% less than the stated principal amount, and this decrease will be by an amount proportionate to the full decline in the value of the underlying index over the term of the securities. Under these circumstances, the payment at maturity will be less than 90% of the stated principal amount per security. For example, if the final index value is 70% less than the initial index value, the securities will be redeemed at maturity for a loss of 70% of principal at $3.00, or 30% of the stated principal amount. **There is no minimum payment at maturity on the securities, and you could lose your entire investment.**

Morgan Stanley Finance LLC

Dual Directional Trigger Participation Securities Based on the Performance of the S&P 500® Index due June 3, 2020

Principal at Risk Securities

How the Securities Work

Payoff Diagram

The payoff diagram below illustrates the payment at maturity on the securities based on the following terms:

Stated principal amount:	$10 per security
Maximum upside payment at maturity:	$11.025 per security (110.25% of the stated principal amount)
Trigger level:	90% of the initial index value
Minimum payment at maturity:	None

Dual Directional Trigger Participation Securities Payoff Diagram

See the next page for a description of how the securities work.

Morgan Stanley Finance LLC

Dual Directional Trigger Participation Securities Based on the Performance of the S&P 500® Index due June 3, 2020

Principal at Risk Securities

How it works

§ **Upside Scenario if the Underlying Index Appreciates.** If the final index value is greater than the initial index value, the investor would receive the $10 stated principal amount plus 100% of the appreciation of the underlying index over the term of the securities, subject to the maximum upside payment at maturity. Under the terms of the securities, an investor will realize the maximum upside payment at maturity of $11.025 per security (110.25% of the stated principal amount) at a final index value of 110.25% of the initial index value.

§ If the underlying index appreciates 5%, investors will receive a 5% return, or $10.50 per security.

§ If the underlying index appreciates 70%, the investor would receive only the maximum upside payment at maturity of $11.025 per security, or 110.25% of the stated principal amount.

§ **Absolute Return Scenario.** If the final index value is less than or equal to the initial index value and is greater than or equal to the trigger level of 90% of the initial index value, the investor would receive a 1% positive return on the securities for each 1% negative return on the underlying index.

§ If the underlying index depreciates 8%, the investor would receive an 8% return, or $10.80 per security.

§ The maximum return you may receive in this scenario is a positive 10% return at maturity.

§ **Downside Scenario.** If the final index value is less than the trigger level of 90% of the initial index value, the investor would receive an amount less than the $10 stated principal amount, based on a 1% loss of principal for each 1% decline in the underlying index. Under these circumstances, the payment at maturity will be less than 90% of the stated principal amount per security. There is no minimum payment at maturity on the securities.

§ If the underlying index depreciates 70%, the investor would lose 70% of the investor’s principal and receive only $3.00 per security at maturity, or 30% of the stated principal amount.

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Dual Directional Trigger Participation Securities Based on the Performance of the S&P 500® Index due June 3, 2020

Principal at Risk Securities

Risk Factors

The following is a non-exhaustive list of certain key risk factors for investors in the securities. For further discussion of these and other risks, you should read the section entitled "Risk Factors" in the accompanying product supplement for Participation Securities, index supplement and prospectus. We also urge you to consult your investment, legal, tax, accounting and other advisers in connection with your investment in the securities.

§ **The securities do not pay interest or guarantee return of any principal.** The terms of the securities differ from those of ordinary debt securities in that the securities do not pay interest or guarantee the payment of any principal amount at maturity. If the final index value is less than the trigger level (which is 90% of the initial index value), the absolute return feature will no longer be available and the payout at maturity will be an amount in cash that is at least 10% less than the $10 stated principal amount of each security, and this decrease will be by an amount proportionate to the full amount of the decline in the value of the underlying index over the term of the securities, without any buffer. There is no minimum payment at maturity on the securities, and, accordingly, you could lose your entire initial investment in the securities.

§ **The appreciation potential of the securities is limited by the maximum upside payment at maturity.** The appreciation potential of the securities is limited by the maximum upside payment at maturity of $11.025 per security, or 110.25% of the stated principal amount. Because, if the underlying index appreciates, the payment at maturity will be limited to 110.25% of the stated principal amount for the securities, any increase in the final index value over the initial index value by more than 10.25% of the initial index value will not further increase the return on the securities. The maximum positive return you can receive if the underlying index depreciates is also limited by the trigger level.

§ **The market price of the securities will be influenced by many unpredictable factors.** Several factors, many of which are beyond our control, will influence the value of the securities in the secondary market and the price at which MS & Co. may be willing to purchase or sell the securities in the secondary market, including the value (including whether the value is below the trigger level), volatility (frequency and magnitude of changes in value) and dividend yield of the underlying index, interest and yield rates in the market, time remaining until the securities mature, geopolitical conditions and economic, financial, political, regulatory or judicial events that affect the underlying index or equities markets generally and which may affect the final index value of the underlying index, and any actual or anticipated changes in our credit ratings or credit spreads. The level of the underlying index may be, and has recently been, volatile, and we can give you no assurance that the volatility will lessen. See "S&P 500® Index Overview" below. You may receive less, and possibly significantly less, than the stated principal amount per security if you try to sell your securities prior to maturity.

§ **The securities are subject to our credit risk, and any actual or anticipated changes to our credit ratings or credit spreads may adversely affect the market value of the securities.** You are dependent on our ability to pay all amounts due on the securities at maturity and therefore you are subject to our credit risk. If we default on its obligations under the securities, your investment would be at risk and you could lose some or all of your investment. As a result, the market value of the securities prior to maturity will be affected by changes in the market's view of our creditworthiness. Any actual or anticipated decline in our credit ratings or increase in the credit spreads charged by the market for taking our credit risk is likely to adversely affect the market value of the securities.

§ **As a finance subsidiary, MSFL has no independent operations and will have no independent assets.** As a finance subsidiary, MSFL has no independent operations beyond the issuance and administration of its securities and will have no independent assets available for distributions to holders of MSFL securities if they make claims in respect of such securities in a bankruptcy, resolution or similar proceeding. Accordingly, any recoveries by such holders will be limited to those available under the related guarantee by Morgan Stanley and that guarantee will rank *pari passu* with all other unsecured, unsubordinated obligations of Morgan Stanley. Holders will have recourse only to a single claim against Morgan Stanley and its assets under the guarantee. Holders of securities issued by MSFL should accordingly assume that in any such proceedings they would not have any priority over and should be treated *pari passu* with the claims of other unsecured, unsubordinated creditors of Morgan Stanley, including holders of Morgan Stanley-issued securities.

Morgan Stanley Finance LLC

Dual Directional Trigger Participation Securities Based on the Performance of the S&P 500® Index due June 3, 2020

Principal at Risk Securities

§ **The amount payable on the securities is not linked to the value of the underlying index at any time other than the valuation date.** The final index value will be based on the index closing value on the valuation date, subject to postponement for non-index business days and certain market disruption events. Even if the value of the underlying index appreciates prior to the valuation date but then drops by the valuation date, the payment at maturity may be less, and may be significantly less, than it would have been had the payment at maturity been linked to the value of the underlying index prior to such drop. Although the actual value of the underlying index on the stated maturity date or at other times during the term of the securities may be higher than the final index value, the payment at maturity will be based solely on the index closing value on the valuation date.

§ **Investing in the securities is not equivalent to investing in the underlying index.** Investing in the securities is not equivalent to investing in the underlying index or its component stocks. Investors in the securities will not have voting rights or rights to receive dividends or other distributions or any other rights with respect to the stocks that constitute the underlying index.

§ **Adjustments to the underlying index could adversely affect the value of the securities.** The underlying index publisher may add, delete or substitute the stocks constituting the underlying index or make other methodological changes that could change the value of the underlying index. The underlying index publisher may discontinue or suspend calculation or publication of the underlying index at any time. In these circumstances, the calculation agent will have the sole discretion to substitute a successor index that is comparable to the discontinued underlying index and will be permitted to consider indices that are calculated and published by the calculation agent or any of its affiliates.

§ **The rate we are willing to pay for securities of this type, maturity and issuance size is likely to be lower than the rate implied by our secondary market credit spreads and advantageous to us. Both the lower rate and the inclusion of costs associated with issuing, selling, structuring and hedging the securities in the original issue price reduce the economic terms of the securities, cause the estimated value of the securities to be less than the original issue price and will adversely affect secondary market prices.** Assuming no change in market conditions or any other relevant factors, the prices, if any, at which dealers, including MS & Co., may be willing to purchase the securities in secondary market transactions will likely be significantly lower than the original issue price, because secondary market prices will exclude the issuing, selling, structuring and hedging-related costs that are included in the original issue price and borne by you and because the secondary market prices will reflect our secondary market credit spreads and the bid-offer spread that any dealer would charge in a secondary market transaction of this type as well as other factors.

The inclusion of the costs of issuing, selling, structuring and hedging the securities in the original issue price and the lower rate we are willing to pay as issuer make the economic terms of the securities less favorable to you than they otherwise would be.

However, because the costs associated with issuing, selling, structuring and hedging the securities are not fully deducted upon issuance, for a period of up to 6 months following the issue date, to the extent that MS & Co. may buy or sell the securities in the secondary market, absent changes in market conditions, including those related to the underlying index, and to our secondary market credit spreads, it would do so based on values higher than the estimated value, and we expect that those higher values will also be reflected in your brokerage account statements.

§ **The estimated value of the securities is determined by reference to our pricing and valuation models, which may differ from those of other dealers and is not a maximum or minimum secondary market price.** These pricing and valuation models are proprietary and rely in part on subjective views of certain market inputs and certain assumptions about future events, which may prove to be incorrect. As a result, because there is no market-standard way to value these types of securities, our models may yield a higher estimated value of the securities than those generated by others, including other dealers in the market, if they attempted to value the securities. In addition, the estimated value on the pricing date does not represent a minimum or maximum price at which dealers, including MS & Co., would be willing to purchase your securities in the secondary market (if any exists) at any time. The value of your securities at any time after the date of this document will vary based on many factors that cannot be predicted with accuracy, including our creditworthiness and changes in market conditions. See also “The market price of the securities will be influenced by many unpredictable factors” above.

§ **The securities will not be listed on any securities exchange and secondary trading may be limited.** The securities will not be listed on any securities exchange. Therefore, there may be little or no secondary market for the securities. MS & Co. may, but is not obligated to, make a market in the securities and, if it once chooses to make a market, may cease doing so at any time. When it does make a market, it will generally do so for transactions of routine secondary market size at prices based on its estimate of the current value of the securities, taking into account its bid/offer spread, our credit spreads, market volatility, the notional size of the proposed sale, the cost of unwinding any related hedging positions, the time remaining to maturity and the likelihood that it will be able to resell the securities. Even if there is a secondary market, it may not provide enough liquidity to allow you to trade or sell the securities easily. Since other broker-dealers may not participate significantly in the secondary market for the securities, the price at which you may be able to trade your securities is likely to depend on the price, if any, at which MS & Co. is willing to transact. If, at any time, MS & Co. were to cease making a market in the securities, it is likely that there would be no secondary market for the securities. Accordingly, you should be willing to hold your securities to maturity.

§ **The calculation agent, which is a subsidiary of Morgan Stanley and an affiliate of MSFL, will make determinations with respect to the securities.** As calculation agent, MS & Co. has determined the initial index value and the trigger level, will determine the final index value, including whether the value of the underlying index has decreased to below the trigger level, and will calculate the amount of cash you receive at maturity, if any. Moreover, certain determinations made by MS & Co., in its capacity as calculation agent, may require it to exercise discretion and make subjective judgments, such as with respect to the occurrence or non-occurrence of market disruption events and the selection of a successor index or calculation of the final index value in the event of a market disruption event or discontinuance of the underlying index. These potentially subjective determinations may adversely affect the payout to you at maturity, if any. For further information regarding these types of determinations, see “Description of Participation Securities—Postponement of Valuation Date(s),” “—Alternate Exchange Calculation in case of an Event of Default” and “—Calculation Agent and Calculations” in the accompanying product supplement. In addition, MS & Co. has determined the estimated value of the securities on the pricing date.

