

F5 NETWORKS INC
Form 10-K/A
December 12, 2006

Table of Contents

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

**Form 10-K/A
Amendment No. 2
FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

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

For the fiscal year ended September 30, 2005

or

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

Commission File Number 000-26041

F5 Networks, Inc.

(Exact name of Registrant as specified in its charter)

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

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

**401 Elliott Ave West
Seattle, Washington 98119**
(Address of principal executive offices)
(206) 272-5555

(Registrant's telephone number, including area code)

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

Common Stock, no par value

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

None

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

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

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

DOCUMENTS INCORPORATED BY REFERENCE

Information required in response to Part III of Form 10-K (Items 10, 11, 12, 13 and 14) is hereby incorporated by reference to the specified portions of the Registrant's Definitive Proxy Statement for the Annual Shareholders Meeting held on March 2, 2006.

Table of Contents

EXPLANATION OF AMENDMENT

We are amending our Annual Report on Form 10-K for the fiscal year ended September 30, 2005, which was originally filed on December 12, 2005 (the Original Report) and amended by our Annual Report on Form 10-K/A, which was filed on December 15, 2005 (the First Amendment), to restate our consolidated financial statements for the years ended September 30, 2005, 2004 and 2003 and the related disclosures. This Form 10-K/A (this Amendment), also includes the restatement of selected consolidated financial data as of and for the years ended September 30, 2005, 2004, 2003, 2002 and 2001, which is included in Item 6, and the unaudited quarterly financial data for each of the quarters in the years ended September 30, 2005 and 2004, which is included in Item 8.

The restatement of the Original Report (as amended by the First Amendment) reflected in this Amendment (collectively the Restatement) includes adjustments arising from the determinations of a Special Committee of our Board of Directors, consisting of independent members of our Board of Directors, which was formed in May 2006 to conduct an internal investigation into our past stock option practices.

For more information on these matters, please refer to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations Restatement of Consolidated Financial Statements, Special Committee and Company Findings, Internal Controls, Remedial Measures and Related Proceedings, Note 2, Restatement of Consolidated Financial Statements, of the Notes to the Consolidated Financial Statements, and Item 9A, Controls and Procedures.

We have not amended and we do not intend to amend any of our other previously filed annual reports on Form 10-K for the periods affected by the Restatement other than this Amendment. As a result of the Restatement of our consolidated financial statements, we will also restate the interim financial statements for the quarterly and year to date periods ended December 31, 2005 and 2004, March 31, 2006 and 2005 and June 30, 2005 to be included in our quarterly reports on Forms 10-Q for the periods ended December 31, 2005, March 31, 2006 and June 30, 2006. For this reason, the consolidated financial statements and related financial information contained in such previously filed reports should no longer be relied upon. Except for the sections of this Amendment entitled Restatement of Consolidated Financial Statements, Special Committee and Company Findings, Internal Controls, Remedial Measures and Related Proceedings and Risk Factors (included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations), Item 3, Legal Proceedings, Item 9A, Controls and Procedures, and Note 2 and Note 12 (unaudited) of the Notes to Consolidated Financial Statements, all of the information in this Amendment is as of September 30, 2005 and does not reflect events occurring after the date of the Original Report, other than the First Amendment and the Restatement, or modify or update disclosures (including the exhibits to the First Amendment, except for the updated Exhibits 31.1, 31.2, and 32.1 described below) affected by subsequent events.

For the convenience of the reader, this Amendment sets forth the Original Report (as amended by the First Amendment) in its entirety, as amended by, and to reflect, the Restatement. The following items have been amended principally as a result of, and to reflect, the Restatement, and no other information in the Original Report (as amended by the First Amendment) is amended hereby as a result of the Restatement:

Part I Item 1 Business;

Part I Item 3 Legal Proceedings;

Part II Item 5 Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities;

Part II Item 6 Selected Consolidated Financial Data;

Part II Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations;

Part II Item 8 Financial Statements and Supplementary Data;

Part II Item 9A Controls and Procedures; and

Part IV Item 15 Exhibits and Financial Statement Schedules.

This Amendment should be read in conjunction with our periodic filings made with the SEC subsequent to the date of the Original Report, including any amendments to those filings, as well as any Current Reports filed on Form 8-K subsequent to the date of the Original Report. In addition, in accordance with applicable SEC rules, this Amendment includes updated certifications from our Chief Executive Officer (CEO) and Chief Accounting Officer (CAO) as Exhibits 31.1, 31.2, and 32.1.

F5 NETWORKS, INC.
ANNUAL REPORT ON FORM 10-K/A
Amendment No. 2
For the Fiscal Year Ended September 30, 2005
Table of Contents

		Page
	<u>Explanation of Amendment</u>	2
	PART I	
<u>Item 1.</u>	<u>Business</u>	4
<u>Item 2.</u>	<u>Properties</u>	16
<u>Item 3.</u>	<u>Legal Proceedings</u>	16
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Securities Holders</u>	17
	PART II	
	<u>Market For Registrant's Common Equity, Related Stockholder Matters and Issuer</u>	17
<u>Item 5.</u>	<u>Purchases of Equity Securities</u>	
<u>Item 6.</u>	<u>Selected Financial Data</u>	18
	<u>Management's Discussion and Analysis of Financial Condition and Results of</u>	20
<u>Item 7.</u>	<u>Operations</u>	
<u>Item 7A.</u>	<u>Quantitative and Qualitative Disclosure About Market Risk</u>	38
<u>Item 8.</u>	<u>Financial Statements and Supplementary Data</u>	39
	<u>Changes in and Disagreements with Accountants on Accounting and Financial</u>	79
<u>Item 9.</u>	<u>Disclosure</u>	
<u>Item 9A.</u>	<u>Controls and Procedures</u>	79
<u>Item 9B.</u>	<u>Other Information</u>	81
	PART III	
<u>Item 10.</u>	<u>Directors and Executive Officers of the Registrant</u>	81
<u>Item 11.</u>	<u>Executive Compensation</u>	81
	<u>Security Ownership of Certain Beneficial Owners and Management and Related</u>	81
<u>Item 12.</u>	<u>Stockholder Matters</u>	
<u>Item 13.</u>	<u>Certain Relationships and Related Transactions</u>	81
<u>Item 14.</u>	<u>Principal Accountant Fees and Services</u>	81
	PART IV	
<u>Item 15.</u>	<u>Exhibits and Financial Statement Schedules</u>	81
SIGNATURES		82
<u>EXHIBIT 21.1</u>		
<u>EXHIBIT 31.1</u>		
<u>EXHIBIT 31.2</u>		
<u>EXHIBIT 32.1</u>		

Table of Contents**Forward-Looking Statements**

The statements contained in this report that are not purely historical are 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. Because these forward-looking statements are subject to a number of risks and uncertainties, our actual results could differ materially from those expressed or implied by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed under Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations Risk Factors, below and in other documents we file from time to time with the Securities and Exchange Commission. All forward-looking statements included in this report are based on information available to us on the date hereof. Our business and the associated risks may have changed since the date this report was originally filed with the SEC. We assume no obligation to update any such forward-looking statements. Further, except for the forward-looking statements included in Item 9A, Controls and Procedures, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations Restatement of Consolidated Financial Statements, Special Committee and Company Findings, Internal Controls, Remedial Measures and Related Proceedings and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations Risk Factors, all forward-looking statements contained in this Amendment, unless they are specifically otherwise stated to be made as of a different date, are made as of December 12, 2005, the filing date of the Original Report. In addition, except for the sections of this Amendment entitled Restatement of Consolidated Financial Statements, Special Committee and Company Findings, Internal Controls, Remedial Measures and Related Proceedings and Risk Factors (included in Item 7 below), Item 3, Legal Proceedings, Item 9A, Controls and Procedures, and Note 2, Restatement of Consolidated Financial Statements, and Note 12, Subsequent Events Related to the Special Committee and Company Investigations and the Restatement (unaudited), of the Notes to Consolidated Financial Statements, this Amendment does not reflect events occurring after the filing of the Original Report on December 12, 2005, other than the Restatement, and we undertake no obligation to update the forward-looking statements in this Amendment.

Item 1. Business**General**

F5 Networks, Inc. is a leading provider of application delivery networking products that improve the performance, availability and security of applications running on networks that use the Internet Protocol (IP). IP traffic between servers running applications and clients using those applications passes through our products where the content is inspected to ensure that it is delivered securely and in a way that optimizes the performance and availability of both the network and the applications.

Our BIG-IP products help manage IP traffic between network servers, clients and other devices in a way that maximizes the availability, scalability and throughput of those network components and the applications that run on them. Our complementary FirePass SSL VPN products let enterprises provide anyone connected to the Internet with secure remote access to their corporate networks and applications by leveraging standard Web browser technology. Our TrafficShield application firewall, which is available as a stand-alone appliance and as a software module on BIG-IP, provides content-based, application-level security against malicious attacks that network firewalls and other security devices can't prevent. Our BIG-IP products share a common full-proxy operating system, TMOS, or Traffic Management Operating System, that enables them to inspect and modify traffic flows to and from servers and has built-in functionality to secure, optimize and ensure the availability of application traffic. Our application delivery networking products that are integrated on the TMOS platform also share a common software interface called iControl, which enables them to communicate with one another and allows them to be integrated with third party products, including custom and commercial enterprise applications.

The flexibility of our software-based technology, the breadth of functionality available on our products and the integration of that functionality through iControl and TMOS are characteristics that we believe differentiate our products from other application delivery networking products. These characteristics enable us to provide comprehensive solutions that address many elements required for IP-based networks and business applications,

including high availability, high performance, intelligent traffic management, streamlined manageability, bandwidth optimization, remote access to corporate networks, and network and application security. In connection with our products, we offer a broad range of services including consulting, training, installation, maintenance and other technical support services.

On October 4, 2005, we acquired Swan Labs, Inc., or Swan Labs, for \$43 million in cash. As a result of the transaction, we acquired all the assets of Swan Labs, including its principal products, WANJet and WebAccelerator. WANJet devices are deployed in

Table of Contents

data centers and branch offices to speed up file transfers, email, and the performance of any IP-based application that runs over a Wide Area Network (WAN). WebAccelerator works in concert with WANJet to speed up the performance of IP-based enterprise applications running over WANs. The acquisition of Swan Labs expands our product line and gives us broader access to the WAN optimization and web acceleration markets.

We were incorporated on February 26, 1996 in the State of Washington. Our headquarters is in Seattle, Washington and our mailing address is 401 Elliott Avenue West, Seattle, Washington 98119. The telephone number at our executive offices is (206) 272-5555. We have subsidiaries or branch offices in Australia, Canada, China, France, Germany, Hong Kong, Israel, Japan, Malaysia, Northern Ireland, Russia, Singapore, South Korea, Taiwan, Thailand and the United Kingdom. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports are available free of charge on our website, www.f5.com, as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission. The information found on our Internet site is not part of this or any other report we file with or furnish to the Securities and Exchange Commission.

Unless the context otherwise requires, in this Annual Report on Form 10-K, the terms F5 Networks, the Company, we, us, and our refer to F5 Networks, Inc. and its subsidiaries. Our fiscal year ends on September 30 and fiscal years are referred to by the calendar year in which they end. For example, fiscal year 2005 and fiscal 2005 refer to the fiscal year ended September 30, 2005.

Industry Background

Internet Protocol (IP) is a communications language used to transmit data over the Internet. Since the late 1990 s, businesses have responded to the power, flexibility and economy of the Internet by deploying new IP-based applications, upgrading their client-server applications to new IP-enabled versions, and enabling existing or legacy applications for use over the Internet. Over the next several years, we believe this process will accelerate as more and more organizations discover the benefits of deploying IP-enabled applications and new technologies continue to enhance the performance, reliability and security of both applications and IP networks. In addition, we believe the growth of Internet usage will continue to be driven by new applications such as Web Services, Voice over IP, increased penetration of broadband Internet access, enabling the remote use of more applications, and the increasing popularity of mobile Internet access through wireless devices such as cellular telephones, PDAs and notebook computers.

Internet Architecture

IP requires all data transmitted across the Internet to be divided into packets at the source and reassembled at the destination. The Open Systems Interconnect (OSI) Reference Model is the framework that divides network functions into seven layers and specifies how the layers should interact to enable all of a network s different hardware and software components to work together to accomplish this process. Prior to transmission, each packet of data is automatically given a header that identifies the source and destination of the packet. This header information is used in the OSI Model for the purposes of identifying, routing and sequencing data packets, and is stripped from the data upon arrival at its destination. Layers 2-4 of the OSI Model perform standardized, repetitive tasks such as ensuring that packets of information sent over the Internet arrive at the destination to which they are addressed and are reassembled in the correct sequence. Consequently, most Layer 2-4 switches are hardware-based devices that use application-specific integrated circuits (ASICs) and are optimized for speed. Unlike Layers 2-4, Layer 7, which in practice includes the functions ascribed to Layers 5 and 6 in the OSI model, is complex and variable and must support end-user applications and processes on a wide variety of platforms and devices. While most Layer 4 switches rely on hardware-based architectures to maximize throughput, the demands of processing data at Layer 7 increasingly require flexibility and adaptability that can be achieved only through a software-based solution. The challenge in building highly flexible, function-rich, software-based switches for application delivery networking is to deliver these capabilities at speeds that do not slow the speed of network traffic.

Application Delivery Networking

As more applications are IP-enabled, there is growing demand for Layer 7 technology that can read the entire contents or flow of data in a packetized transmission and make intelligent decisions based on a dynamic set of business rules about how to handle the transmission to make the applications, network, and servers always secure,

fast, and available. Basic Layer 7 functions include load-balancing (distributing traffic across multiple servers while making them appear to be a single server), and health-checking (monitoring the performance of servers and applications to ensure that they are working properly before routing traffic to them). In addition, Layer 7 processing encompasses a growing number of functions that have typically been performed by the server or the application itself, or by point solutions running on separate devices. Functions in this category include: SSL Acceleration using Secure Socket Layer (SSL) encryption to secure traffic between the server and the browser on an end user's client device; Rate

Table of Contents

Shaping prioritizing transmissions according to preset rules that give precedence to different types of traffic; Compression reducing the volume of data transmitted to take maximum advantage of available bandwidth; TCP Optimization improving server efficiency by maintaining an open connection with a server during interactive sessions; IPv6 Translation enabling communication and interoperability between networked devices using IPv6, the newest version of the Internet Protocol, and those using the older version IPv4; and modifying the content of a transaction to improve security.

In addition to optimizing the performance and availability of their networks and applications, enterprises face the increasingly complex challenge of providing security for applications and data that are accessible over their IP networks. Layer 7 or application level security includes three basic components: providing employees, partners and customers with secure access to corporate applications; ensuring that access is limited to those applications for which a user is specifically authorized; and protecting the integrity of applications and data.

Currently, the most widespread solution for secure remote access is technology that uses the IP Security (IPSec) Protocol to establish a secure virtual private network (VPN) between a remote device, such as a user's home PC or a laptop, and the corporate network. Although an IPSec VPN tunnel is very secure, it has a number of drawbacks. One is that IPSec requires the remote device to have special software installed on it, and maintaining the most current version of this software on all user devices is time consuming and costly. A more serious issue is that once IPSec establishes a connection between a user and the corporate network, the user has full access to any application in the network and the only way to prevent unauthorized use is to secure each application or physically segment the network. As an alternative to using IPSec VPNs for remote access, technology that employs SSL encryption to establish a secure VPN has emerged and is making rapid inroads in the market. Because this technology relies on the SSL capabilities resident in any standard Web browser, it is not necessary to install additional software on the remote device. This makes it possible to access the network from a cell phone, PDA, kiosk, laptop, PC, or any other device with a standard browser. In addition, SSL VPN technology supports the creation of separate VPN tunnels to each application for which a user is authorized. This allows enterprises to exercise more control over who can gain access to various parts of the network and to specific applications.