§ **Hedging and trading activity by our affiliates could potentially adversely affect the value of the securities.** One or more of our affiliates and/or third-party dealers have carried out, and will continue to carry out, hedging activities related to the securities (and to other instruments linked to the underlying index or its component stocks), including trading in the stocks that constitute the underlying index as well as in other instruments related to the underlying index. As a result, these entities may be unwinding or adjusting hedge positions during the term of the securities, and the hedging strategy may involve greater and more frequent dynamic adjustments to the hedge as the valuation date approaches. Some of our affiliates also trade the stocks that constitute the underlying index and other financial instruments related to the underlying index on a regular basis as part of their general broker-dealer and other businesses. Any of these hedging or trading activities on or prior to the pricing date could have increased the initial index value, and, therefore, could have increased the trigger level, which is the value at or above which the underlying index must close on the valuation date so that investors do not suffer a significant loss on their initial investment in the securities. Additionally, such hedging or trading activities during the term of the securities, including on the valuation date, could adversely affect the value of the underlying index on the valuation date, and, accordingly, the amount of cash an investor will receive at maturity, if any.

§ **The U.S. federal income tax consequences of an investment in the securities are uncertain.** Please read the discussion under “Additional Information—Tax considerations” in this document and the discussion under "United States Federal Taxation" in the accompanying product supplement for participation securities (together, the "Tax Disclosure Sections") concerning the U.S. federal income tax consequences of an investment in the securities. If the Internal Revenue Service (the "IRS") were successful in asserting an alternative treatment, the timing and character of income on the securities might differ significantly from the tax treatment described in the Tax Disclosure Sections. For example, under one possible treatment, the IRS could seek to recharacterize the securities as debt instruments. In that event, U.S. Holders would be required to accrue into income original issue discount on the securities every year at a "comparable yield" determined at the time of issuance and recognize all income and gain in respect of the securities as ordinary income. Additionally, as discussed under "United States Federal Taxation—FATCA" in the accompanying product supplement for participation securities, the withholding rules commonly referred to as "FATCA" would apply to the securities if they were recharacterized as debt instruments. However, recently proposed regulations (the preamble to which specifies that taxpayers are permitted to rely on them pending finalization) eliminate the withholding requirement on payments of gross proceeds of a taxable disposition. The risk that financial instruments providing for buffers, triggers or similar downside protection features, such as the securities, would be recharacterized as debt is greater than the risk of recharacterization for comparable financial instruments that do not have such features. We do not plan to request a ruling from the IRS regarding the tax treatment of the securities, and the IRS or a court may not agree with the tax treatment described in the Tax Disclosure Sections.

In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. The notice focuses in particular on whether to require holders of these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; the degree, if any, to which income (including any mandated accruals) realized by non-U.S. investors should be subject to withholding tax; and whether these instruments are or should be subject to the "constructive ownership" rule, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose an interest charge. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the securities, possibly with retroactive effect. Both U.S. and Non-U.S. Holders should consult their tax advisers regarding the U.S. federal income tax consequences of an investment in the securities, including possible alternative treatments, the issues presented by this notice and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

Morgan Stanley Finance LLC

Dual Directional Trigger Participation Securities Based on the Performance of the S&P 500® Index due June 3, 2020

Principal at Risk Securities

S&P 500® Index Overview

The S&P 500® Index, which is calculated, maintained and published by S&P Dow Jones Indices LLC ("S&P"), consists of stocks of 500 component companies selected to provide a performance benchmark for the U.S. equity markets. The calculation of the S&P 500® Index is based on the relative value of the float adjusted aggregate market capitalization of the 500 component companies as of a particular time as compared to the aggregate average market capitalization of 500 similar companies during the base period of the years 1941 through 1943. For additional information about the S&P 500® Index, see the information set forth under "S&P 500® Index" in the accompanying index supplement.

Information as of market close on April 12, 2019:

Bloomberg Ticker Symbol:	SPX
Current Index Value:	2,907.41
52 Weeks Ago:	2,663.99
52 Week High (on 9/20/2018):	2,930.75
52 Week Low (on 12/24/2018):	2,351.10

The following graph sets forth the daily index closing values of the underlying index for each quarter in the period from January 1, 2014 through April 12, 2019. The related table sets forth the published high and low closing values, as well as end-of-quarter closing values, of the underlying index for each quarter in the same period. The index closing value of the underlying index on April 12, 2019 was 2,907.41. We obtained the information in the table and graph below from Bloomberg Financial Markets, without independent verification. The underlying index has at times experienced periods of high volatility. You should not take the historical values of the underlying index as an indication of its future performance, and no assurance can be given as to the index closing value of the underlying index on the valuation date.

S&P 500® Index

Daily Index Closing Values

January 1, 2014 to April 12, 2019

Morgan Stanley Finance LLC

Dual Directional Trigger Participation Securities Based on the Performance of the S&P 500® Index due June 3, 2020

Principal at Risk Securities

S&P 500® Index	**High**	**Low**	**Period End**
2014			
First Quarter	1,878.04	1,741.89	1,872.34
Second Quarter	1,962.87	1,815.69	1,960.23
Third Quarter	2,011.36	1,909.57	1,972.29
Fourth Quarter	2,090.57	1,862.49	2,058.90
2015			
First Quarter	2,117.39	1,992.67	2,067.89
Second Quarter	2,130.82	2,057.64	2,063.11
Third Quarter	2,128.28	1,867.61	1,920.03
Fourth Quarter	2,109.79	1,923.82	2,043.94
2016			
First Quarter	2,063.95	1,829.08	2,059.74
Second Quarter	2,119.12	2,000.54	2,098.86
Third Quarter	2,190.15	2,088.55	2,168.27
Fourth Quarter	2,271.72	2,085.18	2,238.83
2017			
First Quarter	2,395.96	2,257.83	2,362.72
Second Quarter	2,453.46	2,328.95	2,423.41
Third Quarter	2,519.36	2,409.75	2,519.36
Fourth Quarter	2,690.16	2,529.12	2,673.61
2018			
First Quarter	2,872.87	2,581.00	2,640.87
Second Quarter	2,786.85	2,581.88	2,718.37
Third Quarter	2,930.75	2,713.22	2,913.98
Fourth Quarter	2,925.51	2,351.10	2,506.85
2019			
First Quarter	2,854.88	2,447.89	2,834.4
Second Quarter (through April 12, 2019)	2,907.41	2,867.19	2,907.41

"Standard & Poor's®," "S&P®," "S&P 500®," "Standard & Poor's 500" and "500" are trademarks of Standard and Poor's Financial Services LLC. See "S&P 500® Index" in the accompanying index supplement.

Morgan Stanley Finance LLC

Dual Directional Trigger Participation Securities Based on the Performance of the S&P 500® Index due June 3, 2020

Principal at Risk Securities

Additional Terms of the Securities

Please read this information in conjunction with the summary terms on the front cover of this document.

Additional Terms:

If the terms described herein are inconsistent with those described in the accompanying product supplement, index supplement or prospectus, the terms described herein shall control.

Underlying index publisher:	S&P Dow Jones Indices LLC or any successor thereof
Postponement of maturity date:	If, due to a market disruption event or otherwise, the valuation date is postponed so that it falls less than two business days prior to the scheduled maturity date, the maturity date will be postponed to the second business day following the valuation date as postponed.
Denominations:	$10 per security and integral multiples thereof
Trustee:	The Bank of New York Mellon
Calculation agent:	MS & Co.
Issuer notice to registered security holders, the trustee and the depositary:	In the event that the maturity date is postponed due to postponement of the valuation date, the issuer shall give notice of such postponement and, once it has been determined, of the date to which the maturity date has been rescheduled (i) to each registered holder of the securities by mailing notice of such postponement by first class mail, postage prepaid, to such registered holder's last address as it shall appear upon the registry books, (ii) to the trustee by facsimile confirmed by mailing such notice to the trustee by first class mail, postage prepaid, at its New York office and (iii) to The Depository Trust Company (the "depositary") by telephone or facsimile, confirmed by mailing such notice to the depositary by first class mail, postage prepaid. Any notice that is mailed to a registered holder of the securities in the manner herein provided shall be conclusively presumed to have been duly given to such registered holder, whether or not such registered holder receives the notice. The issuer shall give such notice as promptly as possible, and in no case later than (i) with respect to notice of postponement of the maturity date, the business day immediately preceding the scheduled maturity date and (ii) with respect to notice of the date to which the maturity date has been rescheduled, the business day immediately following the actual valuation date. The issuer shall, or shall cause the calculation agent to, (i) provide written notice to the trustee and to the depositary of the amount of cash, if any, to be delivered with respect to the

securities, on or prior to 10:30 a.m. (New York City time) on the business day preceding the maturity date, and (ii) deliver the aggregate cash amount, if any, due with respect to the securities to the trustee for delivery to the depositary, as holder of the securities, on the maturity date.

Morgan Stanley Finance LLC

Dual Directional Trigger Participation Securities Based on the Performance of the S&P 500® Index due June 3, 2020

Principal at Risk Securities

Additional Information About the Securities

Additional Information:	
Minimum ticketing size:	$1,000 / 100 securities
Tax considerations:	Although there is uncertainty regarding the U.S. federal income tax consequences of an investment in the securities due to the lack of governing authority, in the opinion of our counsel, Davis Polk & Wardwell LLP, under current law, and based on current market conditions, a security should be treated as a single financial contract that is an "open transaction" for U.S. federal income tax purposes. Assuming this treatment of the securities is respected and subject to the discussion in "United States Federal Taxation" in the accompanying product supplement for participation securities, the following U.S. federal income tax consequences should result based on current law: § A U.S. Holder should not be required to recognize taxable income over the term of the securities prior to settlement, other than pursuant to a sale or exchange. § Upon sale, exchange or settlement of the securities, a U.S. Holder should recognize gain or loss equal to the difference between the amount realized and the U.S. Holder's tax basis in the securities. Such gain or loss should be long-term capital gain or loss if the investor has held the securities for more than one year, and short-term capital gain or loss otherwise. In 2007, the U.S. Treasury Department and the Internal Revenue Service (the "IRS") released a notice requesting comments on the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. The notice focuses in particular on whether to require holders of these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; the degree, if any, to which income (including any mandated accruals) realized by non-U.S. investors should be subject to withholding tax; and whether these instruments are or should be subject to the "constructive ownership" rule, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose an interest charge. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the securities, possibly with retroactive effect.

As discussed in the accompanying product supplement for participation securities, Section 871(m) of the Internal Revenue Code of 1986, as amended, and Treasury regulations promulgated thereunder ("Section 871(m)") generally impose a 30% (or a lower applicable treaty rate) withholding tax on dividend equivalents paid or deemed paid to Non-U.S. Holders with respect to certain financial instruments linked to U.S. equities or indices that include U.S. equities (each, an "Underlying Security"). Subject to certain exceptions, Section 871(m) generally applies to securities that substantially replicate the economic performance of one or more Underlying Securities, as determined based on tests set forth in the applicable Treasury regulations (a "Specified Security"). However, pursuant to an IRS notice, Section 871(m) will not apply to securities issued before January 1, 2021 that do not have a delta of one with respect to any Underlying Security. Based on our determination that the securities do not have a delta of one with respect to any Underlying Security, our counsel is of the opinion that the securities should not be Specified Securities and, therefore, should not be subject to Section 871(m).

Our determination is not binding on the IRS, and the IRS may disagree with this determination. Section 871(m) is complex and its application may depend on your particular circumstances, including whether you enter into other transactions with respect to an Underlying Security. If withholding is required, we will not be required to pay any additional amounts with respect to the amounts so withheld. You should consult your tax adviser regarding the potential application of Section 871(m) to the securities.