Along with the need to provide secure connectivity between users and applications, enterprises face an immediate and growing need to protect applications and other data center resources from application-level security threats that pass through conventional firewalls and slip past intrusion detection and prevention (IDS and IPS) devices. SQL Slammer Worm, a virus that infected millions of servers in a matter of minutes and nearly shut down the Internet in January 2003, is a prime example of how attacks are now focused at the application level. By exploiting characteristics of the User Datagram Protocol (UDP) which allows direct transmission of data to a server, SQL Slammer Worm slipped past network security devices disguised as a simple data request. Once inside the application, the code rewrote the server's own instructions, replicating and sending copies of itself to thousands of other servers. Because it was a day-zero attack i.e., a brand new threat with no prior history intrusion detection and prevention devices were not equipped with a signature to identify the SQL Slammer Worm and were unable to prevent it.

In the wake of the SQL Slammer Worm and plagued by other malicious attacks, enterprises have begun to look beyond traditional security measures for solutions that can detect and shut down day-zero, application-level attacks. Under the general category of application security, F5's solutions apply a positive security model that contrasts with the negative security model used by IDS and IPS devices. In a negative security model, incoming traffic is checked against a list of signatures for known worms, viruses and other security threats, and if no match is found the traffic is allowed to pass. In a positive security model, incoming traffic is checked against a set of rules that define what specific elements are permissible in traffic headed for a particular application and rejects traffic containing anything that does not conform to the rules. In the case of SQL Slammer Worm, a positive security device would have recognized that the UDP packet carrying the SQL Slammer Worm was not a simple data request and blocked the transmission.

Although products that incorporate a positive security model have been around for many years, they have been inherently slow and this has limited their use to enterprises that have historically placed a high priority on security. Now that application-level attacks threaten to paralyze global business, there is growing demand among enterprises for application security that can ward off these attacks. The challenge is to deliver products that apply a positive

security model to application traffic without slowing network performance.

Since most large enterprises have hundreds if not thousands of servers and applications, it is not practical to build functions that optimize the performance, availability and security of applications into the applications themselves. Even if it were, maintenance costs would be prohibitive and the net result would be a negative impact on the overall performance of servers and applications. Deploying point solutions in the network eliminates those problems but creates a new set of challenges. Using point solutions from multiple vendors can create interoperability issues, and problems that do occur can be difficult to troubleshoot. From a security standpoint, it is also much more difficult to audit traffic passing through multiple devices. As a result, enterprise customers are

Table of Contents

demanding products that integrate the growing number of Layer 7 application traffic management and security functions on a single platform. In the past, we have referred to these functions collectively as application traffic management. However, as the scope and complexity of functions performed at Layer 7 has increased, we believe the term application delivery networking is more apt to describe the components of our addressable market, which include application security, application optimization and application availability.

The F5 Solution

We are a leading provider of application delivery networking products that ensure the security, optimization and availability of applications for any user, anywhere. We believe our products offer the most intelligent architecture and advanced functionality in the marketplace along with performance, flexibility and usability features that help organizations improve the way they serve their employees, customers, and partners while lowering operational costs.

Software Based Products. From inception, we have been committed to the belief that the complexity of Layer 7 application delivery networking requires a software-based rather than a hardware-based solution. We believe our modular software architecture enables us to deliver the broadest range of integrated functionality in the market and facilitates the addition and integration of new functionality. We also believe that integrating our software with commodity hardware components enables us to build products that deliver superior performance, functionality and flexibility at competitive prices.

Full Proxy Architecture. The core of our software technology is the Traffic Management Operating System (TMOS) introduced in September 2004 as part of BIG-IP version 9. We believe this is a major enhancement of our previous technology that enables BIG-IP version 9 to deliver functionality that is superior on many levels to any other application delivery networking product in the market. With TMOS, BIG-IP version 9 employs a full proxy architecture that enables it to inspect, modify and direct both inbound and outbound traffic flows across multiple packets. This ability to manage application traffic to and from servers enables BIG-IP version 9 to direct, optimize and secure that traffic in ways that are not possible with other application delivery networking solutions.

Modular Functionality. In addition to its full proxy architecture, TMOS is specifically designed to facilitate the development and integration of application delivery networking functions as modules that can be added to BIG-IP's core functionality to keep pace with rapidly evolving customer needs. Add-on modules currently available with BIG-IP version 9 include: Intelligent Compression; SSL Acceleration; Layer 7 Rate Shaping; Advanced Client Authentication; IPv6 Gateway; Caching; and others. Recently, we also began shipping TrafficShield, our application firewall, as a software module on BIG-IP, and we are currently beta-testing Global Traffic Manager (GTM) and Link Controller modules on BIG-IP systems at customer sites.

Application Awareness. The open architecture of TMOS includes an application programming interface (API) called iControl that allows our products to communicate with one another and with third-party software and devices. Through this unique feature, third-party applications and network devices can take an active role in shaping IP network traffic, directing traffic based on exact business requirements defined by our customers and solutions partners and tailored to specific applications. This application awareness capability is one of the most important features of our software-based products and further differentiates our solutions from those of our competitors.

Adaptive Intelligence. The full-proxy capabilities of TMOS enable it to inspect or read the entire contents of a transmission across multiple packets and identify specific elements of that transmission, including items such as names, dates, and any type of number or label. Using our industry standard Tool Command Language (TCL) scripting capability, customers can use those elements as variables to create iRules that modify the content and direct the flow of traffic in ways tailored to the dynamic needs of their applications.

Integrated Layer 7 Solutions. The combination of our full proxy architecture and enhanced iRules enables BIG-IP to intercept, inspect and act on the contents of traffic from virtually every type of IP-enabled application. In addition, the modularity of the TMOS architecture allows us to deliver tightly integrated solutions that secure, optimize and ensure the availability of applications and the networks they run on.

Our TrafficShield Application Firewall, which we acquired in 2004, was originally designed to run on a full proxy architecture and has recently been ported to TMOS. Using the full proxy capabilities of TMOS, TrafficShield inspects the contents of a transmission and applies a positive security model to identify and neutralize embedded security threats by comparing the contents with rules that define permissible content for specific applications. This has enabled

us to integrate the application security functions of TrafficShield

7

Table of Contents

with the security and networking features built into TMOS and with the application optimization and availability functions that run on top of TMOS. As a result of this integration, TrafficShield can run as a stand-alone product or as a software module on BIG-IP.

Like TrafficShield, our FirePass SSL-VPN products incorporate a full proxy architecture to provide secure remote access to corporate networks. Incoming requests for access to the network are terminated at the device where the user is authenticated and authorized to access specific applications before the traffic is sent on to the servers that host those applications. Once the connection is established, access is only permitted to those applications for which a user is authorized, and all traffic between the user and the applications is encrypted and audited. We plan to port the FirePass software to TMOS following the release of our next-generation hardware platform. FirePass is currently integrated with our other products primarily through iControl.

During the next 12 months, we also plan to port the application acceleration and WAN optimization technology we recently acquired from Swan Labs to TMOS and integrate it with our other products.

Strategy

Our objective is to lead the industry in delivering the enabling architecture that integrates the network with the applications. This allows organizations to significantly improve costly and time consuming business processes and provide new sources of revenue through highly differentiated offerings. Key components of our strategy include:

Offering a complete application security solution and product set. We plan to utilize the core technologies from our BIG-IP, FirePass and TrafficShield products to deliver standalone and integrated systems that protect applications from hostile and inadvertent threats, including user-to-system application security and system-to-system application security problems. We believe these solutions will differentiate our products in the security market and provide a unique solution to the problem of vulnerability of mission-critical applications.

Investing in technology to continue to meet customer needs. We will continue to invest in research and development to provide our customers with comprehensive, integrated application traffic management and security solutions. Our product development efforts will continue to leverage the unique attributes of our software-based platforms to deliver new features and functions that address the complex and changing needs of our customers. We will continue to use commodity hardware in order to ensure performance and cost competitiveness.

Enhancing the existing channel model. We are investing significant resources in order to further develop our indirect sales channels. We plan to expand our indirect sales channels through leading industry resellers, systems integrators, Internet service providers and other channel partners. We are also recruiting new channel partners and leveraging our existing channels to sell our new security products.

Continuing to build and expand relationships with strategic iControl partners. We plan to capitalize on our strategic relationships with enterprise software vendors who have created interfaces to our products through our iControl application programming interface. These vendors provide us significant leverage in the selling process, because they recommend our products to their customers. In order to differentiate ourselves further from our competitors we plan to explore opportunities to further embed iControl into existing and new third party products and to jointly market and sell our solutions to enterprise customers with these key partners.

Enhancing our brand. We plan to continue building brand awareness that positions us as one of the leading providers of application delivery networking solutions. Our goal is to make the F5 brand to be synonymous with superior technology, high-quality customer service and ease of use.

Products

Our core technology is software for application delivery networking, including application security and secure remote access. Our products are systems that integrate our software with hardware that is built using a combination of commodity components and our own custom ASIC for Layer 4 processing. Our current offerings include three product families: BIG-IP, FirePass and TrafficShield. In addition, we recently acquired two new application optimization products WANJet and WebAccelerator-with the purchase of Swan Labs.

Table of Contents***BIG-IP***

Our family of BIG-IP Local Traffic Managers includes both IP application switches and server appliances. Members of the BIG-IP family differ primarily in the hardware configurations that make up each system. Our current product family includes four application switches: high-end (BIG-IP 6800 and 6400), mid-range (BIG-IP 3400), and an entry-level (BIG-IP 1500). In addition to CPUs for Layer 7 processing, all but the entry-level systems come equipped with our own proprietary ASIC for high-performance Layer 4 processing, a commodity Layer 2-3 switch for connectivity, and commodity ASICs for SSL encryption and decryption and compression. The BIG-IP 520 and 540 server appliances are equipped with CPUs for high-speed Layer 4-7 processing and are designed to accommodate easily-installed upgrade cards that provide fast, integrated SSL encryption and decryption.

Other products in our BIG-IP systems family include BIG-IP Global Traffic Manager, formerly called 3-DNS Controller; BIG-IP ISP Traffic Manager, formerly called Link Controller; and Application Accelerator, introduced in FY05. BIG-IP Global Traffic Manager allows enterprises with geographically dispersed data centers to direct traffic to a particular data center in accordance with customized business rules, or to redirect traffic to an available data center if one of their sites becomes overloaded or is shut down for any reason. BIG-IP ISP Traffic Manager allows enterprises with more than one Internet service provider to manage the use of their available bandwidth to minimize costs while ensuring the highest quality of service. Application Accelerator speeds up the performance and improves the bandwidth utilization of IP-based applications running over wide area networks. All three products can be purchased separately as stand-alone systems or bundled with BIG-IP Local Traffic Manager on a single system.

FirePass

Our FirePass systems provide SSL VPN access for remote users of IP networks and any applications connected to those networks from any standard Web browser on any device. The components of FirePass include a dynamic policy engine, which manages user authentication and authorization privileges, and special components that enable corporations to give remote users controlled access to the full array of applications and resources within the network.

Our FirePass line of SSL VPN servers currently includes the FirePass 1000 and the FirePass 4100, which support 100 and 2000 concurrent users, respectively. Both support the complete range of FirePass software features and offer a comprehensive solution for secure remote access to corporate applications. FirePass 1000 and 4100 are designed to support medium to large businesses.

TrafficShield

TrafficShield is a Web application firewall that provides comprehensive, proactive, application-layer protection against both generalized and targeted attacks. TrafficShield employs a positive security model (deny all unless allowed) to permit only valid and authorized application transactions. As a result, TrafficShield can prevent day-zero attacks and other types of security threats that pass through traditional firewalls and signature-based devices such as intrusion detection and intrusion prevention systems. TrafficShield is available as both a stand-alone system and as an add-on software module for our BIG-IP product family.

WANJet

WANJet, acquired with the purchase of Swan Labs on October 4, 2005, combines WAN optimization and traffic shaping in a single device to accelerate file transfers, email, data replication, and other applications over IP networks. It provides LAN-like performance on any WAN, ensuring predictable application performance for all users, and encrypts and secures all transfers without performance penalties. WANJet is deployed as dual-sided (symmetric) solution that optimizes application traffic to and from data centers and branch offices.

WebAccelerator

WebAccelerator, also acquired through our purchase of Swan Labs, speeds web transactions end-to-end by optimizing individual network object requests, connections, and end-to-end transactions from the browser through to databases. Installed single-sided (asymmetric) in the data center, or dual-sided (symmetric) in the data center and in branch locations, WebAccelerator enhances web application performance from any location, speeding up interactive performance, improving download times, utilizing bandwidth more efficiently, and dramatically reducing the cost and improving the response time of delivering Web-enabled applications to the distributed users.

Currently both WANJet and WebAccelerator run on Swan Labs SL400 hardware platform in the data center and SL 200 platforms in branch locations. Over the next 12 to 18 months, we plan to port both WANJet and

WebAccelerator software to run on TMOS and our standard F5 hardware platforms and to integrate their technology with our other products.

Table of Contents

Enabling Technologies

Our application delivery networking products come equipped with iControl and iControl Services Manager functions, which are designed to facilitate the broader use of our products. iControl allows customers and independent software vendors to modify their programs to communicate with our products, eliminating the need for human involvement, lowering the cost of performing basic network functions and reducing the likelihood of error. Although we do not derive revenue from iControl itself, the sale of iControl-enabled applications by independent software vendors such as Microsoft and Oracle helps promote and often leads directly to the sale of our other products.

iControl Services Manager takes advantage of iControl to provide a single, centralized management and operational interface for our devices. This feature allows customers with dozens or hundreds of our products to upgrade or modify the software on those products simultaneously from a single console. This lowers the cost and simplifies the task of deploying, managing and maintaining our products and reduces the likelihood of error when blanket changes are implemented.

Product Development

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

Our principal software engineering group is located in our headquarters in Seattle, Washington. Our core FirePass product development team is located in San Jose, California. Our core TrafficShield product development team is located in Tel Aviv, Israel. Our hardware engineering group is located in Spokane, Washington. The primary product development facility for WANJet and WebAccelerator is in San Jose, California. There is also a smaller development facility for these products in Belfast, Northern Ireland. Members of these teams collaborate closely with one another to ensure the interoperability and performance of our hardware and software systems. In fiscal 2006, we plan to relocate our San Jose development teams to a single facility.

During the fiscal years ended September 30, 2005, 2004 and 2003, we had research and product development expenses of \$31.5 million, \$24.4 million and \$19.5 million, respectively.

Customers

Our customers include a wide variety of enterprise customers (Fortune 1000 or Business Week Global 1000 companies) including those in telecommunications, financial services, technology, manufacturing, transportation and government. In fiscal year 2005, international sales represented 40.5% of our net revenues. Refer to note 10 of our consolidated financial statements included in this annual report on Form 10-K for additional information regarding our revenues by geographic area.

Consistent with our goal of building a strong channel sales model, the majority of our revenue is generated by sales through our distributors and value-added resellers. For fiscal year 2005, sales to Ingram Micro Inc., one of our distributors, represented 18.6% of our revenues. Our agreement with Ingram Micro is a standard, non-exclusive distribution agreement that renews automatically on an annual basis and is terminable by either party with 30 days prior written notice. The agreement grants Ingram Micro the right to distribute our products to resellers in North America and certain other territories internationally, with no minimum purchase requirements.

Sales and Marketing

Sales

We sell our products and services to large enterprise customers through a variety of channels, including distributors, value-added resellers and systems integrators. A substantial amount of our revenue for fiscal year 2005 was derived from these channel sales. We also sell our products and services to major accounts through our own direct sales force. Our agreements with our channel partners are not exclusive and do not prevent them from selling competitive products. These agreements typically have terms of one year with no obligation to renew, and typically do not provide for exclusive sales territories or minimum purchase requirements.

Table of Contents

Direct sales. Our field sales personnel are located in major cities throughout the Americas; Europe, the Middle East, and Africa (EMEA); Japan and the Asia Pacific region. The inside sales team generates and qualifies leads for regional sales managers and helps manage accounts by serving as a liaison between the field and internal corporate resources. We sell our products directly to a limited group of customers, primarily large enterprise end-users whose accounts are managed by our major account services team. Field systems engineers also support our regional sales managers and channel partners by participating in joint sales calls and providing pre-sale technical resources as needed.