Both U.S. and non-U.S. investors considering an investment in the securities should read the discussion under "Risk Factors" in this document and the discussion under "United States Federal Taxation" in the accompanying product supplement for participation securities and consult their tax advisers regarding all aspects of the U.S. federal income tax consequences of an investment in the securities, including possible alternative treatments, the issues presented by the aforementioned notice and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

The discussion in the preceding paragraphs under "Tax considerations" and the discussion contained in the section entitled "United States Federal Taxation" in the accompanying product supplement for participation securities, insofar as they purport to describe provisions of U.S. federal income tax laws or legal conclusions with respect thereto, constitute the full opinion of Davis Polk & Wardwell LLP regarding the material U.S. federal tax consequences of an investment in the securities.

Morgan Stanley Finance LLC

Dual Directional Trigger Participation Securities Based on the Performance of the S&P 500® Index due June 3, 2020

Principal at Risk Securities

Use of proceeds and hedging:	The proceeds from the sale of the securities will be used by us for general corporate purposes. We will receive, in aggregate, $10 per security issued, because, when we enter into hedging transactions in order to meet our obligations under the securities, our hedging counterparty will reimburse the cost of the agent's commissions. The costs of the securities borne by you and described on page 2 above comprise the agent's commissions and the cost of issuing, structuring and hedging the securities. On or prior to the pricing date, we hedged our anticipated exposure in connection with the securities by entering into hedging transactions with our affiliates and/or third-party dealers. We expect our hedging counterparties to have taken positions in stocks of the underlying index and in futures and/or options contracts on the underlying index or any component

stocks of the underlying index listed on major securities markets. Such purchase activity could have increased the value of the underlying index on the pricing date, and, therefore, could have increased the trigger level, which is the value at or above which the underlying index must close on the valuation date so that investors do not suffer a significant loss on their initial investment in the securities. In addition, through our affiliates, we are likely to modify our hedge position throughout the term of the securities, including on the valuation date, by purchasing and selling the stocks constituting the underlying index, futures or options contracts on the underlying index or its component stocks listed on major securities markets or positions in any other available securities or instruments that we may wish to use in connection with such hedging activities. As a result, these entities may be unwinding or adjusting hedge positions during the term of the securities, and the hedging strategy may involve greater and more frequent dynamic adjustments to the

	hedge as the valuation date approaches. We cannot give any assurance that our hedging activities will not affect the value of the underlying index, and, therefore, adversely affect the value of the securities or the payment you will receive at maturity, if any. For further information on our use of proceeds and hedging, see "Use of Proceeds and Hedging" in the accompanying product supplement for Participation Securities.
Benefit plan investor considerations:	Each fiduciary of a pension, profit-sharing or other employee benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") (a "Plan"), should consider the fiduciary standards of ERISA in the context of the Plan's particular circumstances before authorizing an investment in the securities. Accordingly, among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification requirements of ERISA and would be consistent with the documents and instruments governing the Plan.

In addition, we and certain of our affiliates, including MS & Co., may each be considered a "party in interest" within the meaning of ERISA, or a "disqualified person" within the meaning of the Internal Revenue Code of 1986, as amended (the "Code"), with respect to many Plans, as well as many individual retirement accounts and Keogh plans (such accounts and plans, together with other plans, accounts and arrangements subject to Section 4975 of the Code, also "Plans"). ERISA Section 406 and Section 4975 of the Code generally prohibit transactions between Plans and parties in interest or disqualified persons. Prohibited transactions within the meaning of ERISA or the Code would likely arise, for example, if the securities are acquired by or with the assets of a Plan with respect to which MS & Co. or any of its affiliates is a service provider or other party in interest, unless the securities are acquired pursuant to an exemption from the "prohibited transaction" rules. A violation of these "prohibited transaction" rules could result in an excise tax or other liabilities under ERISA and/or Section 4975 of the Code for those persons, unless exemptive relief is available under an applicable statutory or administrative exemption.

The U.S. Department of Labor has issued five prohibited transaction class exemptions ("PTCEs") that may provide exemptive relief for direct or indirect prohibited trff;">

Litigation expense	—	1	—	(134)
Total	299,241	288,923	893,350	873,978
Income from operations	151,953	139,144	437,307	415,121
Other income, net	2,259	2,589	7,194	6,534
Income before income taxes	154,212	141,733	444,501	421,655
Provision for income taxes	31,469	44,071	123,693	136,637
Net income	$ 122,743	$ 97,662	$ 320,808	$ 285,018
Net income per share — basic	$ 2.01	$ 1.53	$ 5.21	$ 4.42
Weighted average shares — basic	60,970	63,935	61,531	64,539
Net income per share — diluted	$ 1.99	$ 1.52	$ 5.16	$ 4.38

Weighted average shares — diluted	61,633	64,361	62,214	65,116

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

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F5 NETWORKS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited, in thousands)

	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
Net income	$122,743	$97,662	$320,808	$285,018
Other comprehensive (loss) income:				
Foreign currency translation adjustment	(1,441)	444	(896)	(1,304)
Available-for-sale securities:				
Unrealized gains (losses) on securities, net of taxes of $177 and $(88) for the three months ended June 30, 2018 and 2017, respectively, and $(1,010) and $(389) for the nine months ended June 30, 2018 and 2017, respectively	436	(147)	(3,100)	(649)
Reclassification adjustment for realized losses (gains) included in net income, net of taxes of $0 and $171 for the three months ended June 30, 2018 and 2017, respectively, and $(4) and $186 for the nine months ended June 30, 2018 and 2017, respectively	1	(285)	10	(310)
Net change in unrealized gains (losses) on available-for-sale securities, net of tax	437	(432)	(3,090)	(959)
Total other comprehensive (loss) income	(1,004)	12	(3,986)	(2,263)
Comprehensive income	$121,739	$97,674	$316,822	$282,755

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

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

	Nine months ended June 30, 2018	2017
Operating activities		
Net income	$320,808	$285,018
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized loss (gain) on disposition of assets and investments	64	(463)
Stock-based compensation	121,007	133,740
Provisions for doubtful accounts and sales returns	1,494	385
Depreciation and amortization	44,081	45,603
Deferred income taxes	19,241	(1,307)
Changes in operating assets and liabilities:		
Accounts receivable	(6,945)	(27,295)
Inventories	(1,488)	3,007
Other current assets	11,590	1,063
Other assets	(68)	(425)
Accounts payable and accrued liabilities	(16,423)	14,270
Deferred revenue	63,402	73,620
Net cash provided by operating activities	556,763	527,216
Investing activities		
Purchases of investments	(499,084)	(255,386)
Maturities of investments	295,479	271,878
Sales of investments	10,748	65,857
Decrease (increase) in restricted cash	42	(87)
Cash provided by sale of fixed asset	1,000	—
Acquisition of intangible assets	—	(4,000)
Purchases of property and equipment	(36,074)	(31,175)
Net cash (used in) provided by investing activities	(227,889)	47,087
Financing activities		
Excess tax benefit from stock-based compensation	—	6,471
Proceeds from the exercise of stock options and purchases of stock under employee stock purchase plan	48,818	46,959
Repurchase of common stock	(450,064)	(450,065)
Net cash used in financing activities	(401,246)	(396,635)
Net (decrease) increase in cash and cash equivalents	(72,372)	177,668
Effect of exchange rate changes on cash and cash equivalents	(1,588)	(1,327)
Cash and cash equivalents, beginning of period	673,228	514,571
Cash and cash equivalents, end of period	$599,268	$690,912

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

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F5 NETWORKS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
1. Summary of Significant Accounting Policies
Description of Business
F5 Networks, Inc. (the "Company") is the leading developer and provider of software-defined application services. The Company's core technology is a full-proxy, programmable, highly-scalable software platform called TMOS, which supports a broad array of features and functions designed to ensure that applications delivered over Internet Protocol (IP) networks are secure, fast and available. The Company's TMOS-based offerings include software products for local and global traffic management, network and application security, access management, web acceleration and a number of other network and application services. These products are available as modules that can run individually or as part of an integrated solution on the Company's high-performance, scalable, purpose-built BIG-IP appliances and VIPRION chassis-based hardware, or as software-only Virtual Editions. The Company also offers distributed denial-of-service (DDoS) protection, application security and other application services by subscription on its cloud-based Silverline platform. In connection with its products, the Company offers a broad range of support services including consulting, training, installation and maintenance.
Basis of Presentation
The year-end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. In the opinion of management, the unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for their fair statement in conformity with accounting principles generally accepted in the United States of America. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted in accordance with the rules and regulations of the Securities and Exchange Commission. The information included in this Form 10-Q should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2017.
Certain prior period amounts relating to deferred taxes have been reclassified to conform to the current year presentation in the Consolidated Balance Sheets as a result of the adoption of ASU 2015-17, Balance Sheet Classification of Deferred Taxes. See Note 1 - Recently Adopted Accounting Standards for additional information.
Revenue Recognition
The Company sells products through distributors, resellers, and directly to end users. Revenue is recognized provided that all of the following criteria have been met:

- Persuasive evidence of an arrangement exists. Evidence of an arrangement generally consists of a purchase order issued pursuant to the terms and conditions of a distributor, reseller or end user agreement.
- Delivery has occurred. The Company uses shipping or related documents, or written evidence of customer acceptance, when applicable, to verify delivery or completion of any performance terms.
- The sales price is fixed or determinable. The Company assesses whether the sales price is fixed or determinable based on payment terms associated with the transaction and whether the sales price is subject to refund or adjustment.
- Collectability is reasonably assured. The Company assesses collectability primarily based on the creditworthiness of the customer as determined by credit checks and related analysis, as well as the Customer's payment history.

Revenue from the sale of products is generally recognized when the product has been shipped and the customer is obligated to pay for the product. When rights of return are present and the Company cannot estimate returns, revenue is recognized when such rights of return lapse. Payment terms to domestic customers are generally net 30 days to net 45 days. Payment terms to international customers range from net 30 days to net 120 days based on normal and customary trade practices in the individual markets.
Revenues for post-contract customer support (PCS) are recognized on a straight-line basis over the service contract term. PCS includes a limited period of telephone support, updates, repair or replacement of any failed product or component that fails during the term of the agreement, bug fixes and rights to upgrades, when and if available. Consulting services are customarily billed at fixed hourly rates, plus out-of-pocket expenses, and revenues are recognized as the consulting is completed. Similarly, training revenue is recognized as the training is completed.

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Arrangement consideration is first allocated between software (consisting of nonessential and stand-alone software) and non-software deliverables. The majority of the Company's products are hardware appliances which contain software essential to the overall functionality of the products. Hardware appliances are generally sold with PCS and on occasion, with consulting and/or training services. Arrangement consideration in such multiple element transactions is allocated to each element based on a fair value hierarchy, where the selling price for an element is based on vendor specific objective evidence (VSOE), if available, third-party evidence (TPE), if available and VSOE is not available; or the best estimate of selling price (BESP), if neither VSOE or TPE is available.

For software deliverables, the Company allocates revenue between multiple elements based on software revenue recognition guidance. Software revenue recognition guidance requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair values of those elements. The fair value of an element must be based on VSOE. Where VSOE of the fair value of delivered elements is not available, revenue is recognized on the "residual method" based on the fair value of undelivered elements. If evidence of fair value of one or more undelivered elements does not exist, all revenue is deferred and recognized at the earlier of the delivery of those elements or the establishment of fair value of the remaining undelivered elements.

The Company establishes VSOE for its products, PCS, consulting and training services based on the sales price charged for each element when sold separately. The sales price is discounted from the applicable list price based on various factors including the type of customer, volume of sales, geographic region and program level. The Company's list prices are generally not fair value as discounts may be given based on the factors enumerated above. The Company uses historical sales transactions to determine whether VSOE can be established for each of the elements. In most instances, VSOE of fair value is the sales price of actual standalone (unbundled) transactions within the past 12 month period, when a substantial majority of transactions (more than 80%) are priced within a narrow range, which the Company has determined to be plus or minus 15% of the median sales price.