Distributor and value-added reseller relationships. We have established relationships with large national and international distributors, local and specialized distributors and value-added resellers from which we derive the majority of our sales. The distributors sell our products, and the value-added resellers not only sell our products, but also assist their customers in network design, installation and testing. Our field sales personnel will work closely with our channel partners to assist them, if necessary, in the selling of our products to their customers.

Systems integrators. We also market our products through strategic relationships we have with systems integrators. Systems integrators leverage products like ours as a core component of application or network-based solutions that they deploy for their customers. In most cases, systems integrators do not directly purchase our products for resale to their customers. Instead they typically recommend our products as part of a broader solution. An example of this approach would be packaged enterprise resource platform, ERP, or customer relationship management, CRM, solutions delivered by systems integrators where our traffic management products provide high availability and increased performance for the ERP or CRM applications.

Marketing

There are two primary aspects to our marketing strategy. First, we believe our future success depends on our ability to understand and anticipate the dynamic needs of our addressable markets and that we develop valuable solutions to address those needs. Our marketing organization works directly with customers, partners and our product development teams to identify and create innovative solutions to further enhance our leadership position. The second aspect is to continue to build upon our iControl strategy. We have established relationships with various independent software vendors who have adapted their applications to interact with our products via the iControl interface. iControl enhances the functionality of third party applications by enabling them to control the network in an automated way, based on business policies and rules associated with the application. As a result, customers who purchase iControl-enabled applications have an incentive to purchase our products in order to take advantage of the enhanced functionality made possible through our technical cooperation. We also offer an on-line community website called DevCentral that provides technical resources to customers, prospects and partners wanting to extend and optimize F5 solutions using iControl to meet their specific needs.

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

Backlog

At the end of fiscal years 2005 and 2004, we had product backlog of approximately \$11.7 million and \$10.6 million, respectively. Backlog represents orders confirmed with a purchase order for products to be shipped generally within 90 days to customers with approved credit status. Orders are subject to cancellation, rescheduling by customers or product specification changes by the customers. Although we believe that the backlog orders are firm, purchase orders may be cancelled by the customer prior to shipment without significant penalty. For this reason, we believe that our product backlog at any given date is not a reliable indicator of future revenues.

Customer Service and Technical Support

We believe that our ability to provide consistent, high-quality customer service and technical support is a key factor in attracting and retaining large enterprise customers. Accordingly we offer a broad range of support services that include installation, phone support, hardware repair and replacement, software updates, consulting and training services. We deliver these services directly to end users and also utilize a multi-tiered support model, leveraging the

capabilities of our channel partners when applicable. Our technical support staff is strategically located in regional service centers to support our global customer base.

Table of Contents

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

Our customers typically purchase a one-year maintenance contract which entitles them to an array of services provided by our technical support team. Maintenance services provided under the contract include online updates, software error correction releases, hardware repair and replacement, and remote support through a 24 hours a day, 7 days a week help desk, although not all service contracts entitle a customer to round-the-clock call center support. Updates to our software are only available to customers with a current maintenance contract. Our technical support team also offers seminars and training classes for customers on the configuration and use of products, including local and wide area network system administration and management. In addition, we have a professional services team able to provide a full range of fee-based consulting services, including comprehensive network management, documentation and performance analysis, and capacity planning to assist in predicting future network requirements.

We also offer, as part of our maintenance service, an online, automated, self-help customer support function called Ask F5 that allows customers to answer many commonly asked questions without having to call our support desk. This allows the customer to rapidly address issues and questions, while significantly reducing the number of calls to our support desk. This enables us to provide comprehensive customer support while keeping our support-related expenses at a manageable, consistent level.

Manufacturing

We outsource the manufacturing of our pre-configured hardware platforms to contract manufacturers, primarily Solectron Corporation, for assembly according to our specifications. The contract manufacturers install our software onto the hardware platforms and conduct functionality testing, quality assurance and documentation control prior to shipping our products. Our agreement with Solectron allows them to procure component inventory on our behalf based upon a rolling production forecast. Subcontractors supply Solectron with standard parts and components for our products based on our production forecast. We are contractually obligated to purchase component inventory that our contract manufacturer procures in accordance with the forecast, unless we give notice of order cancellation in advance of applicable lead times. As protection against component shortages and to provide replacement parts for our service teams, we also stock limited supplies of certain key components for our products.

Hardware platforms for our products consist primarily of commodity parts and certain custom components designed and approved by our hardware engineering group. Most of our components are purchased from sources which we believe are readily available from other suppliers. However, several components used in the assembly of our products are purchased from single or limited sources such as our proprietary Layer 4 ASIC that is manufactured for us by a third party contract semiconductor foundry.

Competition

As the increasing breadth of our product offerings has enabled us to address a broader array of opportunities within the overall Application Delivery Networking market, our competition has become more numerous and more diverse. Our principal competitor in the traffic management market is Cisco Systems, Inc. Other competitors in this market include Nortel Networks Corporation, Juniper Networks, Inc. (which acquired Redline Networks, Inc.), Citrix Systems, Inc. (which acquired Netscaler), Foundry Networks, Inc. and Radware Ltd. In the adjacent WAN optimization and application acceleration markets, we compete mainly with Juniper (which recently acquired Peribit Systems), Cisco (which recently acquired FineGround), and increasingly Packeteer, Inc.

In the SSL VPN market, we compete with Juniper, Citrix, Aventail Corporation, Nokia, Nortel, and Symantec and a number of smaller players. Because SSL VPNs are a potential replacement for IPSec VPNs, the most widely deployed solution for secure remote access today, we also compete with Check Point Software Technologies, Ltd. which along with Juniper are the market leaders in IPSec VPNs.

Application firewalls represent an emerging market opportunity that is populated mainly by private, early-development-stage companies. One of these companies, Teros, Inc., was recently acquired by Citrix Systems. As we enter this market with our TrafficShield products, we anticipate that we will also encounter competition from vendors of traditional firewalls and other types of security devices, many of which are larger and better-known

vendors than we are.

Some of our competitors have a longer operating history and greater financial, technical, marketing and other resources than we do. These larger competitors also have a more extensive customer base and broader customer relationships, including relationships

Table of Contents

with many of our current and potential customers. In addition, many have large, well-established, worldwide customer support and professional services organizations and a more extensive direct sales force and sales channels. Because of our relatively smaller size, market presence and resources, our larger competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements. There is also the possibility that these companies may adopt aggressive pricing policies to gain market share. As a result, our competitors could undermine our ability to win new customers and maintain our existing customer base.

Intellectual Property

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

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

Employees

As of September 30, 2005, we employed 792 full-time persons, including 217 in product development, 331 in sales and marketing, 147 in professional services and technical support and 97 in finance, administration and operations. None of our employees are represented by a labor union. We have experienced no work stoppages and believe that our employee relations are good.

Directors and Executive Officers of the Registrant

The following table sets forth certain information with respect to our executive officers and directors as of November 30, 2005:

Name	Age	Position
John McAdam	54	President, Chief Executive Officer and Director
Edward J. Eames	47	Senior Vice President of Business Operations
M. Thomas Hull	46	Senior Vice President of Worldwide Sales
Dan Matte	39	Senior Vice President of Marketing
Jeff Pancottine	45	Senior Vice President and GM, Security Business Unit
Andy Reinland	41	Senior Vice President and Chief Finance Officer
Joann M. Reiter	48	Senior Vice President and General Counsel
John Rodriguez	45	Senior Vice President and Chief Accounting Officer
Karl Triebes	38	Senior Vice President of Product Development and Chief Technology Officer
A. Gary Ames(2)(3)	61	Director
Keith D. Grinstein(1)(2)(3)	45	Director
Karl D. Guelich(1)(2)(3)	63	Director
Alan J. Higginson(1)(3)	58	Chairman of the Board of Directors
Rich Malone(3)	57	Director

(1) Member of the Audit Committee.

- (2) Member of the Compensation Committee.
- (3) Member of the Governance and Nominating Committee.

John McAdam has served as our President, Chief Executive Officer and a director since July 2000. Prior to joining us, Mr. McAdam served as General Manager of the Web server sales business at International Business Machines Corporation from

Table of Contents

September 1999 to July 2000. From January 1995 until August 1999, Mr. McAdam served as the President and Chief Operating Officer of Sequent Computer Systems, Inc., a manufacturer of high-end open systems, which was sold to International Business Machines Corporation in September 1999. Mr. McAdam holds a B.S. in Computer Science from the University of Glasgow, Scotland.

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

Table of Contents

M. Thomas Hull has served as our Senior Vice President of Worldwide Sales since October 2003. Prior to joining us, Mr. Hull served as President and Chief Executive Officer of Picture IQ Corporation from April 2001 to October 2003. From September 1998 through April 1999, he served as Vice President of Corporate Sales for Visio Corporation. From April 1999 to January 2000, he served as Senior Vice President of Worldwide Sales for Visio Corporation through its acquisition by Microsoft Corporation in January 2000. From January 2000 through July 2000, Mr. Hull continued to oversee sales of the Visio product set for Microsoft Corporation. He holds a B.S. in Electrical Engineering from the University of Washington.

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

Jeff Pancottine has served as our Senior Vice President and General Manager of our Security Business Unit since June 2004 and as Senior Vice President of Marketing and Business Development since October 2000. Prior to joining us, Mr. Pancottine served as Senior Vice President of Sales and Marketing for the Media Systems Division of Real Networks, Inc., from April 2000 to October 2000. Prior to that, Mr. Pancottine was the Vice President of Business Marketing at Intel Corporation, from November 1999 to April 2000. From June 1997 to November 1999, Mr. Pancottine held the position of Vice President of Global Marketing at Sequent Computer Systems, Inc. Mr. Pancottine holds a Master of Engineering in Computer Science from Cornell University, and a B.S. in Computer Science from the University of California at Riverside. Mr. Pancottine terminated his employment with us in early 2006.

Andy Reinland was promoted to Senior Vice President and Chief Finance Officer effective October 25, 2005. Reinland joined F5 in 1998, serving as a senior financial analyst and, most recently, Vice President of Finance. Prior to joining F5, Reinland was Chief Financial Officer for RTIME, Inc., a developer of real-time 3D software for Internet applications, which was acquired by Sony. Mr. Reinland started his career in public accounting. Mr. Reinland holds a B.A. in Business from Washington State University.

Joann M. Reiter was promoted to Senior Vice President and General Counsel in October 2005 and prior to that had served as our Vice President and General Counsel since April 2000 and as General Counsel from April 1998 through April 2000. She has served as our Corporate Secretary since June 1999. Prior to joining us, Ms. Reiter served as Director of Operations for Excell Data Corporation, an information technology consulting and system integration services company from September 1997 through March 1998. From September 1992 through September 1997 she served as Director of Legal Services and Business Development for CellPro, Inc. a medical device manufacturer. She holds a J.D. from the University of Washington and is a member of the Washington State Bar Association. Ms. Reiter tendered her resignation effective as of November 22, 2006.

John Rodriguez was promoted to Senior Vice President and Chief Accounting Officer effective October 25, 2005. For SEC reporting purposes, Mr. Rodriguez is the principal financial officer. Rodriguez joined F5 in 2001 as Corporate Controller. His most recent position held was Vice President and Corporate Controller. Prior to F5, Rodriguez was Vice President and Chief Financial Officer of CyberSafe, a security solutions company, and Senior Director of Finance and Operations at Mosaix, which was acquired by Lucent Technologies. Mr. Rodriguez started his career in public accounting. Mr. Rodriguez holds a B.A. in Business from the University of Washington.

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

A. Gary Ames was appointed as one of our directors in July 2004. Mr. Ames served as President and Chief Executive Officer of MediaOne International, a provider of broadband and wireless communications from July 1995

until his retirement in June of 2000. From January 1990 to July 1995, he served as President and Chief Executive Officer of U S West Communications, a regional provider of residential and business telephone services, and operator and carrier services. Mr. Ames also serves as director of Albertsons, Inc., Tektronix, Inc., Pac-West Telecomm, Inc. and iPass, Inc.

Keith D. Grinstein has served as one of our directors since December 1999. He also serves as board chair for Coinstar, Inc., a coin counting machine company, and as lead outside director for Nextera, Inc. an economics-consulting firm. Mr. Grinstein is a partner of Second Avenue Partners, LLC, a venture capital fund. Mr. Grinstein's past experience includes serving as President, Chief Executive Officer and Vice Chair of Nextel International Inc., and as President and Chief Executive Officer of the Aviation Communications Division of AT&T Wireless Services Inc. Mr. Grinstein holds a B.A. from Yale University and a J.D. from Georgetown University.

Table of Contents

Karl D. Guelich has served as one of our directors since June 1999 and as board chair from January 2003 through April 2004. Mr. Guelich has been in private practice as a certified public accountant since his retirement from Ernst & Young LLP in 1993, where he served as the Area Managing Partner for the Pacific Northwest offices headquartered in Seattle from October 1986 to November 1992. Mr. Guelich holds a B.S. in Accounting from Arizona State University.

Alan J. Higginson has served as board chair since April 2004, and as one of our directors since May 1996. Mr. Higginson has been the President and Chief Executive Officer of Hubspan, Inc., an e-business infrastructure provider, since August 2001. From November 1995 to November 1998, Mr. Higginson served as President of Atrieva Corporation, a provider of advanced data backup and retrieval technology. Mr. Higginson holds a B.S. in Commerce and an M.B.A. from the University of Santa Clara.

Rich Malone has served as one of our directors since August 2003. Mr. Malone has been the Chief Information Officer of Edward Jones Investments Inc. since 1979, when he joined Edward Jones Investments as a General Principal. In 1985, he became a member of the management committee of Edward Jones Investments. Mr. Malone is currently a member of the BITS Advisory Group, the Xerox Executive Advisory Forum and serves on the Technology Advisory Committee at Arizona State University.

Item 2. Properties

Our principal administrative, sales, marketing, research and development facilities are located in Seattle, Washington and consist of approximately 195,000 square feet. In April 2000, we amended and restated the lease agreement on two buildings for our corporate headquarters. The lease commenced in July 2000 on the first building; and the lease on the second building commenced in September 2000. The lease for both buildings expires in 2012 with an option for renewal. The lease for the second building has been fully subleased through 2012. We believe that our existing properties are in good condition and suitable for the conduct of our business. We also lease office space for our product development personnel in Spokane, Washington, San Jose, California, Israel, Northern Ireland, and Russia and for our sales and support personnel in Washington D.C., New York, Hong Kong, Singapore, China, Taiwan, Malaysia, South Korea, Japan, Australia, Germany, France, and the United Kingdom. We believe that our future growth can be accommodated by current facilities or by leasing additional space if necessary.

Item 3. Legal Proceedings

In July and August 2001, a series of putative securities class action lawsuits were filed in United States District Court, Southern District of New York against certain investment banking firms that underwrote the Company's initial and secondary public offerings, the Company and some of the Company's officers and directors. These cases, which have been consolidated under *In re F5 Networks, Inc. Initial Public Offering Securities Litigation*, No. 01 CV 7055, assert that the registration statements for the Company's June 4, 1999 initial public offering and September 30, 1999 secondary offering failed to disclose certain alleged improper actions by the underwriters for the offerings. The consolidated, amended complaint alleges claims against the Company and those of our officers and directors named in the complaint under Sections 11 and 15 of the Securities Act of 1933, and under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. Other lawsuits have been filed making similar allegations regarding the public offerings of more than 300 other companies. All of these various consolidated cases have been coordinated for pretrial purposes as *In re Initial Public Offering Securities Litigation*, Civil Action No. 21-MC-92. In October 2002, the directors and officers were dismissed without prejudice. The issuer defendants filed a coordinated motion to dismiss these lawsuits in July 2002, which the Court granted in part and denied in part in an order dated February 19, 2003. The Court declined to dismiss the Section 11 and Section 10(b) and Rule 10b-5 claims against the Company. In June 2004, a stipulation of settlement for the claims against the issuer defendants, including the Company, was submitted to the Court. On August 31, 2005, the Court granted preliminary approval of the settlement. The settlement is subject to a number of conditions, including final approval by the Court. If the settlement does not occur, and litigation against us continues, we believe we have meritorious defenses and intend to defend the case vigorously. Securities class action litigation could result in substantial costs and divert our management's attention and resources. Due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of the litigation, and any unfavorable outcome could have a material adverse impact on our business, financial condition and operating results.