The Company believes that the VSOE of fair value of training and consulting services is represented by the billable rate per hour, based on the rates charged to customers when they purchase standalone training or consulting services. The price of consulting services is not based on the type of customer, volume of sales, geographic region or program level.

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

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

The Company regularly validates the VSOE of fair value and BESP for elements in its multiple element arrangements.

The Company accounts for taxes collected from customers and remitted to governmental authorities on a net basis and excluded these amounts from revenues.

Goodwill and Acquired Intangible Assets

Goodwill represents the excess purchase price over the estimated fair value of net assets acquired as of the acquisition date. The Company tests goodwill for impairment on an annual basis and between annual tests when impairment indicators are identified, and goodwill is written down when impaired. Goodwill was recorded in connection with various acquisitions in fiscal year 2014 and prior years. For its annual goodwill impairment test in all periods to date, the Company has operated under one reporting unit and the fair value of its reporting unit has been determined by the

Company's enterprise value. The Company performs its annual goodwill impairment test during the second fiscal quarter.

As described in the "Recently Adopted Accounting Standards" section of Note 1, the Company elected to early adopt ASU 2017-04 for its annual goodwill impairment test that was performed during the second quarter of fiscal 2018. ASU 2017-04 simplifies the subsequent measurement of goodwill to eliminate Step 2 from the goodwill impairment test. Instead, under the amendments in this Update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. For its annual impairment test performed in the second quarter of

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fiscal 2018, the Company completed a quantitative assessment and determined that there was no impairment of goodwill. The Company also considered potential impairment indicators of goodwill at June 30, 2018 and noted no indicators of impairment.

As part of the annual goodwill impairment test, the Company has the option to perform a qualitative assessment to determine whether further impairment testing is necessary. Examples of events and circumstances that might indicate that the reporting unit's fair value is less than its carrying amount include macro-economic conditions such as deterioration in the entity's operating environment or industry or market considerations; entity-specific events such as increasing costs, declining financial performance, or loss of key personnel; or other events such as a sustained decrease in the stock price on either an absolute basis or relative to peers. If, as a result of its qualitative assessment, it is more-likely-than-not (i.e. greater than 50% chance) that the fair value of the Company's reporting unit is less than its carrying amount, the quantitative impairment test will be required. Otherwise, no further testing will be required. If the Company chooses to bypass the qualitative assessment, it completes a quantitative assessment in performing its annual impairment test.

The Company's intangible assets subject to amortization are amortized using the straight-line method over their estimated useful lives, ranging from three to ten years. The Company evaluates the recoverability of intangible assets periodically by taking into account events or circumstances that may warrant revised estimates of useful lives or that indicate the asset may be impaired. The Company considered potential impairment indicators of acquired intangible assets at June 30, 2018 and noted no indicators of impairment.

Software Development Costs

The authoritative guidance requires certain internal software development costs related to software to be sold to be capitalized upon the establishment of technological feasibility. The Company's software development costs incurred subsequent to achieving technological feasibility have not been significant, and all software development costs have been expensed as research and development activities as incurred.

Internal Use Software

In accordance with the authoritative guidance, the Company capitalizes application development stage costs associated with the development of internal-use software and software developed related to its SaaS-based product offerings. The capitalized costs are then amortized over the estimated useful life of the software, which is generally three to five years, and are included in property and equipment in the accompanying consolidated balance sheets.

Stock-Based Compensation

The Company accounts for stock-based compensation using the straight-line attribution method for recognizing compensation expense. The Company recognized $38.7 million and $43.2 million of stock-based compensation expense for the three months ended June 30, 2018 and 2017, respectively, and $121.0 million and $133.7 million of stock-based compensation

expense for the nine months ended June 30, 2018 and 2017, respectively. As of June 30, 2018, there was $139.6 million of total unrecognized stock-based compensation cost, the majority of which will be recognized over the next two years. Going forward, stock-based compensation expenses may increase as the Company issues additional equity-based awards to continue to attract and retain key employees.

The Company issues incentive awards to its employees through stock-based compensation consisting of restricted stock units (RSUs). On October 27, 2017, the Company's Board of Directors and Compensation Committee approved 1,086,939 RSUs to employees and executive officers pursuant to the Company's annual equity awards program. The value of RSUs is determined using the fair value method, which in this case, is based on the number of shares granted and the quoted price of the Company's common stock on the date of grant.

The Company recognizes compensation expense for only the portion of restricted stock units that are expected to vest. Therefore, the Company applies estimated forfeiture rates that are derived from historical employee termination behavior. Based on historical differences with forfeitures of stock-based awards granted to the Company's executive officers and Board of Directors versus grants awarded to all other employees, the Company has developed separate forfeiture expectations for these two groups. In determining the fair value of shares issued under the Employee Stock Purchase Plan (ESPP), the Company uses the Black-Scholes option pricing model. Compensation expense related to the shares issued pursuant to the ESPP is recognized on a straight-line basis over the offering period.

The Company issues incentive awards to certain current executive officers as part of its annual equity awards program. Fifty percent of the aggregate number of RSUs issued to executive officers vest in equal quarterly increments, and 50% are subject to the Company achieving specified performance goals.

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For the prior year performance stock grants, attainment is based on the Company achieving specific quarterly revenue and EBITDA targets. In each case, 70% of the quarterly performance stock grant is based on achieving at least 80% of the quarterly revenue goal set by the Company's Board of Directors, and the other 30% is based on achieving at least 80% of the quarterly EBITDA goal set by the Company's Board of Directors. The quarterly performance stock grant is paid linearly over 80% of the targeted goals. At least 100% of both goals must be attained in order for the quarterly performance stock grant to be awarded over 100%. Each goal is evaluated individually and subject to the 80% achievement threshold and the 100% over-achievement threshold. Each goal is also capped at achievement of 200% above target.

For the fiscal 2018 performance stock grants, the Company's Compensation Committee adopted a new set of metrics that are differentiated from the quarterly revenue and EBITDA measures, including (1) 50% of the annual performance stock grant is based on achieving 80% of the annual revenue goal set by the Company's Board of Directors; (2) 25% of the annual performance stock grant is based on achieving at least a 15% increase in annual stand-alone software revenue compared to the prior year; and (3) 25% of the annual performance stock grant is based on relative total shareholder return benchmarked to the S&P 500 index. In each case, no vesting or payment with respect to a performance goal shall occur unless a minimum threshold is met for the applicable goal. Vesting and payment with respect to the performance goal is linear above the threshold of the applicable goal and is capped at achievement of 200% above target.

As of June 30, 2018, the following annual equity grants for executive officers or a portion thereof are outstanding:

Grant Date	RSUs Granted	Vesting Schedule	Vesting Period	Date Fully Vested
November 1, 2017	140,135	Annually	4 years	November 1, 2021
November 1, 2016	115,347	Quarterly	4 years	November 1, 2020
November 2, 2015	145,508	Quarterly	4 years	November 1, 2019
November 1, 2014	171,575	Quarterly	4 years	November 1, 2018

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

Common Stock Repurchase

On October 25, 2017, the Company announced that its Board of Directors authorized an additional $1.0 billion for its common stock share repurchase program. This new authorization is incremental to the existing $3.4 billion program, initially approved in October 2010 and expanded in each fiscal year. Acquisitions for the share repurchase programs will be made from time to time in private transactions or open market purchases as permitted by securities laws and other legal requirements. The programs can be terminated at any time. As of June 30, 2018, the Company repurchased and retired 3,210,478 shares at an average price of $140.19 per share during fiscal year 2018 and the Company had $723.6 million remaining authorized to purchase shares at June 30, 2018.

Earnings Per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income by the weighted average number of common and dilutive common stock equivalent shares outstanding during the period. The Company's nonvested restricted stock awards and restricted stock units do not have nonforfeitable rights to dividends or dividend equivalents and are not considered participating securities that should be included in the computation of earnings per share under the two-class method.

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

	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
Numerator				
Net income	$122,743	$97,662	$320,808	$285,018
Denominator				
Weighted average shares outstanding — basic	60,970	63,935	61,531	64,539
Dilutive effect of common shares from stock options and restricted stock units	663	426	683	577
Weighted average shares outstanding — diluted	61,633	64,361	62,214	65,116
Basic net income per share	$2.01	$1.53	$5.21	$4.42
Diluted net income per share	$1.99	$1.52	$5.16	$4.38

For the three and nine months ended June 30, 2018 and 2017, there were no common shares potentially issuable from stock options excluded from the calculation of diluted earnings per share because the exercise price was greater than the average market price of common stock.

Comprehensive Income

Comprehensive income includes certain changes in equity that are excluded from net income. Specifically, unrealized gains or losses on securities and foreign currency translation adjustments are included in accumulated other comprehensive income or loss.

Recently Adopted Accounting Standards

In July 2015, the FASB issued ASU 2015-11, Simplifying the Measurement of Inventory (ASU 2015-11), which changes the subsequent measurement of inventory from lower of cost or market to lower of cost and net realizable value. The Company adopted ASU 2015-11 during the first quarter of fiscal 2018. The adoption of ASU 2015-11 did not have a material impact on the Company's consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes (ASU 2015-17), which requires that all deferred tax assets and liabilities be classified as noncurrent in a classified balance sheet. The Company adopted ASU 2015-17 during the first quarter of fiscal year 2018 on a retrospective basis, which resulted in reclassification of $53.0 million of deferred tax assets, net of deferred tax liabilities, from current to non-current as of September 30, 2017.

In March 2016, the FASB issued ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (ASU 2016-09), which is intended to simplify several aspects of the accounting for share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows.

The Company adopted ASU 2016-09 during the first quarter of fiscal year 2018. Excess tax benefits and tax deficiencies from share-based compensation are now recorded to the consolidated income statements rather than to additional paid-in capital within equity on a prospective basis. The Company recognized $4.0 million and $5.2 million of tax benefits for the three and nine months ended June 30, 2018, respectively. The Company also elected to prospectively apply the change in presentation requirement wherein excess tax benefits of awards are classified as operating activities in the consolidated statements of cash flows. Prior periods have not been reclassified to conform to the fiscal 2018 presentation.

The Company did not elect an accounting policy change to record forfeitures as they occur and will continue to estimate forfeitures at each period.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other: Simplifying the Test for Goodwill Impairment (ASU 2017-04), which simplifies the goodwill impairment process by eliminating Step 2 from the quantitative goodwill impairment test. Under this update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The new standard is effective for fiscal years, and interim periods

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within those fiscal years, beginning after December 15, 2019. The Company elected to early adopt ASU 2017-04 for its annual goodwill impairment test that was performed during the second quarter of fiscal 2018. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

Recently Issued Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09). ASU 2014-09 and the related amendments outline a new, single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The new model will require revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration a company expects to receive in exchange for those goods or services. The standard can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. In July 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which delays the effective date of ASU 2014-09 by one year. The updated standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017 with early adoption permitted for annual reporting periods beginning after December 15, 2016.