As of September 30, 2005 we were not aware of any additional pending legal proceedings that, individually or in the aggregate, would have had a material adverse effect on the Company's business, operating results, or financial condition. We may in the future be party to litigation arising in the ordinary course of business, including claims that we allegedly infringe upon third-party trademarks or other intellectual property rights. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

Table of Contents

See Note 12, *Subsequent Events Related to the Special Committee and Company Investigations and the Restatement*, of the Notes to Consolidated Financial Statements for more information regarding legal and regulatory proceedings that arose following September 30, 2005.

Item 4. Submission of Matters to a Vote of Securities Holders

No matters were submitted to a vote of the shareholders during the fourth quarter of fiscal 2005.

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

Our common stock is traded on The Nasdaq Global Market under the symbol FFIV. As described in Note 12, *Subsequent Events Related to the Special Committee and Company Investigations and the Restatement*, of the Notes to Consolidated Financial Statements, on August 14, 2006, we received a written Staff Determination Notice from The Nasdaq Stock Market (Nasdaq) stating that we were not in compliance with Nasdaq's Marketplace Rule 4310(c)(14) and that our securities were subject to delisting. We appealed this determination with the Nasdaq Listings Qualifications Panel (Panel), and the Panel granted our request for continued listing on the Nasdaq Stock Market, subject to certain conditions we expect to satisfy within the time period request by the Panel.

	Fiscal Year 2005		Fiscal Year 2004	
	High	Low	High	Low
First Quarter	\$49.79	\$30.47	\$27.45	\$19.25
Second Quarter	\$59.12	\$41.25	\$39.21	\$25.13
Third Quarter	\$54.01	\$41.30	\$35.60	\$21.85
Fourth Quarter	\$51.25	\$35.34	\$31.28	\$21.40

The last reported sales price of our common stock on the Nasdaq National Market on December 5, 2005 was \$53.07.

As of December 5, 2005, there were 105 holders of record of our common stock. As many of our shares of common stock are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of beneficial holders of our common stock represented by these record holders.

Dividend Policy

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

Unregistered Securities Sold in 2005

We did not sell any unregistered shares of our common stock during the fiscal year 2005.

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

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

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

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

Net income (loss) per share basic	\$ 1.26	\$ 1.09	\$ 0.09
Weighted average shares basic	37,220	33,221	26,453
Net income (loss) per share diluted	\$ 1.21	\$ 1.01	\$ 0.08
Weighted average shares diluted	38,761	35,961	28,175

Consolidated Balance Sheet Data:

Cash, cash equivalents, and short-term investments(3)	\$ 236,181	\$ 140,501
Restricted cash(4)	3,871	6,243
Long-term investments(3)	128,834	81,792
Total assets	537,739	360,593
Long-term liabilities	9,964	6,228
Total shareholders equity	460,167	307,745

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

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

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

Supplemental Unaudited Information Regarding Restatement Adjustments

The supplemental unaudited information presented below has been included to facilitate an understanding of the components of the Restatement adjustments to retained earnings at September 31, 2002:

	Cumulative effect of restatement on years prior to				
	2003	2002	2001	2000	1999
Stock-based compensation expense	\$ 20,234	\$ 5,248	\$ 6,996	\$ 7,826	\$ 164

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

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

The statements contained below that are not purely historical are 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. Because these forward-looking statements are subject to a number of risks and uncertainties, our actual results could differ materially from those expressed or implied by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed under the heading Risk Factors below and in other documents we file from time to time with the Securities and Exchange Commission. All forward-looking statements set forth below are based on information available to us on the date hereof. Our business and the associated risks may have changed since the date this report was originally filed with the SEC. We assume no obligation to update any such forward-looking statements. Further, except for the forward-looking statements included in Item 9A, Controls and Procedures, and under the headings Restatement of Consolidated Financial Statements, Special Committee and Company Findings, Internal Controls, Remedial Measures and Related Proceedings and Risk Factors in this Item 7, all forward-looking statements contained in this Amendment, unless they are specifically otherwise stated to be made as of a different date, are made as of December 12, 2005, the filing date of the Original Report. In addition, except for the sections of this Amendment entitled Restatement of Consolidated Financial Statements, Special Committee and Company Findings, Internal Controls, Remedial Measures and Related Proceedings and Risk Factors (included in this Item 7 below), Item 3, Legal Proceedings, Item 9A, Controls and Procedures, and Note 2, Restatement of Consolidated Financial Statements, and Note 12, Subsequent Events Related to Special Committee and Company Investigations and the Restatement (unaudited), of the Notes to Consolidated Financial Statements, this Amendment does not reflect events occurring after the filing of the Original Report filed on December 12, 2005, other than the Restatement, and we undertake no obligation to update the forward-looking statements in this Amendment.

The discussion and analysis set forth below in this Item 7 has been amended to reflect the Restatement as described above in the Explanation of Amendment to this Amendment and in Note 2, Restatement of Consolidated Financial Statements, to the Notes to Consolidated Financial Statements. For this reason, the data set forth in this section may not be comparable to discussions and data in our previously filed Annual Reports on Form 10-K.

Restatement of Consolidated Financial Statements, Special Committee and Company Findings, Internal Controls, Remedial Measures and Related Proceedings***Restatement of Consolidated Financial Statements***

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

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

On May 22, 2006, our Board of Directors formed a special committee of outside directors with broad authority to conduct a review of our stock option practices, including a review of our underlying stock option documentation and procedures (the Special Committee). The Special Committee was originally composed of three members of our Board of Directors, one of which was also on the Audit Committee, Karl Guelich, Rich Malone and Gary Ames. In July 2006, the Special Committee was reconstituted to consist of two independent members of our Board of Directors, Gary Ames and Deborah Bevier (who joined our Board of Directors on July 14, 2006). The Special Committee

retained the law firm of Wilson Sonsini Goodrich & Rosati P.C. (Wilson Sonsini) as its independent outside legal counsel. Wilson Sonsini engaged Deloitte Financial Advisory Services LLP as independent accounting experts to aid in its investigation.

Table of Contents

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

In October 2006, the Special Committee determined that the recorded grant dates for certain stock options granted during fiscal years 1999 through 2004 should not be relied upon as the measurement date for accounting purposes and that the accounting treatment used for the vesting of certain stock options was incorrect. Because the prices at the originally stated grant dates were lower than the prices on the actual dates of determination, we determined we should have recognized material amounts of stock-based compensation expense which were not previously accounted for in our previously issued financial statements. Therefore, the Audit Committee after consultation with management, concluded that our previously filed unaudited interim and audited financial statement for the years ended September 30, 2005, 2004, 2003, 2002, 2001, 2000 and 1999, as well as the unaudited interim financial statements for the quarters ended December 31, 2005 and March 31, 2006, should be restated because these financial statements contained material misstatements.

Special Committee and Company Findings

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

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

As a result of the Special Committee's investigation, as well as our internal review of our stock option practices and historical financial statements, we have determined the following:

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

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

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

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

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

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

Table of Contents

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

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

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

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

Internal Controls

Based on the definition of "material weakness" in the Public Company Accounting Oversight Board's Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements, the restatement of financial statements in prior filings with the SEC is a strong indicator of the existence of a "material weakness" in the design or operation of internal control over financial reporting. Based on this definition, management has concluded the issues identified above resulted in a material weakness in our internal control over financial reporting for stock-based compensation as of September 30, 2005 and has disclosed this to the Audit Committee and to our independent registered public accountants. A further discussion of this material weakness, as well as management's remedial measures regarding this material weakness, is set forth in Part II, Item 9A.

Remedial Measures

In connection with the conclusion of its review, the Special Committee recommended that our Board of Directors, and its compensation and audit committees, consider and adopt certain remedial measures related to the issues raised in the Special Committee's investigation, including:

A best practices review and evaluation of our equity compensation controls, processes and procedures;

A best practices review and evaluation of our controls, process and procedures for documentation of corporate actions, including drafting and finalizing minutes, unanimous written consents and other similar corporate documentation;

The adoption of a policy requiring that all equity compensation awards to the board members, officers and employees be granted and priced according to a predetermined schedule; and

Table of Contents

The implementation of a cross-functional training program for certain key employees concerning (i) our equity compensation programs and related improvements to equity compensation controls, processes and procedures; (ii) the accounting implications of our equity compensation programs; and (iii) the legal implications our equity compensation programs.

In addition, at the recommendation of the Special Committee, we have identified and hired an interim general counsel to replace our previous general counsel, who has tendered her resignation.

Management along with our Board of Directors has implemented, or is in the process of implementing, such remedial measures.

Related Proceedings

Internal Revenue Service Audit. We received a notice from the Internal Revenue Service (the IRS) indicating the IRS would be auditing our tax returns for the 2002, 2003, and 2004. We have produced documents and other information to the IRS and are currently in discussions with the IRS to resolve all issues arising from this audit. We do not believe this audit and any settlement with the IRS will have a material adverse impact on our consolidated financial position or results of operations.

Derivative Suits. On May 24, 2006, a shareholder action captioned Adams v. Amdahl et al. was filed against certain of our current and former officers and directors in the King County Superior Court in Washington. The complaint generally alleges that the defendants breached their fiduciary duties to us in connection with the granting of certain stock options. Five additional shareholder derivative complaints, based on substantially the same allegations, were subsequently filed in the Washington federal and state courts. Although litigation is subject to inherent uncertainties, we do not believe the results of these pending actions will, individually or in the aggregate, have a material adverse impact on our consolidated financial position or results of operations.

Nasdaq Delisting. On July 20, 2006 we announced that it would be unlikely that the Special Committee's review would be completed in time for us to file our Form 10-Q for the quarter ended June 30, 2006, by the SEC's deadline of August 14, 2006. In August 2006, we failed to timely file our Form 10-Q for the period ended June 30, 2006 as a result of the ongoing Special Committee investigation. On August 14, 2006, we received a written Staff Determination Notice from Nasdaq stating that we are not in compliance with Nasdaq's Marketplace Rule 4310(c)(14) because we have not timely filed our Quarterly Report on Form 10-Q for the quarter ended June 30, 2006, and that, therefore, our securities are subject to delisting. On August 18, 2006, we appealed Nasdaq's Staff's delisting determination to the Panel and requested an oral hearing before the Panel. On August 23, 2006, Nasdaq's Staff stayed the delisting action pending a final written decision on our appeal by the Panel. A hearing before the Panel occurred on September 22, 2006. On November 28, 2006, we received notice that the Panel had granted our request for continued listing on the Nasdaq Stock Market, subject to certain conditions we expect to satisfy within the time period requested by the Panel.

There is no assurance that we will not be subject to inquiries related to our stock option grant practices by other federal, state or foreign regulatory agencies.

Cost of Related Proceedings and Restated Financial Statements. We have incurred substantial expenses for legal, accounting, tax and other professional services in connection with the Special Committee investigation, our internal review of our historical stock option practices and financial statements, the preparation of the restated financial statements, the SEC and Department of Justice investigation and inquiries from other government agencies, and the related derivative litigation. We estimate these expenses were approximately \$7.0 million in aggregate through the quarter ended September 30, 2006.

Overview

We are a global provider of software and hardware products and services that help companies efficiently and securely manage their Internet traffic. Our products enhance the delivery, optimization and security of application traffic on Internet-based networks. We market and sell our products primarily through indirect sales channels in the Americas (primarily the United States); Europe, the Middle East, and Africa (EMEA); Japan and the Asia Pacific region. Enterprise customers (Fortune 1000 or Business Week Global 1000 companies) in financial services, transportation, government and telecommunications industries continue to make up the largest percentage of our customer base.

During the fiscal year 2005, we announced plans to acquire all of the common stock of Swan Labs, Inc. for cash of \$43.0 million. The merger closed on October 4, 2005, subsequent to our year end. As a result of the transaction, we acquired all the assets of Swan Labs, including its principal products, WANJet and WebAccelerator. WANJet devices are deployed in data centers and branch offices to speed up file transfers, email, and the performance of any IP-based application that runs over a Wide Area Network, or WAN. WebAccelerator works in concert with WANJet to speed up the performance of IP-based enterprise applications running over WANs.

Table of Contents

The acquisition of Swan Labs expands our product line and gives us broader access to the WAN optimization and web acceleration markets.

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

Revenues. The majority of our revenues are derived from sales of our core products; BIG-IP Local Traffic Manager; BIG-IP Global Traffic Manager; BIG-IP ISP Traffic Manager; TrafficShield Application Firewall, and FirePass SSL VPN servers. We also derive revenues from the sales of services including annual maintenance contracts, installation, training and consulting services. We carefully monitor the sales mix of our revenues within each reporting period. We believe customer acceptance rates of our new products and feature enhancements are key indicators of future trends. We also consider overall revenue concentration by customer and by geographic region as additional indicators of current and future trends.

Cost of revenues and gross margins. We strive to control our cost of revenues and thereby maintain our gross margins. Significant items impacting cost of revenues are hardware costs paid to our contract manufacturers, third-party software license fees, and amortization of developed technology, personnel and overhead expenses. Our margins have remained relatively stable over the past two years; however factors such as sales price, product mix, inventory obsolescence, returns, component price increases, and warranty costs could significantly impact our gross margins from quarter to quarter and represent the significant indicators we monitor on a regular basis.

Operating expenses. Operating expenses are substantially driven by personnel and related overhead expenses. Existing headcount and future hiring plans are the predominant factors in analyzing and forecasting future operating expense trends. Other significant operating expenses that we monitor include marketing and promotions, travel, professional fees, computer costs related to the development of new products, facilities and depreciation expenses.

Liquidity and cash flows. Our financial condition remains strong with significant cash and investments and no long term debt. The increase in cash and investments during the fiscal year 2005 was primarily due to net income from operations, with operating activities providing cash of \$85.0 million. Capital expenditures during the fiscal year 2005 were comprised primarily of tenant improvements and information technology infrastructure and equipment to support the growth of our core business activities. On October 4, 2005, subsequent to our year end, we acquired all of the common stock of Swan Labs, Inc. for cash of \$43.0 million. We will continue to evaluate possible acquisitions of or investments in businesses, products, or technologies that we believe are strategic, which may require the use of cash.

Balance sheet. We view cash, short-term and long-term investments, deferred revenue, accounts receivable balances and day's sales outstanding as important indicators of our financial health. Deferred revenues continued to increase due to the growth in the amount of annual maintenance contracts purchased on new products and maintenance renewal contracts related to our existing product installation base. Our day's sales outstanding for the fourth quarter of fiscal 2005 was 47. We expect to maintain this metric in the mid-to-high 40's range going forward.

Critical Accounting Policies

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

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

Revenue Recognition. We recognize revenue in accordance with the guidance provided under Statement of Position (SOP) No. 97-2, Software Revenue Recognition, and SOP No. 98-9 Modification of SOP No. 97-2, Software Revenue Recognition, with Respect to Certain Transactions, Statement of Financial Accounting Standards (SFAS) No. 48,

Revenue Recognition When Right of Return Exists, and SEC Staff Accounting Bulletin (SAB) No. 101, Revenue Recognition in Financial Statements, and SAB No. 104, Revenue Recognition.

Table of Contents

We sell products through distributors, resellers, and directly to end users. We recognize product revenue upon shipment, net of estimated returns, provided that collection is determined to be probable and no significant obligations remain. In certain regions where we do not have the ability to reasonably estimate returns, revenue is recognized upon sale to the end user. In this situation, we receive a sales report from the channel partner to determine when the sales transaction to the end user has occurred. Payment terms to domestic customers are generally net 30 days. Payment terms to international customers range from net 30 to 90 days based on normal and customary trade practices in the individual markets. We have offered extended payment terms ranging from three to six months to certain customers, in which case, revenue is recognized when payments are made.

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

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

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

Reserve for Warranties. A warranty reserve is established based on our historical experience and an estimate of the amounts necessary to settle future and existing claims on products sold as of the balance sheet date. While we believe that our warranty reserve is adequate and that the judgment applied is appropriate, such amounts estimated to be due and payable could differ materially from what will actually transpire in the future.

Accounting for Income Taxes. We utilize the liability method of accounting for income taxes as set forth by Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, or SFAS 109. Accordingly, we are required to estimate our income taxes in each of the jurisdictions in which we operate as part of the process of preparing our consolidated financial statements. This process involves estimating our actual current tax exposure, including assessing the risks associated with tax audits, together with assessing temporary differences resulting from the different treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities. Due to the evolving nature and complexity of tax rules combined with the large number of jurisdictions in which we operate, it is possible that our estimates of our tax liability could change in the future, which may result in additional tax liabilities and adversely affect our results of operations, financial condition and cash flows.

Stock-based compensation. We adopted the fair value recognition provisions of Financial Accounting Standards Board (FASB) Statement No. 123(R), *Share-Based Payment*, (FAS 123R) on July 1, 2005, and as a result recognized \$4.6 million of expense related to stock-based compensation charges included in operating expenses in the fourth quarter of fiscal 2005. Prior to July 1, 2005, we accounted for share-based payments under the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees* and related

Interpretations, as permitted by FASB Statement No. 123, *Accounting for Stock-Based Compensation*. In accordance with APB 25 no compensation cost was required to be recognized for options granted that had an exercise price equal to the market value of the underlying common stock on the date of grant.

We adopted FAS 123R using the modified-prospective-transition method. Under that transition method, compensation cost recognized in the fiscal year 2005 includes: a) compensation cost for all share-based payments granted prior to, but not yet vested as

Table of Contents

of July 1, 2005, based on the grant-date fair value estimated in accordance with the original provisions of FAS 123, and b) compensation cost for all share-based payments granted subsequent to July 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of FAS 123R. Other than the restatement, the results for the prior periods have not been restated.

Effective July 1, 2005 we adopted the straight-line attribution method for recognizing compensation expense. Previously under the disclosure-only provisions of SFAS 123, the Company used the accelerated method of expense recognition pursuant to FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans* (FIN 28). For all unvested options outstanding as of July 1, 2005, the previously measured but unrecognized compensation expense, based on the fair value at the original grant date, will be recognized on an accelerated basis over the remaining vesting period. For share-based payments granted subsequent to July 1, 2005, compensation expense, based on the fair value on the date of grant, will be recognized on a straight-line basis over the vesting period. As of September 30, 2005, there was \$32.7 million of total unrecognized compensation cost, the majority of which will be recognized ratably over the next two years. Going forward, stock compensation expenses may increase as we issue additional equity-based awards to continue to attract and retain key employees.

In addition, the Company recently modified the method in which it issues incentive awards to its employees through stock-based compensation. In prior years, stock-based compensation consisted only of stock options. Beginning in the fourth quarter of fiscal 2005, the Company began to grant restricted stock unit awards instead of stock options. The value of restricted stock units is determined using the intrinsic value method, which in this case, is based on the number of shares granted and the quoted price of our common stock on the date of grant. Alternatively, in determining the fair value of stock options, we use the Black-Scholes option pricing model that employs the following key assumptions. Expected volatility is based on the annualized daily historical volatility of our stock price, over the expected life of the option. Expected term of the option is based on historical employee stock option exercise behavior, the vesting terms of the respective option and a contractual life of ten years. Our stock price volatility and option lives involve management's best estimates at that time, both of which impact the fair value of the option calculated under the Black-Scholes methodology and, ultimately, the expense that will be recognized over the life of the option.

SFAS 123R also requires that we recognize compensation expense for only the portion of options or stock units that are expected to vest. Therefore, we apply estimated forfeiture rates that are derived from historical employee termination behavior. Our estimated forfeiture rate in the fourth quarter of fiscal 2005 is 5%. If the actual number of forfeitures differs from those estimated by management, additional adjustments to compensation expense may be required in future periods.

Results of Operations

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

	Years Ended September 30,		
	2005	2004	2003
	(In thousands, except for percentages)		
Net Revenues			
Products	\$ 219,603	\$ 126,169	\$ 84,197
Services	61,807	45,021	31,698
Total	\$ 281,410	\$ 171,190	\$ 115,895
Percentage of net revenues			
Products	78.0%	73.7%	72.6%
Services	22.0	26.3	27.4
Total	100.0%	100.0%	100.0%

Net Revenues. Total net revenues increased 64.4% in fiscal year 2005 from fiscal year 2004, compared to an increase of 47.7% in fiscal year 2004 from fiscal year 2003. The improvement was due to increased demand for our application delivery networking products and higher services revenues resulting from our increased installed base of products. During fiscal year 2005, each of our primary geographic regions reported higher revenues compared to the prior year period. International revenues represented 40.5%, 39.4% and 34.9% of net revenues in fiscal years 2005, 2004 and 2003, 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 74.1% in fiscal year 2005 and 49.8% in fiscal year 2004 as compared to the previous fiscal year, respectively. The increase in fiscal 2005 was primarily due to absolute growth in the volume of product sales of our BIG-IP product

Table of Contents

line as well as incremental revenues derived from sales of our FirePass and TrafficShield product lines. Sales of our BIG-IP family of application delivery networking products represented 89.1%, 90.3%, and 99.3% of total product revenues in fiscal years 2005, 2004 and 2003, respectively. The decrease as a percentage of total sales was due to an improvement in sales of our other products, such as our FirePass products which represented 9.7% of product revenues in fiscal year 2005.

Net service revenues increased 37.3% in fiscal year 2005 compared to a 42.0% increase for fiscal year 2004 from the prior year, respectively. The decrease in the growth rate was due to an increase in the amount of support services provided by our channel partners. The increase of services revenues in absolute dollars was the result of a growing customer base and continued growth in service renewals from existing customers.

Ingram Micro Inc., one of our domestic distributors, accounted for 18.6%, 19.1%, and 12.6% of our total net revenues in fiscal years 2005, 2004 and 2003, respectively. Ingram Micro accounted for 26.2%, 26.9% and 17.8% of our accounts receivable as of September 30, 2005, 2004 and 2003, respectively.

	Years Ended September 30,		
	2005 (as restated)(1)	2004 (as restated)(1)	2003 (as restated)(1)
	(In thousands, except for percentages)		
Cost of net revenues and Gross margin			
Products	\$ 48,990	\$ 28,406	\$ 17,843
Services	16,194	10,993	9,132
Total	65,184	39,399	26,975
Gross margin	\$ 216,226	\$ 131,791	\$ 88,920
Cost of net revenues and Gross margin (as a percentage of related net revenue)			
Products	22.3%	22.5%	21.2%
Services	26.2	24.4	28.8
Total	23.2	23.0	23.3
Gross margin	76.8%	77.0%	76.7%

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

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 as a percentage of net product revenues remained relatively consistent at 22.3% in fiscal year 2005 as compared to 22.5%

and 21.2% in fiscal years 2004 and 2003, respectively. The increase in absolute dollars is consistent with the increase in product revenues for the corresponding period. Higher indirect product costs including amortization charges of our acquired technology and warranty costs associated with the growth in overall product installation base contributed to the percentage increase as compared to fiscal year 2003.

Cost of Net Service Revenues. Cost of net service revenues consist of the salaries and related benefits of our professional services staff, travel, facilities, and depreciation expenses. Cost of net service revenues as a percentage of net service revenues increased to 26.2% in fiscal year 2005 as compared to 24.4% and 28.8% in fiscal years 2004 and 2003, respectively. The increase in fiscal year 2005 is primarily due to increased salary and benefits attributed to growth in headcount. Professional services headcount at the end of fiscal year 2005 increased to 147 from 124 at the end of fiscal year 2004. Going forward, we expect to continue to increase our cost of service revenues to support our expanded product lines and growing customer base.

Table of Contents

	Years Ended September 30,		
	2005	2004	2003
	(as	(as	(as
	restated)(1)	restated)(1)	restated)(1)
	(In thousands, except for percentages)		
Operating expenses			
Sales and marketing	\$ 89,866	\$ 66,446	\$ 54,897
Research and development	31,516	24,438	19,455
General and administrative	25,486	15,761	12,210
Total	\$ 146,868	\$ 106,645	\$ 86,562
Operating expenses (as a percentage of net revenue)			
Sales and marketing	31.9%	38.8%	47.4%
Research and development	11.2	14.3	16.8
General and administrative	9.1	9.2	10.5
Total	52.2%	62.3%	74.7%

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

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. Stock-based compensation charges for awards to our sales and marketing personnel are included beginning in the fourth quarter of fiscal year 2005. The decrease in sales and marketing expenses as a percentage of total net revenues is the result of leveraging our existing sales and distribution infrastructure to support the increased net revenues. In absolute dollars, sales and marketing expenses increased 35.2% in fiscal year 2005 and 21.0% in fiscal year 2004 as compared to the previous fiscal year, respectively. The increases were primarily due to higher commission and personnel costs, consistent with the increased revenue and headcount for the corresponding period. Sales and marketing headcount at the end of fiscal 2005 increased to 331 from 229 at the end of fiscal 2004 and 211 at the end of fiscal 2003. Stock-based compensation charges of \$2.4 million contributed to the overall increase in fiscal year 2005. We expect to continue to increase sales and marketing expenses in absolute dollars in order to grow revenues and increase our market share.

Research and Development. Research and development expenses consist of the salaries and related benefits for our product development personnel, prototype materials and expenses related to the development of new and improved products, facilities and depreciation expenses. In absolute dollars, research and development expenses increased 29.0% in fiscal year 2005 and 25.6% in fiscal year 2004 as compared to the previous fiscal year, respectively. The increases in fiscal years 2005 and 2004 were primarily due to higher salary and benefits costs attributed to an increase in headcount to 217 in fiscal year 2005 from 185 in fiscal year 2004 and 145 in fiscal 2003. The growth in employee headcount was primarily related to enhancement of our current products and our ability to develop new,

technologically advanced products that meet the changing needs of our customers. Stock-based compensation charges of \$1.5 million contributed to the overall increase in fiscal year 2005. We expect to continue to increase research and development expenses as our future success is dependent on the continued development of our products.

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. The decrease in general and administrative expenses as a percentage of total net revenues is the result of leveraging our existing corporate infrastructure to support the increased net revenues. In absolute dollars, general and administrative expenses increased 61.7% in fiscal year 2005 and increased 29.1% in fiscal year 2004 as compared to the previous fiscal year, respectively. The increase in fiscal year 2005 is due to increased salary and benefit expenses of \$2.6 million and higher professional service fees of \$1.9 million. The increase in personnel costs is consistent with the growth in headcount. General and administrative headcount at the end of fiscal 2005 increased to 97 from 75 at the end of fiscal 2004. Stock-based compensation charges of \$2.8 million contributed to the overall increase in fiscal year 2005. The increase in general and administrative expenses is expected to remain at these increased levels as the Company continues to build its infrastructure to support the worldwide growth of our business.

Table of Contents

	Years Ended September 30,		
	2005	2004	2003
	(as	(as	(as
	restated)(1)	restated)(1)	restated)(1)
	(In thousands, except for percentages)		
Other Income and Income Taxes			
Income from operations	\$ 69,358	\$ 25,146	\$ 2,358
Other income, net	8,076	2,731	751
Income before income taxes	77,434	27,877	3,109
Provision (benefit) for income taxes	30,532	(8,451)	853
Net income	\$ 46,902	\$ 36,328	\$ 2,256
Other Income and Income Taxes (as percentage of net revenue)			
Income from operations	24.6%	14.7%	2.0%
Other income, net	2.9	1.6	0.6
Income before income taxes	27.5	16.3	2.7
Provision (benefit) for income taxes	10.8	(4.9)	0.7
Net income	16.7%	21.2%	1.9%

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

Other Income, Net. Other income, net, consists of interest income and foreign currency transaction gains and losses. Other income, net, increased 195.7% in fiscal year 2005 and increased 263.6% in fiscal year 2004 as compared to the previous fiscal year, respectively. The significant increase was due to a combination of higher yields and increased investment balances. The increased investment balances are the result of cash provided from operating and financing activities during the fiscal years 2005 and fiscal year 2004. Net proceeds of \$113.6 million received from the sale of common stock in a public offering completed in November of 2003 was the most significant addition to our investment balances.

Provision for Income Taxes. We recorded a 39.4% provision for income taxes for the fiscal year 2005. As of fiscal year-end 2005 we do not have a valuation allowance on any of our deferred tax assets in any of the jurisdictions in which we operate because we believe that the assets are more likely than not to be realized. In making this determination we have considered projected future taxable income and ongoing prudent and feasible tax planning strategies in assessing the appropriateness of a valuation allowance. Our net deferred tax assets as of fiscal year end 2005, 2004 and 2003 were \$40.4 million, \$31.6 million and \$0, respectively. Our world wide 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 that are taken on returns filed in the various geographic locations in which we operate, introduction of new accounting standards or changes in tax laws or interpretations thereof in any of the various geographic locations in which we operate. We have recorded liabilities to address potential 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 fiscal year 2004, the primary difference between the statutory tax rate and the effective tax rate was due to previously unrecognized deferred tax assets which were recognized. SFAS 109, provides for the recognition of deferred tax assets if realization is more likely than not. Based on available evidence, which includes our historical operating performance and the reported cumulative net losses in all prior years, we had provided for a full valuation allowance against our deferred tax assets at the end of fiscal year 2003. Based upon our operating performance in fiscal year 2004 and projected future taxable income, we determined that our U.S. deferred tax assets were more likely than not to be realizable. Therefore, the valuation allowance was reversed and as a result we realized an income tax benefit of \$11.9 million. The credit from the release of the valuation allowance was partially offset by actual U.S. and international tax expenses resulting in a net benefit for income taxes of \$8.5 million in fiscal year 2004. The provision for income taxes in fiscal year 2003 consisted primarily of taxes payable in foreign jurisdictions.

Table of Contents**Liquidity and Capital Resources**

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

	Years Ended September 30,		
	2005	2004	2003
(In thousands)			
Liquidity and Capital Resources			
Cash and cash equivalents and investments	\$ 365,015	\$ 222,293	\$ 79,010
Cash provided by operating activities	84,987	40,590	14,610
Cash used in investing activities	(126,760)	(164,713)	(38,053)
Cash provided by financing activities	68,867	138,468	12,833

Cash and cash equivalents, short-term investments and long-term investments totaled \$365.0 million as of September 30, 2005 compared to \$222.3 million as of September 30, 2004, representing an increase of \$142.7 million. The increase was due to the cash flow from operations and cash from employee stock option exercises. In fiscal year 2004, overall cash and investments increased \$143.3 million compared to the fiscal year 2003. The increase was primarily due to the net proceeds of \$113.6 million from the sale of 5,175,000 shares of common stock in a public offering completed in November 2003.

Cash provided by operating activities during fiscal year 2005 was \$85.0 million compared to \$40.6 million in fiscal year 2004 and \$14.6 million in fiscal year 2003. Cash provided by operating activities resulted primarily from cash generated from net income, after adjusting for non-cash charges, changes in operating assets and liabilities and an increase in advance payments from customers.

Cash used in investing activities was \$126.8 million for the fiscal year 2005, \$164.7 million for fiscal year 2004 and \$38.1 million for fiscal year 2003. The cash used in the fiscal year 2005 was primarily due to the purchase of investments and property and equipment partially offset by the sale of investments. The cash used in fiscal year 2004 was due to the purchase of investments, primarily made possible by the proceeds of our public offering, and the purchase of property and equipment and the acquisition of MagniFire, partially offset by the sale of investments. The cash used in fiscal year 2003 was primarily the result of the cash used to acquire substantially all the assets of uRoam and the purchase of investments and property and equipment partially offset by the sale of investments.

Cash provided by financing activities was \$68.9 million for fiscal year 2005 compared to \$138.5 million for fiscal year 2004 and \$12.8 million for the fiscal year 2003. In fiscal years 2005 and 2003, our financing activities consisted of cash proceeds received from the exercise of stock options and purchases under our employee stock purchase plan. During the fiscal year 2004, our financing activities included \$113.6 million of net proceeds received from a public stock offering as well as cash received from the exercise of employee stock options and purchases under our employee stock purchase plan.