The Company currently plans to adopt ASU 2014-09 in the first quarter of fiscal 2019 on a modified retrospective basis. The Company has initiated an assessment of its systems, data and processes related to the implementation of this accounting standard. Under the new standard, the Company expects to defer and amortize incremental costs to obtain a contract, which are primarily commission costs, over the expected customer life rather than expensing them as incurred under current practice. Additionally, under the new standard, the Company would be required to recognize a portion of term license revenues upfront, at the time of delivery rather than ratably over the related contract period. The Company does not anticipate that the implementation of this updated standard and related amendments will have a material impact on its consolidated income statements. The Company is continuing to evaluate the impact that this updated standard and the related amendments will have on its consolidated balance sheets and footnote disclosures.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) (ASU 2016-02), which requires lessees to recognize on the balance sheet a right-of-use asset, representing its right to use the underlying asset for the lease term, and a corresponding lease liability for all leases with terms greater than twelve months. The Company’s leases consist of operating leases for its office and lab spaces. The guidance also requires qualitative and quantitative disclosures designed to assess the amount, timing and uncertainty of cash flows arising from leases. Adoption of the new lease standard requires measurement of leases at the beginning of the earliest period presented on a modified retrospective basis. The new standard will be effective for the Company beginning October 1, 2019, with early adoption permitted. The Company previously stated that it anticipates early adoption of the new standard in the first quarter of fiscal 2019 in conjunction with the adoption of the new revenue standard. However, after further assessment, the Company has decided to adopt the new standard on its original effective date of October 1, 2019. The Company is currently assessing the impact that this standard will have on its consolidated financial statements and footnote disclosures.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (ASU 2016-13), which replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted. The Company does not anticipate that the adoption of this standard will have a material impact on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (ASU 2016-15), which clarifies how companies present and classify certain cash receipts and cash payments in the statement of cash flows. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. The Company is currently assessing the impact that this updated standard will have on its consolidated financial statements and footnote disclosures.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (ASU 2016-18), which will require a company’s cash flow statement to explain the changes during a reporting period of the totals for cash, cash equivalents, restricted cash, and restricted cash equivalents. Additionally, amounts for restricted cash and restricted cash equivalents are to be included with cash and cash equivalents if the cash flow statement includes a reconciliation of the total cash balances for a reporting period. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. The Company does not anticipate that the adoption of this standard will have a material impact on its consolidated financial statements.

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In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business (ASU 2017-01), which provides a more robust framework to use in determining when a set of assets and activities is considered a business. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted for certain transactions. The Company will evaluate the impact of adopting this standard prospectively, for any transaction involving the acquisition or disposal of assets or businesses.

In March 2017, the FASB issued ASU 2017-08, Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20) - Premium Amortization on Purchased Callable Debt Securities (ASU 2017-08), which shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The Company does not anticipate that the adoption of this standard will have a material impact on its consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation-Stock Compensation (ASU 2017-09), which provides clarification on when modification accounting should be used for changes to the terms or conditions of a share-based payment award. This ASU does not change the accounting for modifications but clarifies that modification accounting guidance should only be applied if there is a change to the value, vesting conditions or award classification and would not be required if the changes are considered non-substantive. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. The Company does not anticipate that the adoption of this standard will have a material impact on its consolidated financial statements.

2. Fair Value Measurements

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

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

The levels of fair value hierarchy are:

Level 1: Quoted prices in active markets for identical assets and liabilities at the measurement date that the Company has the ability to access.

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

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

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

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

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The Company's financial assets measured at fair value on a recurring basis subject to the disclosure requirements at June 30, 2018, were as follows (in thousands):

	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Identical Securities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value at June 30, 2018
Cash equivalents	$22,626	$ 3,644	$ —	$26,270
Short-term investments				
Available-for-sale securities — certificates of deposits	—	1,742	—	1,742
Available-for-sale securities — corporate bonds and notes	—	266,082	—	266,082
Available-for-sale securities — municipal bonds and notes	—	41,044	—	41,044
Available-for-sale securities — U.S. government securities	—	107,319	—	107,319
Available-for-sale securities — U.S. government agency securities	—	69,045	—	69,045
Long-term investments				
Available-for-sale securities — corporate bonds and notes	—	269,842	—	269,842
Available-for-sale securities — municipal bonds and notes	—	21,168	—	21,168
Available-for-sale securities — U.S. government securities	—	18,195	—	18,195
Available-for-sale securities — U.S. government agency securities	—	20,207	—	20,207
Total	$22,626	$ 818,288	$ —	$840,914

The Company's financial assets measured at fair value on a recurring basis subject to the disclosure requirements at September 30, 2017, were as follows (in thousands):

	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Identical Securities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value at September 30, 2017
Cash equivalents	$13,967	$ 3,192	$ —	$ 17,159
Short-term investments				
Available-for-sale securities — corporate bonds and notes	—	172,493	—	172,493
Available-for-sale securities — municipal bonds and notes	—	67,409	—	67,409
Available-for-sale securities — U.S. government securities	—	72,930	—	72,930
Available-for-sale securities — U.S. government agency securities	—	30,868	—	30,868
Long-term investments				

Available-for-sale securities — corporate bonds and notes	—	191,782	—	191,782
Available-for-sale securities — municipal bonds and notes	—	26,643	—	26,643
Available-for-sale securities — U.S. government securities	—	29,374	—	29,374
Available-for-sale securities — U.S. government agency securities	—	37,003	—	37,003
Total	$13,967	$ 631,694	$ —	$ 645,661

The Company uses the fair value hierarchy for financial assets and liabilities. The Company's non-financial assets and liabilities, which include goodwill, intangible assets, and long-lived assets, are not required to be carried at fair value on a recurring basis. These non-financial assets and liabilities are measured at fair value on a non-recurring basis when there is an indicator of impairment, and they are recorded at fair value only when impairment is recognized. The Company reviews goodwill and intangible assets for impairment annually, during the second quarter of each fiscal year, or as circumstances indicate the possibility of impairment. The Company monitors the carrying value of long-lived assets for impairment whenever events or changes in circumstances indicate its carrying amount may not be recoverable. During the three and nine months ended June 30, 2018 and 2017, the Company did not recognize any impairment charges related to goodwill, intangible assets, or long-lived assets.

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The carrying amounts of other current financial assets and other current financial liabilities approximate fair value due to their short-term nature.

3. Short-Term and Long-Term Investments

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

June 30, 2018	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Certificates of deposits	$ 1,742	$ —	$ —	$ 1,742
Corporate bonds and notes	266,930	5	(853)	266,082
Municipal bonds and notes	41,091	5	(52)	41,044
U.S. government securities	107,542	—	(223)	107,319
U.S. government agency securities	69,203	—	(158)	69,045
	$ 486,508	$ 10	$ (1,286)	$ 485,232

September 30, 2017	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds and notes	$ 172,560	$ 25	$ (92)	$ 172,493
Municipal bonds and notes	67,382	36	(9)	67,409
U.S. government securities	72,991	—	(61)	72,930
U.S. government agency securities	30,954	—	(86)	30,868
	$ 343,887	$ 61	$ (248)	$ 343,700

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

June 30, 2018	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds and notes	$ 273,022	$ 18	$ (3,198)	$ 269,842
Municipal bonds and notes	21,304	—	(136)	21,168
U.S. government securities	18,401	—	(206)	18,195
U.S. government agency securities	20,401	—	(194)	20,207
	$ 333,128	$ 18	$ (3,734)	$ 329,412

September 30, 2017	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds and notes	$ 192,278	$ 25	$ (521)	$ 191,782
Municipal bonds and notes	26,639	46	(42)	26,643
U.S. government securities	29,427	—	(53)	29,374
U.S. government agency securities	37,164	—	(161)	37,003
	$ 285,508	$ 71	$ (777)	$ 284,802

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The following table summarizes investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for more than 12 months as of June 30, 2018 (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
June 30, 2018	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds and notes	$453,680	$ (3,661)	$42,658	$ (390)	$496,338	$ (4,051)
Municipal bonds and notes	50,766	(188)	—	—	50,766	(188)
U.S. government securities	115,069	(419)	7,986	(10)	123,055	(429)
U.S. government agency securities	35,605	(140)	46,996	(212)	82,601	(352)
Total	$655,120	$ (4,408)	$97,640	$ (612)	$752,760	$ (5,020)

The following table summarizes investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for more than 12 months as of September 30, 2017 (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
September 30, 2017	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds and notes	$262,852	$ (528)	$35,401	$ (85)	$298,253	$ (613)
Municipal bonds and notes	30,256	(49)	881	(2)	31,137	(51)
U.S. government securities	94,312	(105)	7,992	(9)	102,304	(114)
U.S. government agency securities	36,121	(83)	31,750	(164)	67,871	(247)
Total	$423,541	$ (765)	$76,024	$ (260)	$499,565	$ (1,025)

The Company invests in securities that are rated investment grade or better. The Company reviews the individual securities in its portfolio to determine whether a decline in a security's fair value below the amortized cost basis is other-than-temporary. The Company determined that as of June 30, 2018, there were no investments in its portfolio that were other-than-temporarily impaired.

4. Inventories

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

Inventories consist of the following (in thousands):

	June 30, 2018	September 30, 2017
Finished goods	$21,529	$ 20,280
Raw materials	9,793	9,554
	$31,322	$ 29,834

5. Commitments and Contingencies

Guarantees and Product Warranties

In the normal course of business to facilitate sales of its products, the Company indemnifies other parties, including customers, resellers, lessors, and parties to other transactions with the Company, with respect to certain matters. The Company has agreed to hold the other party harmless against losses arising from a breach of representations or covenants, or out of intellectual property infringement or other claims made against certain parties. These agreements may limit the time within

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which an indemnification claim can be made and the amount of the claim. The Company has entered into indemnification agreements with its officers and directors and certain other employees, and the Company's bylaws contain similar indemnification obligations to the Company's agents. It is not possible to determine the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement.

The Company generally offers warranties of one year for hardware for those customers without service contracts, with the option of purchasing additional warranty coverage in yearly increments. The Company accrues for warranty costs as part of its cost of sales based on associated material product costs and technical support labor costs. Accrued warranty costs as of June 30, 2018 and September 30, 2017 were not considered material.

Commitments

As of June 30, 2018, the Company's principal commitments consisted of obligations outstanding under operating leases. The Company leases its facilities under operating leases that expire at various dates through 2033. There have been no material changes in the Company's lease obligations compared to those discussed in Note 7 to its annual consolidated financial statements.

The Company currently has arrangements with contract manufacturers and other suppliers for the manufacturing of its products. The arrangement with the primary contract manufacturer allows them to procure component inventory on the Company's behalf based on a rolling production forecast provided by the Company. The Company is obligated to the purchase of component inventory that the contract manufacturer procures in accordance with the forecast, unless it gives notice of order cancellation in advance of applicable lead times. As of June 30, 2018, the Company's purchase obligations were $34.1 million.

Legal Proceedings

On April 4, 2016, the Company sued Radware, Inc. in the United States District Court for the Western District of Washington (the case was subsequently moved to the Northern District of California) accusing Radware of infringing three Company patents. The Company's complaint seeks a jury trial and an unspecified amount of monetary damages, as well as interest, costs, and injunctive relief. Radware moved to dismiss the allegations of one patent but the motion was denied.

Radware has filed a counterclaim separately asserting that the Company is infringing U.S. patent no. 9,231,853, an ISP link load balancing patent related to the patents previously asserted by Radware in litigation in California that has been completed. Radware claims that the Company's BIG-IP product infringes. The counterclaim seeks injunctive relief and unspecified damages.

The Company has denied infringement and asserted that the '853 patent is invalid. Both parties filed inter partes reviews (IPRs) on the patents asserted against them. All of Radware's IPRs were denied and the Company's IPR against the '853 patent resulted in cancellation of all but four of the '853 claims and the allowance of one new claim. The Court has entered a schedule for trial in November of 2019. Radware has indicated that it will seek a preliminary injunction to preclude infringement of the claims that survived the IPR.

In addition to the above referenced matters, the Company is subject to other legal proceedings, claims, and litigation arising in the ordinary course of business. Management believes that the Company has meritorious defenses to the allegations made in its pending cases and intends to vigorously defend these lawsuits; however, the Company is unable currently to determine the ultimate outcome of these or similar matters or the potential exposure to loss, if any. There are many uncertainties associated with any litigation and these actions or other third-party claims against the Company may cause it to incur costly litigation and/or substantial settlement charges that could have a material adverse effect on the Company's business, financial condition, results of operations, and cash flows.

The Company records an accrual for loss contingencies for legal proceedings when it believes that an unfavorable outcome is both (a) probable and (b) the amount or range of any possible loss is reasonably estimable. The Company has not recorded an accrual for loss contingencies associated with the legal proceedings or the investigations discussed above.