We expect that our existing cash and investment balances and cash from operations will be sufficient to meet our anticipated working capital and capital expenditures for the foreseeable future.

Obligations and Commitments

The following table summarizes our contractual payment obligations and commitments as of September 30, 2005:

	Payment Obligations by Year						Total
	2006	2007	2008	2009	2010	Thereafter	
(In thousands)							
Operating leases	\$ 7,647	\$ 7,341	\$ 6,700	\$ 6,853	\$ 6,831	\$ 11,915	\$ 47,287
Purchase obligations	8,322						8,322
Total	\$ 15,969	\$ 7,341	\$ 6,700	\$ 6,853	\$ 6,831	\$ 11,915	\$ 55,609

We lease our facilities under operating leases that expire at various dates through 2014.

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

Table of Contents

Recent Accounting Pronouncements

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

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

Table of Contents

Risk Factors

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

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

We expect the application delivery networking market to be characterized by rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards. Our continued success depends on our ability to identify and develop new products and new features for our existing products to meet the demands of these changes, and for those products and features to be accepted by our existing and target customers. If we are unable to identify, develop and deploy new products and new product features on a timely basis, our business and results of operations may be harmed.

In September 2004, we announced the release of our next-generation BIG-IP product featuring the Traffic Management Operating System, or TMOS. This major new version of BIG-IP represented the culmination of over two years of research and development efforts. TMOS is specifically designed to facilitate the development and integration of application delivery functions as modules that can be added to BIG-IP's core functionality to keep pace with rapidly evolving customer needs. We currently offer software modules as add-ons for this product and our continued success depends significantly on our ability to integrate new modules and functionality onto this platform and the acceptance of the new hardware and software platforms associated with this release by our existing and target customers.

The current life cycle of our products is typically 12 to 24 months. The introduction of new products or product enhancements may shorten the life cycle of our existing products, or replace sales of some of our current products, thereby offsetting the benefit of even a successful product introduction, and may cause customers to defer purchasing our existing products in anticipation of the new products. This could harm our operating results by decreasing sales, increasing our inventory levels of older products and exposing us to greater risk of product obsolescence. We have also experienced, and may in the future experience, delays in developing and releasing new products and product enhancements. This has led to, and may in the future lead to, delayed sales, increased expenses and lower quarterly revenue than anticipated. Also, in the development of our products, we have experienced delays in the prototyping of our products, which in turn has led to delays in product introductions. In addition, complexity and difficulties in managing product transitions at the end-of-life stage of a product can create excess inventory of components associated with the outgoing product that can lead to increased expenses. Any or all of the above problems could materially harm our business and operating results.

Our success depends on sales and continued innovation of our BIG-IP product lines

For the fiscal year ended September 30, 2005, we derived 89.1% of our product revenues from sales of our BIG-IP family of application delivery networking product lines. We expect to derive a significant portion of our net revenues from sales of our BIG-IP products in the future. Implementation of our strategy depends upon BIG-IP being able to solve critical network availability and performance problems of our customers. If BIG-IP is unable to solve these problems for our customers or if we are unable to sustain the high levels of innovation in BIG-IP's product feature set needed to maintain leadership in what will continue to be a competitive market environment, our business and results of operations will be harmed.

We may not be able to compete effectively in the emerging application delivery networking market

The markets we serve are new, rapidly evolving and highly competitive, and we expect competition to persist and intensify in the future. Our principal competitors in the application delivery networking market include Cisco Systems, Inc., Nortel Networks Corporation, Foundry Networks, Inc., Citrix Systems, Inc., Radware Ltd. and Juniper Networks, Inc. We expect to continue to face additional competition as new participants enter our market. In addition, larger companies with significant resources, brand recognition and sales channels may form alliances with or acquire competing application delivery networking solutions and emerge as significant competitors. Potential competitors may bundle their products or incorporate an Internet traffic management or security component into existing products in a manner that discourages users from purchasing our products.

Table of Contents**Our quarterly and annual operating results are volatile and may cause our stock price to fluctuate**

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

Further, our operating results may be below the expectations of securities analysts and investors in future quarters or years. Our failure to meet these expectations will likely harm the market price of our common stock.

The average selling price of our products may decrease and our costs may increase, which may negatively impact gross profits

It is possible that the average selling prices of our products will decrease in the future in response to competitive pricing pressures, increased sales discounts, new product introductions by us or our competitors or other factors. Therefore, in order to maintain our gross profits, we must develop and introduce new products and product enhancements on a timely basis and continually reduce our product costs. Our failure to do so will cause our net revenue and gross profits to decline, which will harm our business and results of operations. In addition, we may experience substantial period-to-period fluctuations in future operating results due to the erosion of our average selling prices.

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

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

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

We rely on third party contract manufacturers to assemble our products. We outsource the manufacturing of our hardware platforms to contract manufacturers who assemble these hardware platforms to our specifications. We have experienced minor delays in shipments from contract manufacturers in the past. However, if we experience major delays in the future or other problems, such as inferior quality and insufficient quantity of product, any one or a combination of these factors may harm our business and results of operations. The inability of our contract manufacturers to provide us with adequate supplies of our products or the loss of our contract manufacturer may cause a delay in our ability to fulfill orders while we obtain a replacement manufacturer and may harm our business and results of operations. In particular, because we subcontract substantially all of our manufacturing to a single contract manufacturer, with whom we do not have a long-term contract, any termination, loss or impairment in our arrangement with this single source of hardware assembly, or any impairment of their facilities or operations, would

harm our business, financial condition and results of operation.

Table of Contents

If the demand for our products grows, we will need to increase our raw material and component purchases, contract manufacturing capacity and internal test and quality control functions. Any disruptions in product flow may limit our revenue, may harm our competitive position and may result in additional costs or cancellation of orders by our customers.

Our business could suffer if there are any interruptions or delays in the supply of hardware components from our third-party sources

We currently purchase several hardware components used in the assembly of our products from a number of single or limited sources. Lead times for these components vary significantly. The unavailability of suitable components, any interruption or delay in the supply of any of these hardware components, or the inability to procure a similar component from alternate sources at acceptable prices within a reasonable time, may delay assembly and sales of our products and, hence, our revenues, and may harm our business and results of operations.

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

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

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. In the ordinary course of our business, we are involved in disputes and licensing discussions with others regarding their claimed proprietary rights and cannot assure you that we will always successfully defend ourselves against such claims. If we are found to infringe the proprietary rights of others, or if we otherwise settle such claims, we could be compelled to pay damages or royalties and either obtain a license to those intellectual property rights or alter our products so that they no longer infringe upon such proprietary rights. Any license could be very expensive to obtain or may not be available at all. Similarly, changing our products or processes to avoid infringing the rights of others may be costly or impractical. In addition, we have initiated, and may in the future initiate, claims or litigation against third parties for infringement of our proprietary rights, to determine the scope and validity of our proprietary rights or those of our competitors. Any of these claims, whether claims that we are infringing the proprietary rights of others, or vice versa, with or without merit, may be time-consuming, result in costly litigation and diversion of technical and management personnel or require us to cease using infringing technology, develop non-infringing technology or enter into royalty or licensing agreements. Further, our license agreements typically require us to indemnify our customers, distributors and resellers for infringement actions related to our technology, which could cause us to become involved in infringement claims made against our customers, distributors or resellers. Any of the above-described circumstances relating to intellectual property rights disputes could result in our business and results of operations being harmed.

Many of our products include intellectual property licensed from third parties. In the future, it may be necessary to renew licenses for third party intellectual property or obtain new licenses for other technology. These third party licenses may not be available to us on acceptable terms, if at all. The inability to obtain certain licenses, or litigation regarding the interpretation or enforcement of license rights and related intellectual property issues, could have a material adverse effect on our business, operating results and financial condition. Furthermore, we license some third party intellectual property on a non-exclusive basis and this may limit our ability to protect our intellectual property rights in our products.

We may not be able to sustain or develop new distribution relationships and a reduction or delay in sales to a significant distribution partner could hurt our business

Our sales strategy requires that we establish and maintain multiple distribution channels in the United States and internationally through leading industry resellers, systems integrators, Internet service providers and other channel partners. We have a limited number of agreements with companies in these channels, and we may not be able to increase our number of distribution relationships or maintain our existing relationships. If we are unable to establish or

maintain our indirect sales channels, our business and results of operations will be harmed. In addition, one domestic distributor of our products accounted for 18.6% and 19.1% of our total net revenue for the fiscal years 2005 and 2004, respectively. A substantial reduction or delay in sales of our products to this or any other key distribution partner could harm our business, operating results and financial condition.

Table of Contents**Undetected software errors may harm our business and results of operations**

Software products frequently contain undetected errors when first introduced or as new versions are released. We have experienced these errors in the past in connection with new products and product upgrades. We expect that these errors 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. 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 errors, 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.

Our operating results are exposed to risks associated with international commerce

As our international sales increase, our operating results become more exposed to international operating risks. These risks include risks related to potential recessions in economies outside the United States, foreign currency exchange rates, managing foreign sales offices, regulatory, political, or economic conditions in specific countries, military conflict or terrorist activities, changes in laws and tariffs, inadequate protection of intellectual property rights in foreign countries, foreign regulatory requirements, and natural disasters. All of these factors could have a material adverse effect on our business. We intend to continue expanding into international markets. International sales represented 40.5% and 39.4% of our net revenues for the fiscal years ended September 30, 2005 and 2004, respectively. In particular, in fiscal year 2005, we derived 13.7% of our total revenue from the Japanese market. This revenue is dependent on a number of factors outside our control, including the viability and success of our resellers and the strength of the Japanese economy.

Changes in governmental regulations could negatively affect our revenues

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

Acquisitions, including our recent acquisition of Swan Labs, present many risks and we may not realize the financial and strategic goals that are contemplated at the time of the transaction

With respect to our acquisitions, as well as any other future acquisitions we may undertake, we may find that the acquired assets do not further our business strategy as expected, or that we paid more than what the assets are later worth, or that economic conditions change, all of which may generate future impairment charges. There may be difficulty integrating the operations and personnel of the acquired business, and we may have difficulty retaining the key personnel of the acquired business. We may have difficulty in incorporating the acquired technologies or products with our existing product lines. Our ongoing business and management's attention may be disrupted or diverted by transition or integration issues and the complexity of managing geographically and culturally diverse locations. We may have difficulty maintaining uniform standards, controls, procedures and policies across locations. We may experience significant problems or liabilities associated with the product quality, technology and other matters.

Our inability to successfully operate and integrate newly-acquired businesses appropriately, effectively and in a timely manner, or to retain key personnel of any acquired business, could have a material adverse effect on our ability to take advantage of further growth in demand for integrated traffic management and security solutions and other advances in technology, as well as on our revenues, gross margins and expenses.

Table of Contents**Our success depends on our key personnel and our ability to attract and retain qualified sales and marketing, operations, product development and professional services personnel**

Our success depends to a significant degree upon the continued contributions of our key management, product development, sales, marketing and finance personnel, many of whom may be difficult to replace. The complexity of our application delivery networking products and their integration into existing networks and ongoing support, as well as the sophistication of our sales and marketing effort, requires us to retain highly trained professional services, customer support and sales personnel. Competition for qualified professional services, customer support and sales personnel in our industry is intense because of the limited number of people available with the necessary technical skills and understanding of our products. Our ability to retain and hire these personnel may be adversely affected by volatility or reductions in the price of our common stock, since these employees are generally granted stock options. The loss of services of any of our key personnel, the inability to retain and attract qualified personnel in the future or delays in hiring qualified personnel, may harm our business and results of operations.

We face litigation risks

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

Our historical stock option practices and the restatement of our prior financial statements have exposed us to greater risks associated with litigation. In May 2006, several derivative actions were filed against certain current and former directors and officers based on allegations relating to our historical stock option practices. We cannot assure you that this current litigation will result in the same conclusions reached by the Special Committee.

We may in the future be subject to additional litigation arising in relation to our historical stock option practices and the restatement of our prior period financial statements. Litigation may be time consuming, expensive and distracting for management from the conduct of our business. The adverse resolution of any lawsuit could have a material adverse effect on our business, financial condition and results of operations. We cannot assure you that any future litigation relating to our historical stock option practices will result in the same conclusions reached by the Special Committee. Furthermore, if we are subject to adverse findings in any of these matters, we could be required to pay damages or penalties or have other remedies imposed upon us which could adversely affect our business, results of operations, or financial condition.

The matters relating to the Special Committee's review of our historical stock option practices and the restatement of our consolidated financial statements has resulted in regulatory proceedings against us and may result in future regulatory proceedings, which could have a material adverse impact on our financial condition

On November 8, 2006, we announced that the Special Committee had completed its review of our historical stock option practices. Upon completion of its review, the Special Committee found that the recorded grant dates for certain stock options granted during fiscal years 1999 to 2004 should not be relied upon as the measurement date for accounting purposes and the accounting treatment used for the vesting of certain stock options was incorrect. Based on the Special Committee's review, to correct the accounting treatment, we have amended the Original Report and our Quarterly Reports on Form 10-Q for the three months ended December 31, 2005 and March 31, 2006 to restate the consolidated financial statements contained in those reports.

We have received notice from both the SEC and the Department of Justice that they are conducting informal inquiries into our historical stock option practices, and we have continually cooperated with both agencies. Considerable legal and accounting expenses related to our historical stock option practices have already been incurred to date and significant expenditures may continue to be incurred in the future. We may in the future be subject to additional regulatory proceedings or actions arising in relation to our historical stock option practices and the restatement of our prior period financial statements. Any potential regulatory proceeding or action may be time consuming, expensive and distracting for management from the conduct of our business. The adverse resolution of any potential regulatory proceeding or action could adversely affect our business, results of operations, or financial condition. We cannot assure you that the SEC and Department of Justice inquiries, or any future regulatory action

relating to our historical stock option practices, will result in the same conclusions reached by the Special Committee. Furthermore, if we are subject to adverse findings in any of these matters, we could be required to pay damages or penalties or have other remedies imposed upon us, including criminal penalties, which could adversely affect our business, results of operations, or financial condition.

Table of Contents

As a result of our delayed filing of our Form 10-Q for the quarter ended June 30, 2006, our inability to maintain our Form S-3 eligibility may adversely affect our ability to raise future capital

As a result of our delayed filing of our Form 10-Q for the quarter ended June 30, 2006, we will be ineligible to register our securities on Form S-3 for sale by us or resale by other security holders until we have timely filed all periodic reports under the Securities Exchange Act of 1934 for one year from the date the Form 10-Q for the quarter ended June 30, 2006 was due. In the meantime, we have the ability to use Form S-1 to raise capital or complete acquisitions, which could increase the transaction costs and adversely affect our ability to raise capital or complete acquisitions of other companies during this period.

Anti-takeover provisions could make it more difficult for a third party to acquire us

Our Board of Directors has the authority to issue up to 10,000,000 shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by the stockholders. The rights of the holders of common stock may be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock may have the effect of delaying, deferring or preventing a change of control of our company without further action by our stockholders and may adversely affect the voting and other rights of the holders of common stock. Further, certain provisions of our bylaws, including a provision limiting the ability of stockholders to raise matters at a meeting of stockholders without giving advance notice, may have the effect of delaying or preventing changes in control or management of our company, which could have an adverse effect on the market price of our common stock. In addition, our articles of incorporation provide for a staggered board, which may make it more difficult for a third party to gain control of our board of directors. Similarly, state anti-takeover laws in the State of Washington related to corporate takeovers may prevent or delay a change of control of our company.

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

Interest Rate Risk. Our cash equivalents consist of high-quality securities, as specified in our investment policy guidelines. The policy limits the amount of credit exposure to any one issue or issuer to a maximum of 5% of the total portfolio with the exception of U.S. treasury securities, commercial paper and money market funds, which are exempt from size limitation. The policy requires investments in securities that mature in three years or less, with the average maturity being no greater than one and a half years. These securities are subject to interest rate risk and will decrease in value if interest rates increase. A decrease of one percent in the average interest rate would have resulted in a decrease of approximately \$2.6 million in our interest income for the fiscal year 2005.

	Three Months or Less	Three Months to One Year	Maturing in Greater Than One Year	Total	Fair Value
	(In thousands, except for percentages)				
September 30, 2005					
Included in cash and cash equivalents	\$ 298	\$	\$	\$ 298	\$ 298
Weighted average interest rate	2.5%				
Included in short-term investments	\$89,015	\$ 95,299	\$	\$184,314	\$184,314
Weighted average interest rates	2.6%	2.3%			
Included in long-term investments	\$	\$	\$128,834	\$128,834	\$128,834
Weighted average interest rates			3.1%		
September 30, 2004					
Included in cash and cash equivalents	\$16,363	\$	\$	\$ 16,363	\$ 16,363
Weighted average interest rate	1.1%				
Included in short-term investments	\$64,410	\$ 51,190	\$	\$115,600	\$115,600
Weighted average interest rates	1.3%	1.8%			
Included in long-term investments	\$	\$	\$ 81,792	\$ 81,792	\$ 81,792
Weighted average interest rates			2.0%		
September 30, 2003					
Included in cash and cash equivalents	\$ 3,972	\$	\$	\$ 3,972	\$ 3,972
Weighted average interest rate	1.1%				
Included in short-term investments	\$29,409	\$ 5,118		\$ 34,527	\$ 34,527
Weighted average interest rates	1.6%	2.1%			
Included in long-term investments	\$	\$	\$ 34,132	\$ 34,132	\$ 34,132
Weighted average interest rates			2.0%		

Foreign Currency Risk. The majority of our sales and expenses are denominated in U.S. dollars and as a result, we have not experienced significant foreign currency transaction gains and losses to date. While we have conducted some transactions in foreign currencies during the fiscal year ended September 30, 2005 and expect to continue to do so, we do not anticipate that foreign currency transaction gains or losses will be significant at our current level of operations. However, as we continue to expand our operations internationally, transaction gains or losses may become significant

in the future. We have not engaged in foreign currency hedging to date. However, we may do so in the future.

Table of Contents

Item 8. Financial Statements and Supplementary Data

**F5 NETWORKS, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

	Page
Consolidated Financial Statements	
<u>Report of Independent Registered Public Accounting Firm</u>	40
<u>Consolidated Balance Sheets</u>	42
<u>Consolidated Income Statements</u>	43
<u>Consolidated Statements of Shareholders' Equity</u>	44
<u>Consolidated Statements of Cash Flows</u>	45
<u>Notes to Consolidated Financial Statements</u>	46
Supplementary Data	78
Valuation and Qualifying Accounts and Reserves	78

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

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

Consolidated financial statements and financial statement schedule

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the consolidated financial position of F5 Networks, Inc. and its subsidiaries at September 30, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2005 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. As discussed in Note 2 to the consolidated financial statements, the Company has restated its 2005, 2004 and 2003 consolidated financial statements.

Internal control over financial reporting

Also, we have audited management's assessment, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A, that F5 Networks, Inc. did not maintain effective internal control over financial reporting as of September 30, 2005, because of errors identified related to the granting and modification of stock options and the related accounting for and disclosure of stock-based compensation expense, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit.

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

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

a material effect on the financial statements.

Table of Contents

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

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

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

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

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Seattle, Washington

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

Table of Contents

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

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

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

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

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

Table of Contents

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

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

(1) See Note 2,
Restatement of

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

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

43

Table of Contents

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

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

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

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

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

Table of Contents

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

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

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

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

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

Table of Contents

F5 NETWORKS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

The Company

F5 Networks, Inc., (the Company) provides products and services to help companies efficiently and securely manage their Internet traffic. The Company s products improve the performance, availability and security of applications running on Internet-based networks. Internet traffic between servers running applications and clients using these applications passes through the Company s products where the content is inspected to ensure that it is safe and modified as necessary to ensure that it is delivered securely and in a way that optimizes the performance of both the network and the applications. The Company also offers a broad range of services such as consulting, training, installation, maintenance, and other technical support services.

Certain Risks and Uncertainties

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

Accounting Principles

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

Principles of Consolidation

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

Reclassifications

Certain reclassifications have been made to prior year balances to conform to the current period presentation. The reclassifications had no impact on previously reported net income or shareholders equity.

Use of Estimates

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

Cash and Cash Equivalents

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

Table of Contents**Investments**

The Company classifies its investment securities as available for sale. Investment securities, consisting of corporate and municipal bonds and notes and United States government securities, are reported at fair value with the related unrealized gains and losses included as a component of accumulated other comprehensive income (loss) in shareholders' equity. Realized gains and losses and declines in value of securities judged to be other than temporary are included in other income (expense). The cost of investments for purposes of computing realized and unrealized gains and losses is based on the specific identification method. Investments in securities with maturities of less than one year or where management's intent is to use the investments to fund current operations are classified as short-term investments. Investments with maturities of greater than one year are classified as long-term investments.

Concentration of Credit Risk

The Company extends credit to customers and is therefore subject to credit risk. The Company performs initial and ongoing credit evaluations of its customers' financial condition and does not require collateral. An allowance for doubtful accounts is recorded to account for potential bad debts. Estimates are used in determining the allowance for doubtful accounts and are based upon an assessment of selected accounts and as a percentage of remaining accounts receivable by aging category. In determining these percentages, the Company evaluates historical write-offs, and current trends in customer credit quality, as well as changes in credit policies.

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

Fair Value of Financial Instruments

Short-term and long-term investments are recorded at fair value as the underlying securities are classified as available for sale and marked-to-market at each reporting period. The fair value is determined using quoted market prices for the securities held.

Inventories

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

Inventories consist of the following (in thousands):

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

Restricted Cash

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

Property and Equipment

Property and equipment is stated at cost. Depreciation of property and equipment are provided using the straight-line method over the estimated useful lives of the assets, ranging from two to five years. Leasehold improvements are amortized over the lesser of the

Table of Contents

lease term or the estimated useful life of the improvements. The cost of normal maintenance and repairs is charged to expense as incurred and expenditures for major improvements are capitalized at cost. Gains or losses on the disposition of assets are reflected in the income statements at the time of disposal.

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

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

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

Goodwill

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

Other Assets

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

Software development costs are charged to research and development expense until technological feasibility is established. The Company accounts for internally-generated software development costs in accordance with Statement of Financial Accounting Standards (SFAS) No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed. Thereafter, until the product is released for sale, software development costs are capitalized and reported at the lower of unamortized cost or net realizable value of each product. The establishment of technological feasibility and the ongoing assessment of recoverability of costs require considerable judgment by the Company with respect to certain internal and external factors, including, but not limited to, anticipated future gross product revenues, estimated economic life and changes in hardware and software technology. The Company did not capitalize any software development costs in fiscal year 2005. During the fiscal year 2004, the Company capitalized \$424,000 of software development costs. Related amortization costs of \$272,000, \$328,000, and \$298,000 were recorded during the fiscal years 2005, 2004, and 2003, respectively.

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

Impairment of Long-Lived Assets

The Company assesses the impairment of long-lived assets whenever events or changes in business circumstances indicate that the carrying amount of an asset may not be recoverable. When such events occur, management

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

Table of Contents**Revenue Recognition**

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

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

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

Shipping and Handling

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

Guarantees and Product Warranties

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

The Company offers warranties of one year for hardware, with the option of purchasing additional warranty coverage in yearly increments. The Company accrues for warranty costs as part of its cost of sales based on associated material product costs and technical support labor costs. During the years ended September 30, 2005, 2004 and 2003 warranty expense was \$2.2 million, \$0.9 million and \$0.3 million, respectively.

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

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

Edgar Filing: F5 NETWORKS INC - Form 10-K/A

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

Table of Contents**Research and Development**

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

Advertising

Advertising costs are expensed as incurred. The Company incurred \$1.7 million, \$1.7 million and \$1.0 million in advertising costs during the fiscal years 2005, 2004 and 2003, respectively.

Income Taxes

The Company utilizes the liability method of accounting for income taxes as set forth by Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*, or SFAS 109. Deferred income tax assets and liabilities are determined based upon differences between the financial statement and income tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The realization of deferred tax assets is based on historical tax positions and estimates of future taxable income. A valuation allowance is recorded when it is more likely than not that some of the deferred tax assets will not be realized.

Foreign Currency

The functional currency for the Company's foreign subsidiaries is the local currency in which the respective entity is located, with the exception of F5 Networks, Ltd., in the United Kingdom that uses the U.S. dollar as its functional currency. An entity's functional currency is determined by the currency of the economic environment in which the majority of cash is generated and expended by the entity. The financial statements of all majority-owned subsidiaries and related entities, with a functional currency other than the U.S. dollar, have been translated into U.S. dollars in accordance with Statement of Financial Accounting Standards No. 52 *Foreign Currency Translation*. All assets and liabilities of the respective entities are translated at year-end exchange rates and all revenues and expenses are translated at average rates during the respective period. Translation adjustments are reported as a separate component of accumulated other comprehensive income (loss) in shareholders equity.

Foreign currency transaction gains and losses are a result of the effect of exchange rate changes on transactions denominated in currencies other than the functional currency, including U.S. dollars. Gains and losses on those foreign currency transactions are included in determining net income or loss for the period of exchange. The net effect of foreign currency gains and losses were not significant during the fiscal year ended September 30, 2005. Net transaction losses of \$466,000 and \$544,000 were charged to operations for the fiscal year ended September 30, 2004 and 2003, respectively.

Segments

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

Stock-Based Compensation

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

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

Table of Contents

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

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

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

The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The Company does not anticipate declaring dividends in the foreseeable future. Expected volatility is based on the annualized daily historical volatility of our stock price commensurate with the expected life of the option. Expected term of the option is based on an evaluation of the historical employee stock option exercise behavior, the vesting terms of the respective option and a contractual life of ten years. Our stock price volatility and option lives involve management's best estimates at that time, both of which impact the fair value of the option calculated under the Black-Scholes methodology and, ultimately, the expense that will be recognized over the life of the option. SFAS 123R also requires that we recognize compensation expense for only the portion of options or stock units that are expected to vest. Therefore, the Company applies estimated forfeiture rates that are derived from historical employee termination behavior. The estimated forfeiture rate in the fourth quarter of fiscal 2005 is 5%. If the actual number of forfeitures differs from those estimated by management, additional adjustments to compensation expense may be required in future periods.

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

Table of Contents

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

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

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

Earnings Per Share

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

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

Years Ended September 30,

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

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

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

Table of Contents**Recent Accounting Pronouncements**

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

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

Table of Contents**2. Restatement of Consolidated Financial Statements**

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

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

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

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

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

Special Committee and Company Findings

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

The Special Committee concluded that there were options grants where the Company (i) used improper measurement dates in connection with certain annual stock option grants to employees because the number of shares certain individual employees were entitled to receive was not determined until after the original grant date, (ii) granted options to certain new employees and board members prior to their start dates, (iii) did not have sufficient documentation to support certain measurement dates and did not obtain the necessary approvals for stock options issued to certain individuals, (iv) did not properly account for stock option grants issued to a consultant who later became an employee, and (v) did not properly account for stock options of certain individuals that were modified after the grant date. Based on its investigation, the Special Committee concluded that it continued to have confidence in the

ability of the Company's current senior management to serve in their positions with integrity at the Company. The Special Committee was unable to reach any conclusions regarding the intent of former officers, directors and employees. Based on the Special Committee's findings, the Company has adopted and is implementing a number of remedial measures designed to improve its policies, controls, processes and procedures relating to the granting and modification of stock-based compensation and will provide additional training for personnel responsible for administration of the Company's equity compensation plans.

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

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

Table of Contents

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

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

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

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

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

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

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

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

Table of Contents

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

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

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

Edgar Filing: F5 NETWORKS INC - Form 10-K/A

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

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

Table of Contents

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

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

Edgar Filing: F5 NETWORKS INC - Form 10-K/A

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

Table of Contents

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

	Year Ended September 30,								
	2005			2004			2003		
	As previously reported	Adjustments	As restated	As previously reported	Adjustments	As restated	As previously reported	Adjustments	As restated
Net revenues									
Products	\$ 219,603	\$	\$ 219,603	\$ 126,169	\$	\$ 126,169	\$ 84,197	\$	\$ 84,197
Services	61,807		61,807	45,021		45,021	31,698		31,698
Total	281,410		281,410	171,190		171,190	115,895		115,895
Cost of net revenues									
Products	48,985	\$ 5	48,990	28,404	\$ 2	28,406	17,837	\$ 6	17,843
Services	16,172	22	16,194	10,975	18	10,993	9,068	64	9,132
Total	65,157	27	65,184	39,379	20	39,399	26,905	70	26,975
Gross profit	216,253	(27)	216,226	131,811	(20)	131,791	88,990	(70)	88,920
Operating expenses									
Sales and marketing	89,253	613	89,866	65,378	1,068	66,446	53,504	1,393	54,897
Research and development	31,349	167	31,516	24,361	77	24,438	19,260	195	19,455
General and administrative	23,760	1,726	25,486	15,744	17	15,761	12,037	173	12,210
Total	144,362	2,506	146,868	105,483	1,162	106,645	84,801	1,761	86,562
Income from operations	71,891	(2,533)	69,358	26,328	(1,182)	25,146	4,189	(1,831)	2,358
Other income, net	8,076		8,076	2,731		2,731	751		751
Income before income taxes	79,967	(2,533)	77,434	29,059	(1,182)	27,877	4,940	(1,831)	3,109
Provision (benefit) for income taxes	28,234	2,298	30,532	(3,894)	(4,557)	(8,451)	853		853
Net income	\$ 51,733	\$ (4,831)	\$ 46,902	\$ 32,953	\$ 3,375	\$ 36,328	\$ 4,087	\$ (1,831)	\$ 2,256
Net income per share basic	\$ 1.39	\$ (0.13)	\$ 1.26	\$ 0.99	\$ (0.10)	\$ 1.09	\$ 0.15	\$ (0.06)	\$ 0.09

Weighted average shares basic	37,220		37,220	33,221		33,221	26,453		26,453
Net income per share diluted	\$ 1.34	\$ (0.13)	\$ 1.21	\$ 0.92	\$ 0.09	\$ 1.01	\$ 0.14	\$ (0.06)	\$ 0.08
Weighted average shares diluted	38,733	28	38,761	35,992	(31)	35,961	28,220	(45)	28,175

Table of Contents

Shares used for purposes of computing diluted earnings per share are different in this Amendment than those in the Company's Original Report as unearned stock compensation, significant amounts of which were recorded as part of our restatement and have been presented in shareholders' equity, is considered proceeds for purposes of applying the treasury stock method to determine incremental common shares to be included in diluted shares in periods in which the Company has reported net income.