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6. Income Taxes

The effective tax rate was 20.4% and 27.8% for the three and nine months ended June 30, 2018, respectively, compared to 31.1% and 32.4% for the three and nine months ended June 30, 2017, respectively. The effective tax rate for the three and nine months ended June 30, 2018 includes various impacts from the Tax Cuts and Jobs Act enacted on December 22, 2017. These impacts include a reduction in the U.S. federal income tax rate from 35.0% to 24.5%, partially offset for the nine months ended June 30, 2018 with a $7.0 million provisional tax expense for the deemed repatriation of undistributed foreign earnings, and a $11.6 million expense from the remeasurement of the Company's net deferred tax assets to reflect the change in the U.S. federal income tax rate when temporary differences are expected to reverse. The U.S. federal income tax rate for fiscal year 2018 is 24.5% and reduces to 21% in fiscal year 2019.

In accordance with SEC Staff Accounting Bulletin ("SAB") No. 118, the Company recorded a provisional tax expense of $7.0 million related to the deemed repatriation of undistributed foreign earnings in the period ended December 31, 2017. The Company did not record any adjustments to the provisional tax expense in the period ended June 30, 2018. Additional regulatory guidance may result in a change to the provisional amount. SAB No. 118 provides a one-year measurement period to complete the accounting.

At June 30, 2018, the Company had $27.3 million of unrecognized tax benefits that, if recognized, would affect the effective tax rate. It is anticipated that the Company's existing liabilities for unrecognized tax benefits will change within the next twelve months due to audit settlements or the expiration of statutes of limitations. The Company does not expect these changes to be material to the consolidated financial statements. The Company recognizes interest and, if applicable, penalties for any uncertain tax positions as a component of income tax expense.

The Company and its subsidiaries are subject to U.S. federal income tax as well as the income tax of multiple state and foreign jurisdictions. The Company has concluded all U.S. federal income tax matters for fiscal years through September 30, 2014. The Company is currently under audit by the IRS for fiscal year 2016 and by various states for fiscal years 2013 through 2016. Major jurisdictions where there are wholly owned subsidiaries of F5 Networks, Inc. which require income tax filings include the United Kingdom, Japan, Singapore, and Australia. The earliest periods open for review by local taxing authorities are fiscal years 2016 for the United Kingdom, 2012 for Japan, 2013 for Singapore, and 2014 for Australia. Within the next four fiscal quarters, the statute of limitations will begin to close on the fiscal year 2015 federal income tax return, fiscal years 2013, 2014, and 2015 state income tax returns, and fiscal years 2012 to 2016 foreign income tax returns.

7. Geographic Sales and Significant Customers

Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Management has determined that the Company is organized as, and operates in, one reportable operating segment: the development, marketing and sale of application delivery networking products that optimize the security, performance and availability of network applications, servers and storage systems. The Company does business in four main geographic regions: the Americas (primarily the United States); Europe, the Middle East, and Africa (EMEA); Japan; and the Asia Pacific region (APAC). The Company's chief operating decision-making group reviews financial information presented on a consolidated basis accompanied by information about revenues by geographic region. The Company's foreign offices conduct sales, marketing and support activities. Revenues are attributed by geographic location based on the location of the customer.

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

	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
Americas:				
United States	$275,011	$269,975	$805,594	$791,643
Other	30,453	27,331	87,359	84,211
Total Americas	305,464	297,306	892,953	875,854

EMEA	130,821	121,578	406,712	377,779
Japan	23,008	22,128	67,960	71,415
Asia Pacific	82,910	76,825	231,073	226,995
	$542,203	$517,837	$1,598,698	$1,552,043

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The following distributors of the Company's products accounted for more than 10% of total net revenue:

	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
Ingram Micro, Inc.	16.9%	16.8%	16.3%	16.4%
Tech Data[1]	11.0%	12.2%	11.8%	12.4%
Arrow ECS	10.5%	—	10.9%	10.4%
Synnex Corporation[2]	11.4%	—	11.2%	—
Westcon Group, Inc.	10.1%	19.1%	10.4%	18.6%

(1) On February 27, 2017, Tech Data completed the acquisition of Avnet Technology Solutions.

(2) On September 1, 2017, Synnex Corporation completed the acquisition of Westcon Americas.

The Company tracks assets by physical location. Long-lived assets consist of property and equipment, net, and are shown below (in thousands):

	June 30, 2018	September 30, 2017
United States	$108,542	$ 103,486
EMEA	13,155	15,054
Other countries	4,411	3,880
	$126,108	$ 122,420

8. Subsequent Events

On July 20, 2018, the Company initiated implementation of a restructuring program to match strategic and financial objectives and optimize resources for long term growth, including a reduction in force program affecting approximately 230 employees. As part of the restructuring, the Company plans to close its Lowell, Massachusetts office and reduce leased office space.

The Company estimates expenses relating to these actions at approximately $23.0 million to $25.0 million. The Company currently expects the reduction in force charges, consisting primarily of severance benefits, to be in the range of $20.0 million to $21.5 million; and the lease space reduction, consisting of lease termination and other facility costs, to be in the range of $3.0 million to $3.5 million. The Company anticipates that most of these charges will be recognized in the Company’s fourth fiscal quarter of 2018.

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

The following discussion of our financial condition and results of operations contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933. These statements include, but are not limited to, statements about our plans, objectives, expectations, strategies, intentions or other characterizations of future events or circumstances and are generally identified by the words “expects,” “anticipates,” “intends,” “plans,” “believes,” “seeks,” “estimates,” and similar expressions. These forward-looking statements are based on current information and expectations and are subject to a number of risks and uncertainties. Our actual results could differ materially from those expressed or implied by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in Part II, Item 1A. “Risk Factors” herein and in other documents we file from time to time with the Securities and Exchange Commission. We assume no obligation to revise or update any such forward-looking statements.

Overview

We are a global provider of software-defined application services designed to ensure the fast, secure and reliable delivery of applications and data. Our products include hardware and software systems, software-only solutions, cloud-based subscription services and a common management framework that enables customers to accelerate, optimize, secure and manage applications across hybrid computing infrastructures that combine traditional networks and data centers with software-defined networks, virtualized data centers and cloud-based resources (multi-cloud environments). We market and sell our products primarily through multiple indirect sales channels in the Americas (primarily the United States); Europe, the Middle East, and Africa (EMEA); Japan; and the Asia Pacific region (APAC). Enterprise customers (Fortune 1000 or Business Week Global

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1000 companies) in the technology, telecommunications, financial services, transportation, education, manufacturing and health care industries, along with government customers, continue to make up the largest percentage of our customer base.

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

- Revenues. The majority of our revenues are derived from sales of our application delivery controller (ADC) products including our BIG-IP appliances and high end VIPRION chassis and related software modules and our software-only Virtual Editions; Local Traffic Manager (LTM), DNS Services (formerly Global Traffic Manager); Advanced Firewall Manager (AFM) and Policy Enforcement Manager (PEM), that leverage the unique performance characteristics of our hardware and software architecture; and products that incorporate acquired technology, including Application Security Manager (ASM) and Access Policy Manager (APM); signaling delivery controller products (SDC); and the WebSafe, MobileSafe, Secure Web Gateway and Silverline DDoS and Application security offerings which are sold to customers on a subscription basis. We also derive revenues from the sales of services including annual maintenance contracts, training and consulting services. We carefully monitor the sales mix of our revenues within each reporting period. We believe customer acceptance rates of our new products and feature enhancements are indicators of future trends. We also consider overall revenue concentration by customer and by geographic region as additional indicators of current and future trends.
- Cost of revenues and gross margins. We strive to control our cost of revenues and thereby maintain our gross margins. Significant items impacting cost of revenues are hardware costs paid to our contract manufacturers, third-party software license fees, Silverline infrastructure, amortization of developed technology and personnel and overhead expenses. Our margins have remained relatively stable; however, factors such as sales price, product and services mix, inventory obsolescence, returns, component price increases and warranty costs could significantly impact our gross margins from quarter to quarter and represent significant indicators we monitor on a regular basis.
- Operating expenses. Operating expenses are substantially driven by personnel and related overhead expenses. Existing headcount and future hiring plans are the predominant factors in analyzing and forecasting future operating expense trends. Other significant operating expenses that we monitor include marketing and promotions, travel, professional fees, computer costs related to the development of new products and provision of services, facilities and depreciation expenses.
- Liquidity and cash flows. Our financial condition remains strong with significant cash and investments and no long term debt. The increase in cash and investments for the first nine months of fiscal year 2018 was primarily due to cash provided by operating activities of $556.8 million, largely offset by $450.1 million of cash used to repurchase outstanding common stock under our stock repurchase program. Going forward, we believe the primary driver of cash flows will be net income from operations. Capital expenditures of $36.1 million for the first nine months of fiscal year 2018 were primarily related to the expansion of our facilities to support our operations worldwide as well as investments in information technology infrastructure and equipment purchases to support our core business activities. We will continue to evaluate possible acquisitions of, or investments in businesses, products, or technologies that we believe are strategic, which may require the use of cash.
- Balance sheet. We view cash, short-term and long-term investments, deferred revenue, accounts receivable balances and days sales outstanding as important indicators of our financial health. Deferred revenues increased in the third quarter of fiscal year 2018 due to growth in the amount of annual maintenance contracts purchased on new products and maintenance renewal contracts related to our existing product installation base. Our days sales outstanding for the third quarter of fiscal year 2018 was 49.

Summary of Critical Accounting Policies and Estimates

The preparation of our financial condition and results of operations requires us to make judgments and estimates that may have a significant impact upon our financial results. We believe that, of our significant accounting policies, the following require estimates and assumptions that require complex, subjective judgments by management, which can materially impact reported results: revenue recognition; reserve for doubtful accounts; reserve for product returns; accounting for income taxes; stock-based compensation; goodwill and intangible assets; and investments. None of these accounting policies and estimates have significantly changed since our annual report on Form 10-K for the year ended September 30, 2017 (Form 10-K). Critical accounting policies and estimates are more fully described in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Form 10-K. Actual results may differ from these estimates under different assumptions or conditions.

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Results of Operations

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

	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
	(in thousands, except percentages)			
Net Revenues				
Products	$238,835	$235,109	$703,696	$715,672
Services	303,368	282,728	895,002	836,371
Total	$542,203	$517,837	$1,598,698	$1,552,043
Percentage of net revenues				
Products	44.0 %	45.4 %	44.0 %	46.1 %
Services	56.0	54.6	56.0	53.9
Total	100.0 %	100.0 %	100.0 %	100.0 %

Net revenues. Total net revenues increased 4.7% and 3.0% for the three and nine months ended June 30, 2018, respectively, from the same periods in the prior year. Overall revenue growth for the three and nine months ended June 30, 2018, was primarily due to increased service revenues as a result of our increased installed base of products. International revenues represented 49.3% and 49.6% of total net revenues for the three and nine months ended June 30, 2018, respectively, compared to 47.9% and 49.0% for the same periods in the prior year, respectively. We expect international sales will continue to represent a significant portion of net revenues, although we cannot provide assurance that international revenues as a percentage of net revenues will remain at current levels.

Net product revenues increased 1.6% for the three months ended June 30, 2018, from the same period in the prior year. The increase in net product revenues for the three months ended June 30, 2018 was due to an increase of $4.8 million in sales of our ADN products from the same period in the prior year. Net product revenues decreased 1.7% for the nine months ended June 30, 2018, from the same period in the prior year. The decrease in net product revenues for the nine months ended June 30, 2018 was due to a decrease of $10.8 million in sales of our ADN products from the same period in the prior year.

Net service revenues increased 7.3% and 7.0% for the three and nine months ended June 30, 2018, respectively, from the same periods in the prior year. The increase in net service revenues was primarily due to increases in the purchase or renewal of maintenance contracts driven by additions to our installed base of products.

The following distributors of the Company's products accounted for more than 10% of total net revenue:

	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
Ingram Micro, Inc.	16.9%	16.8%	16.3%	16.4%
Tech Data[1]	11.0%	12.2%	11.8%	12.4%
Arrow ECS	10.5%	—	10.9%	10.4%
Synnex Corporation[2]	11.4%	—	11.2%	—
Westcon Group, Inc.	10.1%	19.1%	10.4%	18.6%

(1) On February 27, 2017, Tech Data completed the acquisition of Avnet Technology Solutions.

(2) On September 1, 2017, Synnex Corporation completed the acquisition of Westcon Americas.

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The following distributors of the Company's products accounted for more than 10% of total receivables:

	June 30, 2018	September 30, 2017	June 30, 2017
Ingram Micro, Inc.	12.3 %	—	12.3 %
Westcon Group, Inc.	11.0 %	—	21.5 %
Arrow ECS	10.1 %	11.5 %	10.8 %
Synnex Corporation[1]	16.4 %	13.6 %	—

(1) On September 1, 2017, Synnex Corporation completed the acquisition of Westcon Americas.

No other distributors accounted for more than 10% of total net revenue or receivables.

	Three months ended June 30, 2018	Three months ended June 30, 2017	Nine months ended June 30, 2018	Nine months ended June 30, 2017
	(in thousands, except percentages)			
Cost of net revenues and Gross Margin				
Products	$45,164	$43,787	$132,556	$129,391
Services	45,845	45,983	135,485	133,553
Total	91,009	89,770	268,041	262,944
Gross profit	$451,194	$428,067	$1,330,657	$1,289,099
Percentage of net revenues and Gross Margin (as a percentage of related net revenue)				
Products	18.9 %	18.6 %	18.8 %	18.1 %
Services	15.1	16.3	15.1	16.0
Total	16.8	17.3	16.8	16.9
Gross profit	83.2 %	82.7 %	83.2 %	83.1 %

Cost of net product revenues. Cost of net product revenues consist of finished products purchased from our contract manufacturers, manufacturing overhead, freight, warranty, provisions for excess and obsolete inventory and amortization expenses in connection with developed technology from acquisitions. Cost of net product revenues increased 3.1% and 2.4% for the three and nine months ended June 30, 2018, respectively, from the comparable periods in the prior year. The increase in cost of net product revenues for the three and nine months ended June 30, 2018 is due to an increase in payments to our contract manufacturers due to global memory shortages, additional investments in our subscription-based software services, and product transitions away from older generation appliances to the new iSeries platform.

Cost of net service revenues. Cost of net service revenues consist of the salaries and related benefits of our professional services staff, travel, facilities and depreciation expenses. For both the three and nine months ended June 30, 2018, cost of net service revenues as a percentage of net service revenues was 15.1%, compared to 16.3% and 16.0% for the same periods in the prior year, respectively. The decrease in cost of net service revenues as a percentage of net service revenues is primarily due to the scalability of our existing customer support infrastructure and increased revenue from maintenance contracts. Professional services headcount at the end of June 2018 decreased to 906 from 919 at the end of June 2017. In addition, cost of net service revenues included stock-based compensation expense of $4.4 million and $14.2 million for the three and nine months ended June 30, 2018, respectively, compared to $4.8 million and $14.6 million for the same periods in the prior year, respectively.

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	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
	(in thousands, except percentages)			
Operating expenses				
Sales and marketing	$165,806	$160,952	$503,710	$490,171
Research and development	94,061	88,602	271,006	264,886
General and administrative	39,374	39,368	118,634	119,055
Litigation expense	—	1	—	(134)
Total	$299,241	$288,923	$893,350	$873,978
Operating expenses (as a percentage of net revenue)				
Sales and marketing	30.6 %	31.1 %	31.5 %	31.6 %
Research and development	17.3	17.1	17.0	17.0
General and administrative	7.3	7.6	7.4	7.7
Litigation expense	—	—	—	—
Total	55.2 %	55.8 %	55.9 %	56.3 %

Sales and marketing. Sales and marketing expenses consist of salaries, commissions and related benefits of our sales and marketing staff, the costs of our marketing programs, including public relations, advertising and trade shows, travel, facilities, and depreciation expenses. Sales and marketing expenses increased 3.0% and 2.8% for the three and nine months ended June 30, 2018, respectively, from the comparable periods in the prior year. The increase in sales and marketing expense was primarily due to an increase of $3.9 million and $7.6 million in commissions for the three and nine months ended June 30, 2018, respectively, from the comparable periods in the prior year. Sales and marketing headcount at the end of June 2018 decreased to 1,721 from 1,794 at the end of June 2017 due to a reduction in workforce that took place in the fourth quarter of fiscal year 2017. Sales and marketing expense included stock-based compensation expense of $16.2 million and $47.2 million for the three and nine months ended June 30, 2018, respectively, compared to $17.5 million and $52.7 million for the same periods in the prior year, respectively.

Research and development. Research and development expenses consist of the salaries and related benefits of our product development personnel, prototype materials and other expenses related to the development of new and improved products, facilities and depreciation expenses. Research and development expenses increased 6.2% and 2.3% for the three and nine months ended June 30, 2018, respectively, from the comparable periods in the prior year. The increase in research and development expense was primarily due to an increase of $2.5 million and $4.1 million in personnel costs for the three and nine months ended June 30, 2018, respectively, from the comparable periods in the prior year. In addition, fees paid to outside consultants for research and development services increased $2.6 million and $4.8 million for the three and nine months ended June 30, 2018, respectively, from the comparable periods in the prior year. Research and development headcount at the end of June 2018 increased to 1,284 from 1,240 at the end of June 2017. Research and development expense included stock-based compensation expense of $11.5 million and $36.4 million for the three and nine months ended June 30, 2018, respectively, compared to $13.6 million and $41.4 million for the same periods in the prior year, respectively. We expect research and development expenses to remain consistent as a percentage of net revenue in the foreseeable future.

General and administrative. General and administrative expenses consist of the salaries, benefits and related costs of our executive, finance, information technology, human resource and legal personnel, third-party professional service fees, bad debt charges, facilities and depreciation expenses. General and administrative expenses remained relatively flat for the three and nine months ended June 30, 2018, from the comparable periods in the prior year. General and administrative headcount at the end of June 2018 remained consistent at 467 compared with the end of June 2017. Stock-based compensation expense was $6.1 million and $21.4 million for the three and nine months ended June 30, 2018, respectively, compared to $6.7 million and $23.5 million for the same periods in the prior year, respectively.

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	Three months ended June 30,		Nine months ended June 30,	
	2018	2017	2018	2017
	(in thousands, except percentages)			
Other income and income taxes				
Income from operations	$151,953	$139,144	$437,307	$415,121
Other income, net	2,259	2,589	7,194	6,534
Income before income taxes	154,212	141,733	444,501	421,655
Provision for income taxes	31,469	44,071	123,693	136,637
Net income	$122,743	$97,662	$320,808	$285,018
Other income and income taxes (as percentage of net revenue)				
Income from operations	28.0 %	26.9 %	27.4 %	26.8 %
Other income, net	0.4	0.5	0.4	0.4
Income before income taxes	28.4	27.4	27.8	27.2
Provision for income taxes	5.8	8.5	7.7	8.8
Net income	22.6 %	18.9 %	20.1 %	18.4 %

Other income, net. Other income, net consists primarily of interest income and foreign currency transaction gains and losses. Other income, net remained relatively flat for the three and nine months ended June 30, 2018, from the comparable periods in the prior year.

Provision for income taxes. The effective tax rate was 20.4% and 27.8% for the three and nine months ended June 30, 2018, respectively, compared to 31.1% and 32.4% for the three and nine months ended June 30, 2017, respectively. The decrease in the effective tax rate for the three and nine months ended June 30, 2018 is primarily due to the impact of the Tax Cuts and Jobs Act enacted on December 22, 2017. Significant impacts include a reduction in the U.S. federal income tax rate from 35.0% to 24.5%, partially offset for the nine months ended June 30, 2018 with a tax on the deemed repatriation of undistributed foreign earnings as of December 31, 2017 and a remeasurement of the Company’s net deferred tax assets. Several provisions of the Tax Cuts and Jobs Act are not effective for the Company until fiscal year 2019, including a further reduction in the U.S. federal income tax rate to 21%, a deduction for foreign derived intangible income, and repeal of the deduction for income attributable to domestic production activities.

We record a valuation allowance to reduce our deferred tax assets to the amount we believe is more likely than not to be realized. In making these determinations we consider historical and projected taxable income, and ongoing prudent and feasible tax planning strategies in assessing the appropriateness of a valuation allowance. Our net deferred tax assets at June 30, 2018 and June 30, 2017 were $35.1 million and $50.5 million, respectively. The net deferred tax assets include valuation allowances of $19.6 million and $16.4 million as of June 30, 2018 and June 30, 2017, respectively, which are primarily related to tax net operating losses incurred in certain foreign jurisdictions, and state tax carryforwards.

Our worldwide effective tax rate may fluctuate based on a number of factors, including variations in projected taxable income in the various geographic locations in which we operate, changes in the valuation of our net deferred tax assets, resolution of potential exposures, tax positions taken on tax returns filed in the various geographic locations in which we operate, and the introduction of new accounting standards or changes in tax laws or interpretations thereof in the various geographic locations in which we operate. We have recorded liabilities to address potential tax exposures related to business and income tax positions we have taken that could be challenged by taxing authorities. The ultimate resolution of these potential exposures may be greater or less than the liabilities recorded which could result in an adjustment to our future tax expense.

In accordance with SEC Staff Accounting Bulletin No. 118, the Company recorded a provisional tax expense related to the deemed repatriation of undistributed foreign earnings. Additional regulatory guidance may result in a change to the provisional amount.

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Liquidity and Capital Resources

Cash and cash equivalents, short-term investments and long-term investments totaled $1,413.9 million as of June 30, 2018, compared to $1,301.7 million as of September 30, 2017, representing an increase of $112.2 million. The increase was primarily due to cash provided by operating activities of $556.8 million for the nine months ended June 30, 2018, which was largely offset by $450.1 million of cash used for the repurchase of outstanding common stock under our stock repurchase program. Cash provided by operating activities for the first nine months of fiscal year 2018 resulted from net income of $320.8 million combined with changes in operating assets and liabilities, as adjusted for various non-cash items including stock-based compensation, deferred revenue, depreciation and amortization charges. Based on our current operating and capital expenditure forecasts, we believe that our existing cash and investment balances, together with cash generated from operations should be sufficient to meet our operating requirements for at least the next twelve months.

Cash used in investing activities was $227.9 million for the nine months ended June 30, 2018, compared to cash provided by investing activities of $47.1 million for the same period in the prior year. Investing activities include purchases, sales and maturities of available-for-sale securities, business acquisitions, capital expenditures and changes in restricted cash requirements. The amount of cash used in investing activities for the nine months ended June 30, 2018 was primarily the result of the purchase of investments and capital expenditures related to the build-out of our new corporate headquarters and the expansion of our international facilities, partially offset by the sale and maturity of investments.

Cash used in financing activities was $401.2 million for the nine months ended June 30, 2018, compared to cash used in financing activities of $396.6 million for the same period in the prior year. Our financing activities for the nine months ended June 30, 2018 consisted of cash required for the repurchase of outstanding common stock under our stock repurchase program of $450.1 million, partially offset by cash received from the exercise of employee stock options and stock purchases under our employee stock purchase plan of $48.8 million.

Obligations and Commitments

As of June 30, 2018, our principal commitments consisted of obligations outstanding under operating leases. We lease our facilities under operating leases that expire at various dates through 2033. There have been no material changes in our principal lease commitments compared to those discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2017.

We outsource the manufacturing of our pre-configured hardware platforms to contract manufacturers who assemble each product to our specifications. Our agreement with our largest contract manufacturer allows them to procure component inventory on our behalf based upon a rolling production forecast. We are contractually obligated to purchase the component inventory in accordance with the forecast, unless we give notice of order cancellation in advance of applicable lead times.

Recent Accounting Pronouncements

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk. We maintain an investment portfolio of various holdings, types, and maturities. Our primary objective for holding fixed income securities is to achieve an appropriate investment return consistent with preserving principal and managing risk. At any time, a sharp rise in market interest rates could have a material adverse impact on the fair value of our fixed income investment portfolio. Conversely, declines in interest rates, including the impact from lower credit spreads, could have a material adverse impact on interest income for our investment portfolio. Our fixed income investments are held for purposes other than trading. Our fixed income investments were not leveraged as of June 30, 2018. We monitor our interest rate and credit risks, including our credit exposures to specific rating categories and to individual issuers. As of June 30, 2018, 26.4% of our fixed income securities balance consisted of U.S. government and U.S. government agency securities. We believe the overall credit quality of our portfolio is strong.

Foreign Currency Risk. The majority of our sales and expenses are denominated in U.S. dollars and as a result, we have not experienced significant foreign currency transaction gains and losses to date.

Management believes there have been no material changes to our quantitative and qualitative disclosures about market risk during the nine month period ended June 30, 2018, compared to those discussed in our Annual Report on Form 10-K for the year ended September 30, 2017.

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Item 4. Controls and Procedures

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

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2018. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of June 30, 2018.

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

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

See Note 5 - Commitments and Contingencies of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for information regarding legal proceedings in which we are involved.

Item 1A. Risk Factors

The following information updates, and should be read in conjunction with, the information discussed in Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended September 30, 2017. The risks discussed below and in our Annual Report on Form 10-K could materially affect our business, financial condition and future results. These are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be insignificant also may materially and adversely affect our business, financial condition or operating results in the future.

Security vulnerabilities in our IT systems or products as well as unforeseen product errors could have a material adverse impact on our business results of operations, financial condition and reputation

In the ordinary course of business, we store sensitive data, including intellectual property, personal data, our proprietary business information and that of our customers, suppliers and business partners on our networks. In addition, we store sensitive data through cloud-based services that may be hosted by third parties and in data center infrastructure maintained by third parties. The secure maintenance of this information is critical to our operations and business strategy. Our information systems and those of our partners and customers are subject to the increasing threat of intrusions by a wide range of actors including computer programmers, hackers or sophisticated nation-state and nation-state supported actors or they may be compromised due to employee error or wrongful conduct, malfeasance, or other disruptions. Despite our security measures, and those of our third-party vendors, our information technology and infrastructure has experienced breaches or disruptions and may be vulnerable in the future to breach, attacks or disruptions. If any breach or attack compromises our networks, creates system disruptions or slowdowns or exploits security vulnerabilities of our products, the information stored on our networks or those of our customers could be accessed and modified, publicly disclosed, lost or stolen, and we may be subject to liability to our customers, suppliers, business partners and others, and suffer reputational and financial harm.

In addition, our products are used to manage critical applications and data for customers and third parties may attempt to exploit security vulnerabilities in our products as well as our internal IT systems. As we continue to focus on the development and marketing of security solutions, we become a bigger target for malicious computer hackers, including sophisticated nation-state and nation-state supported actors who wish to exploit security vulnerabilities in our products or IT systems.

We devote significant resources to addressing security vulnerabilities in our IT systems, product solutions and services through our efforts to engineer more secure solutions and services, enhance security and reliability features in our solutions and services, deploy security updates to address security vulnerabilities and seek to respond to known security incidents in sufficient time to minimize any potential adverse impact. Despite our efforts to harden our infrastructure and build secure solutions, from time to time, we experience attacks and other cyber-threats. These attacks can seek to exploit, among other things, known or unknown vulnerabilities in technology included in our IT infrastructure, solutions and services. For example, in January 2018, vulnerabilities in certain microprocessors were publicly announced under the names Spectre and Meltdown.

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While we have undertaken efforts to mitigate these vulnerabilities, they could render our internal systems, products, and solutions and services susceptible to a cyberattack.

Our products may also contain undetected errors or defects when first introduced or as new versions are released. We have experienced these errors or defects in the past in connection with new products and product upgrades. As our products and customer IT infrastructures become increasingly complex, customers may experience unforeseen errors in implementing our products into their IT environments. We expect that these errors or defects will be found from time to time in new or enhanced products after commencement of commercial shipments. These problems may cause us to incur significant warranty and repair costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relations problems. We may also be subject to liability claims for damages related to product errors or defects. While we carry insurance policies covering this type of liability, these policies may not provide sufficient protection should a claim be asserted. A material product liability claim may harm our business and results of operations.

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

Any errors, defects or vulnerabilities in our products or IT systems could result in:

- expenditures of significant financial and product development resources in efforts to analyze, correct, eliminate, or work-around errors and defects or to address and eliminate vulnerabilities;
- remediation costs, such as liability for stolen assets or information, repairs of system damage;
- increased cybersecurity protection costs which may include systems and technology changes, training, and engagement of third party experts and consultants;
- increased insurance premiums;
- loss of existing or potential customers or channel partners;
- loss of proprietary information leading to lost competitive positioning and lost revenues;
- negative publicity and damage to our reputation;
- delayed or lost revenue;
- delay or failure to attain market acceptance;
- an increase in warranty claims compared with our historical experience, or an increased cost of servicing warranty claims, either of which would adversely affect our gross margins; and
- litigation, regulatory inquiries, or investigations that may be costly and harm our reputation.

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

Our success depends, in large part, on our ability to attract, engage, retain, and integrate qualified executives and other key employees throughout all areas of our business. In order to attract and retain executives and other key employees in a competitive marketplace, we must provide a competitive compensation package, including cash- and equity-based compensation. If we do not obtain the stockholder approval needed to continue granting equity compensation in a competitive manner, our ability to attract, retain, and motivate executives and key employees could be weakened. Failure to successfully hire executives and key employees or the loss of any executives and key employees could have a significant impact on our operations. François Locoh-Donou became the Company's CEO effective April 3, 2017. Transitioning to a new chief executive could be disruptive to our business and could adversely affect our business and results of operations. In addition, Frank Pelzer became the Company's Chief Financial Officer effective May 21, 2018 and Chad Whalen became the Executive Vice President of Worldwide Sales effective July 9, 2018. Further changes in our management team may be disruptive to our business, and any failure to successfully integrate key new hires or promoted employees could adversely affect our business and results of operations. The complexity of our application delivery networking products and their integration into existing networks and ongoing support, as well as the sophistication of our sales and marketing effort, requires us to retain highly trained developers, professional services, customer support and sales personnel. Competition for qualified developers, professional services, customer support and sales personnel in our industry is intense, especially in Silicon Valley and Seattle where we have substantial operations and a need for highly skilled personnel, because of the limited number of people available with the necessary technical skills and understanding of our products. Also, to the extent we hire personnel from competitors, we may

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be subject to allegations that they have been improperly solicited, that they have divulged proprietary or other confidential information, that they have violated non-compete obligations to their prior employers, or that their former employers own their inventions or other work product. Our ability to hire and retain these personnel may be adversely affected by volatility or reductions in the price of our common stock or our ability to get approval from shareholders to offer additional common stock to our employees, since these employees are generally granted restricted stock units. The loss of services of any of our key personnel, the inability to retain and attract qualified personnel in the future or delays in hiring qualified personnel may harm our business and results of operations. In addition, we recently announced a restructuring to re-align our workforce to match strategic and financial objectives and optimize resources for long term growth, including a reduction in force program impacting a number of employees. This restructuring could lead to increased attrition amongst those employees who were not directly affected by the reduction in force program.

We may have exposure to greater than anticipated tax liabilities

Our provision for income taxes is subject to volatility and could be adversely affected by nondeductible stock-based compensation, changes in the research and development tax credit laws, earnings being lower than anticipated in jurisdictions where we have lower statutory rates and being higher than anticipated in jurisdictions where we have higher statutory rates, transfer pricing adjustments, not meeting the terms and conditions of tax holidays or incentives, changes in the valuation of our deferred tax assets and liabilities, changes in actual results versus our estimates, or changes in tax laws, regulations, accounting principles or interpretations thereof, including changes to the tax laws applicable to corporate multinationals. The U.S., the European Union and its member states, and a number of other countries are actively pursuing changes in this regard. In addition, like other companies, we may be subject to examination of our income tax returns by the U.S. Internal Revenue Service and other tax authorities. While we regularly assess the likelihood of adverse outcomes from such examinations and the adequacy of our provision for income taxes, there can be no assurance that such provision is sufficient and that a determination by a tax authority will not have an adverse effect on our results of operations.

The “Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended September 30, 2017 state that, “we do not provide for U.S. income taxes on certain foreign subsidiaries in which we intend to indefinitely reinvest such earnings outside the U.S. If our intent changes or if these funds are needed for U.S. operations, we would be required to accrue or pay U.S. taxes on some or all of these undistributed earnings and our effective tax rate would be adversely affected. Additionally, any changes in U.S. tax laws that would limit the ability to defer taxation on earnings outside of the U.S. could affect the tax treatment of our foreign earnings.”

The Tax Cuts and Jobs Act enacted on December 22, 2017 imposes a tax on the deemed repatriation of undistributed foreign earnings as of December 31, 2017. Effective January 1, 2018, the new U.S. tax law provides a deduction for the foreign-source portion of dividends received from specified foreign corporations. We have recorded a tax expense for the deemed repatriation of foreign earnings as of December 31, 2017, and will record any estimated deferred tax liabilities associated with a future repatriation of earnings to the United States.

We recently implemented a restructuring program, which we cannot guarantee will achieve its intended result

In July 2018, we announced a restructuring program to match strategic and financial objectives and optimize resources for long term growth. We incur substantial costs to implement restructuring plans, and our restructuring activities may subject us to litigation risks and expenses. Our past restructuring plans do not provide any assurance that additional restructuring plans will not be required or implemented in the future. In addition, our restructuring plans may have other consequences, such as attrition beyond our planned reduction in workforce, a negative effect on employee morale and productivity or our ability to attract highly skilled employees. Our competitors may also use our restructuring plans to seek to gain a competitive advantage over us. As a result, our restructuring plans may affect our revenue and other operating results in the future.

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

On October 25, 2017, the Company announced that its Board of Directors authorized an additional $1.0 billion for its common stock share repurchase program. This new authorization is incremental to the existing $3.4 billion program, initially approved in October 2010 and expanded in each fiscal year. Acquisitions for the share repurchase programs will be made from time to time in private transactions or open market purchases as permitted by securities laws and other legal requirements. The programs can be terminated at any time. As of June 30, 2018, the Company repurchased and retired 3,210,478 shares at an average price of $140.19 per share during fiscal year 2018 and the Company had $723.6 million remaining authorized to purchase shares at June 30, 2018.

Shares repurchased and retired as of June 30, 2018 are as follows (in thousands, except shares and per share data):

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased per the Publicly Announced Plan	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plan
October 1, 2017 — October 31, 2017	100,000	$ 121.38	100,000	$ 1,161,514
November 1, 2017 — November 30, 2017	1,142,610	$ 120.68	1,142,610	$ 1,023,627
December 1, 2017 — December 31, 2017	—	$ —	—	$ 1,023,627
January 1, 2018 — January 31, 2018	200,000	$ 138.56	200,000	$ 995,914
February 1, 2018 — February 28, 2018	865,326	$ 141.34	865,326	$ 873,606
March 1, 2018 — March 31, 2018	—	$ —	—	$ 873,606
April 1, 2018 — April 30, 2018	—	$ —	—	$ 873,606
May 1, 2018 — May 31, 2018	902,542	$ 166.22	902,542	$ 723,588
June 1, 2018 — June 30, 2018	—	$ —	—	$ 723,588

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Item 6. Exhibits

Exhibit Number	Exhibit Description
31.1*	—Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	—Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	—Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS*	—XBRL Instance Document
101.SCH*	—XBRL Taxonomy Extension Schema Document
101.CAL*	—XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	—XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	—XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	—XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 1st day of August, 2018.

F5 NETWORKS, INC.

By: /s/ FRANCIS J. PELZER
Francis J. Pelzer
Executive Vice President,
Chief Financial Officer
(principal financial officer and principal accounting officer)