The following table presents the Company's net income per share computations for the years ended September 30, 2005, 2004 and 2003 (in thousands, except per share amounts):

	Income (as restated)	Shares (as restated)	Per share amount (as restated)
Year ended September 30, 2003			
Basic net income per share:			
Net income	\$ 2,256	26,453	\$ 0.09
Effect of dilutive securities:			
Incremental common shares attributable to shares issuable under employee stock option plans		1,722	
Diluted net income per share:	\$ 2,256	28,175	\$ 0.08
Year ended September 30, 2004			
Basic net income per share:			
Net income	\$ 36,328	33,221	\$ 1.09
Effect of dilutive securities:			
Incremental common shares attributable to shares issuable under employee stock option plans		2,740	
Diluted net income per share:	\$ 36,328	35,961	\$ 1.01
Year ended September 30, 2005			
Basic net income per share:			
Net income	\$ 46,902	37,220	\$ 1.26
Effect of dilutive securities:			
Incremental common shares attributable to shares issuable under employee stock option plans		1,541	
Diluted net income per share:	\$ 46,902	38,761	\$ 1.21

Table of Contents

Consolidated Statement of Cash Flows for the years ended September 31, 2005, 2004 and 2003 (in thousands except for share amounts):

	Year Ended September 30,								
	2005			2004			2003		
	As previously reported	Adjustments	As restated	As previously reported	Adjustments	As restated	As previously reported	Adjustments	As restated
Operating activities									
Net income	\$ 51,733	\$ (4,831)	\$ 46,902	\$ 32,953	\$ 3,375	\$ 36,328	\$ 4,087	\$ (1,831)	\$ 2,256
Adjustments to reconcile net income to net cash provided by operating activities:									
Realized loss (gain) on disposition of assets	569		569	21		21	(14)		(14)
Realized (gain) loss on sale of investments				(3)		(3)	232		232
Stock-based compensation	4,573	833	5,406	10	1,182	1,192	83	1,831	1,914
Provision for doubtful accounts and sales returns	1,419		1,419	1,189		1,189	1,148		1,148
Depreciation and amortization	6,797		6,797	5,355		5,355	5,162		5,162
Deferred income taxes	(7,733)		(7,733)	(33,886)		(33,886)			
Tax benefit from employee stock option plans	32,298	(145)	32,153	26,382	(4,697)	21,685			
Changes in operating assets and liabilities, net of amounts acquired:									
Accounts receivable	(20,456)		(20,456)	(4,152)		(4,152)	354		354
Inventories	(1,002)		(1,002)	(928)		(928)	(408)		(408)
	(3,604)		(3,604)	(642)		(642)	(54)		(54)

Edgar Filing: F5 NETWORKS INC - Form 10-K/A

Other current assets								
Other assets	(149)		(149)	(630)		(630)	(512)	(512)
Accounts payable and accrued liabilities	9,283	4,143	13,426	6,163	140	6,303	(320)	(320)
Deferred revenue	11,259		11,259	8,758		8,758	4,852	4,852
Net cash provided by operating activities	\$ 84,987	\$	\$ 84,987	\$ 40,590	\$	\$ 40,590	\$ 14,610	\$ 14,610

Table of Contents

In connection with the preparation of the Company's restated financial statements, the Company also determined that the pro forma disclosures for stock-based compensation expense required under FAS 123, *Accounting for Stock-Based Compensation* included in Note 1 of the Notes to Consolidated Financial Statements included in the Company's originally filed Annual Report on Form 10-K/A (Amendment No. 1), were incorrect. The Company has corrected these errors in Note 1 of these Consolidated Financial Statements. These corrections do not affect the Company's consolidated statements of operations, consolidated balance sheets or consolidated statements of cash flows for any period.

The following table presents the effect of these corrections on the Company's pro forma calculation of its net income and earnings per share for the years ended September 30, 2005, 2004 and 2003 (in thousands, except per share amounts):

	Year Ended September 30,								
	2005			2004			2003		
	As previously reported	Adjustments	As restated	As previously reported	Adjustments	As restated	As previously reported	Adjustments	As restated
Net income (loss)	\$ 51,733	\$ (4,831)	\$ 46,902	\$ 32,953	\$ 3,375	\$ 36,328	\$ 4,087	\$ (1,831)	\$ 2,256
Add: Stock-based employee compensation expense included in reported net income		833	833	10	1,182	1,192	83	1,831	1,914
Deduct: Stock-based employee compensation expense determined under fair value based method for all awards	7,020	141	7,161	18,913	443	19,356	23,371	1,031	24,402
Pro forma net loss	\$ 44,713	\$ (4,139)	\$ 40,574	\$ 14,050	\$ 4,114	\$ 18,164	\$ (19,201)	\$ (1,031)	\$ (20,232)
Net income (loss) per share (basic)	\$ 1.39	\$ (0.13)	\$ 1.26	\$ 0.99	\$ 0.10	\$ 1.09	\$ 0.15	\$ (0.06)	\$ 0.09
Net loss per share (basic), pro forma	\$ 1.20	\$ (0.11)	\$ 1.09	\$ 0.42	\$ 0.13	\$ 0.55	\$ (0.73)	\$ (0.01)	\$ (0.72)
	\$ 1.34	\$ (0.13)	\$ 1.21	\$ 0.92	\$ 0.09	\$ 1.01	\$ 0.14	\$ (0.06)	\$ 0.08

Net income
(loss) per share
(diluted)

Net loss per
share (diluted),
pro forma

\$ 1.15	\$ (0.10)	\$ 1.05	\$ 0.39	\$ 0.12	\$ 0.51	\$ (0.73)	\$ (0.01)	\$ (0.72)
---------	-----------	---------	---------	---------	---------	-----------	-----------	-----------

61

Table of Contents**3. Short-Term and Long-Term Investments**

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2005				
Corporate bonds and notes	\$ 56,352	\$	\$ (275)	\$ 56,077
Municipal bonds and notes	45,500			45,500
U.S. government securities	83,061	1	(325)	82,737
	\$ 184,913	\$ 1	\$ (600)	\$ 184,314

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2004				
Corporate bonds and notes	\$ 37,060	\$ 2	\$ (140)	\$ 36,922
Municipal bonds and notes	59,750		(15)	59,735
U.S. government securities	19,054		(111)	18,943
	\$ 115,864	\$ 2	\$ (266)	\$ 115,600

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2005				
Corporate bonds and notes	\$ 61,932	\$	\$ (1,007)	\$ 60,925
U.S. government securities	68,497		(588)	67,909
	\$ 130,429	\$	\$ (1,595)	\$ 128,834

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2004				
Corporate bonds and notes	\$ 45,286	\$ 31	\$ (328)	\$ 44,989
U.S. government securities	37,007	3	(207)	36,803
	\$ 82,293	\$ 34	\$ (535)	\$ 81,792

The amortized cost and fair value of fixed maturities at September 30, 2005, by contractual years-to-maturity, are presented below (in thousands):

	Amortized Cost	Fair Value
One year or less	\$ 184,913	\$ 184,314
Over one year through five years	130,429	128,834
	\$ 315,342	\$ 313,148

The Company invests in securities that are rated investment grade or better. The unrealized losses on these investments were caused by interest rate increases and not credit quality. The Company has determined the unrealized losses are temporary as the duration of the decline in value of investments has been short, the extent of the decline, in both dollars and as a percentage of costs, is not significant, and the Company has the ability and intent to hold the investments until it recovers at least substantially all of the cost of the investments.

Table of Contents

The following table summarizes investments that have unrealized losses as of September 30, 2005 (in thousands):

	Less Than 12 Months		12 Months of Greater		Total	
	Gross		Gross		Gross	
	Unrealized		Unrealized		Unrealized	
	Fair		Fair		Fair	
	Value	Losses	Value	Losses	Value	Losses
September 30, 2005						
Corporate bonds and notes	\$ 74,686	\$ 796	\$ 33,316	\$ 486	\$ 108,002	\$ 1,282
U.S. government securities	107,912	605	37,733	308	145,645	913
Total	\$ 182,598	\$ 1,401	\$ 71,049	\$ 794	\$ 253,647	\$ 2,195

4. Business Combinations

The Company's acquisitions are accounted for under the purchase method of accounting in accordance with Statement of Financial Accounting Standards No. 141, Business Combinations. The total purchase price is allocated to the tangible and intangible assets acquired and the liabilities assumed based on their estimated fair values. The excess of the purchase price over those fair values is recorded as goodwill. The fair value assigned to the tangible and intangible assets acquired and liabilities assumed are based on estimates and assumptions provided by management, and other information compiled by management, including independent valuations, prepared by valuation specialists that utilize established valuation techniques appropriate for the technology industry. In accordance with Statement of Financial Accounting Standards No. 142, Goodwill and other Intangible Assets, goodwill is not amortized but instead is tested for impairment at least annually.

2004 Acquisition of MagniFire Websystems, Inc.

On May 31, 2004, the Company completed its acquisition of MagniFire Websystems, Inc. a provider of web application firewall products. As a result of the merger, the Company acquired all the assets of MagniFire, including MagniFire's web application firewall product line (TrafficShield), all property, equipment and other assets that MagniFire used in its business and assumed certain of the liabilities of MagniFire. The purchase price was \$30.5 million including \$1.5 million of transactions costs. The results of operations of MagniFire have been included in the Company's consolidated financial statements since June 1, 2004.

The purchase price allocation is as follows (in thousands):

Assets acquired

Cash	\$ 895
Accounts receivable, net	152
Restricted cash	76
Other assets	625
Property and equipment	81
Developed technology	5,000
Goodwill	25,488
Total assets acquired	\$ 32,317

Liabilities assumed

Accrued liabilities	\$ (723)
Deferred tax liability	(1,069)
Deferred revenue	(25)
Total liabilities assumed	(1,817)

Net assets acquired	\$ 30,500
---------------------	-----------

Of the total estimated purchase price, \$5.0 million was allocated to developed technology. To determine the value of the developed technology, a combination of cost and market approaches were used. The cost approach required an estimation of the costs required to reproduce the acquired technology. The market approach measures the fair value of the technology through an analysis of recent comparable transactions. The \$5.0 million allocated to developed technology is being amortized on a straight-line basis over an estimated useful life of five years.

At the time of the acquisition, the estimated purchase price was allocated to goodwill in the amount of \$24.8 million, including the Company's full valuation allowance on deferred taxes. During the fourth quarter of fiscal year 2004, the Company reversed the valuation allowance and therefore increased the amount allocated to goodwill by an additional \$1.1 million due to the deferred tax liability that was assumed as a result of the acquisition. During the fourth quarter of fiscal year 2005, the Company adjusted the fair value of certain other assets and as a result decreased the amount allocated to goodwill by \$0.4 million.

Table of Contents**2003 Acquisition of uRoam, Inc.**

On July 23, 2003, the Company acquired substantially all of the assets of uRoam, Inc. (uRoam), including uRoam's FirePass product line, and assumed certain liabilities for cash of \$25.0 million. The Company also incurred \$2.4 million of direct transaction costs for a total purchase price of \$27.4 million. uRoam's FirePass server is a comprehensive remote access product that enables users to access applications in a secure fashion using industry standard Secured Socket Layer technology. The acquired technology is currently being amortized over its estimated useful life of five years using the straight-line method. The excess of the purchase price over the fair value of the identifiable tangible and intangible net assets acquired of \$24.2 million was recorded as goodwill. The results of operations of uRoam have been included in the Company's consolidated financial statements from the date of acquisition.

The purchase price allocation is as follows (in thousands):

Assets acquired

Accounts receivable, net	\$ 335
Property and equipment	4
Developed technology	3,000
Goodwill	24,188
Total assets acquired	\$ 27,527

Liabilities assumed

Accrued liabilities	\$ (29)
Deferred revenue	(125)
Total liabilities assumed	(154)

Net assets acquired **\$ 27,373**

Pro Forma Results

The unaudited pro forma condensed combined consolidated summary financial information below, presents the combined results of operations as if the acquisitions had occurred on October 1, 2002. For pro forma reporting purposes, the fiscal year 2004 presentation includes the results of operations of MagniFire from October 1, 2003 through May 31, 2004, the date of acquisition. The fiscal year 2003 presentation includes the results of operations of uRoam from October 1, 2002 through July 23, 2003 and the results of MagniFire for the entire year.

Unaudited pro forma financial information is as follows (in thousands, except per share data):

	Year Ended September 30, 2004 (as restated) (1)	Year Ended September 30, 2003 (as restated) (1)
Net revenues - pro forma	\$ 171,309	\$ 116,944
Net income (loss) - pro forma	\$ 28,700	\$ (7,307)
Net income (loss) per share - basic - pro forma	\$ 0.86	\$ (0.28)
Net income (loss) per share - diluted - pro forma	\$ 0.80	\$ (0.28)

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

Net pro forma adjustments (unaudited) of \$1.5 million and \$2.2 million for the fiscal years 2004 and 2003, respectively, have been made to the combined results of operations reflecting the amortization of the developed

technology acquired and the net change in interest income (expense) had the respective acquisition taken place at the beginning of the period. The unaudited pro forma financial information does not reflect integration costs, or cost savings or other synergies anticipated as a result of the acquisition. This information is not necessarily indicative of the operating results that would have occurred if the acquisition had been consummated on the date indicated nor is it necessarily indicative of future operating results of the combined enterprise.

Table of Contents**5. Balance Sheet Details**

Other assets consist of the following (in thousands):

	Years Ended September 30,	
	2005	2004
Software development costs	\$ 521	\$ 793
Acquired technology	5,367	6,967
Deposits and other	2,435	519
	\$ 8,323	\$ 8,279

Amortization expense related to other assets was approximately \$1.9 million, \$1.3 million, and \$0.4 million for the fiscal years ended September 30, 2005, 2004 and 2003, respectively.

Estimated amortization expense for software development costs and acquired technology for the five succeeding fiscal years is as follows (in thousands):

2006	\$ 1,872
2007	\$ 1,849
2008	\$ 1,500
2009	\$ 667
2010	
	\$ 5,888

Accrued liabilities consist of the following (in thousands):

	Years Ended September 30,	
	2005	2004
Payroll and benefits	\$ 11,572	\$ 9,007
Sales and marketing	1,544	1,997
Restructuring	559	625
Warranty	1,564	1,062
Income taxes	4,265	940
Other	4,427	2,457
	\$ 23,931	\$ 16,088

Table of Contents

As of September 30, 2005, restructuring liabilities were \$0.6 million and consisted of obligations under an excess facility operating lease. The excess facility charge was initially recognized during fiscal 2002 as part of the Company's decision to discontinue its cache appliance business and exit its support facility in Washington D.C. The remaining liability approximates the full amount owed through the remainder of the lease term, expiring in 2007, and actual losses are not expected to vary from the original estimate.

The activity of the remaining restructuring liability as of September 30, 2005 and 2004 is presented below (in thousands):

	Balance at September 30, 2004	Additional Charges	Cash Payments and Write-Offs	Balance at September 30, 2005
Excess facilities	\$ 625	\$	\$ (66)	\$ 559
Other				
	\$ 625	\$	\$ (66)	\$ 559
	Balance at September 30, 2003	Additional Charges	Cash Payments and Write-Offs	Balance at September 30, 2004
Excess facilities	\$ 782	\$	\$ (157)	\$ 625
Other	62		(62)	
	\$ 844	\$	\$ (219)	\$ 625

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

	Years Ended September 30,	
	2005	2004
Income taxes payable	\$ 3,880	\$ 1,720
Deferred rent and other	2,770	2,136
	\$ 6,650	\$ 3,856

Table of Contents**6. Income Taxes**

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

	Years Ended September 30,		
	2005	2004	2003
	(as	(as	(as
	restated)	restated)	restated)
	(1)	(1)	(1)
United States	\$ 73,797	\$ 26,533	\$ 1,693
International	3,637	1,344	1,416
	\$ 77,434	\$ 27,877	\$ 3,109

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

	Years Ended September 30,		
	2005	2004	2003
	(as	(as	(as
	restated)	restated)	restated)
	(1)	(1)	(1)
Current			
U.S. federal	\$ 33,827	\$ 133	\$
State	2,451	129	45
Foreign	750	923	657
Total	37,028	1,185	702
Deferred			
U.S. federal	(6,129)	(9,034)	141
State	(653)	(602)	10
Foreign	286		
Total	(6,496)	(9,636)	151
	\$ 30,532	\$ (8,451)	\$ 853

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

	Years Ended September 30,		
	2005	2004	2003
	(as	(as	(as
	restated)	restated)	restated)
	(1)	(1)	(1)
Income tax provision at statutory rate	\$ 27,102	\$ 9,757	\$ 1,088
State taxes, net of federal benefit	1,874	706	36
Impact of international operations	2,417	357	91
Research and development and other credits	(2,057)	(1,397)	(1,017)
Other	3,845	(1,498)	(60)
Change in valuation allowance	(2,649)	(28,062)	4,382

Edgar Filing: F5 NETWORKS INC - Form 10-K/A

Impact of stock option compensation on valuation allowance		11,686	(3,667)
	\$ 30,532	\$ (8,451)	\$ 853

Table of Contents

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

	Years Ended September 30,		
	2005 (as restated) (1)	2004 (as restated) (1)	2003 (as restated) (1)
Deferred tax assets			
Net operating loss carry-forwards	\$ 25,002	\$ 26,427	\$ 22,318
Allowance for doubtful accounts	915	810	844
Accrued compensation and benefits	1,140	690	591
Inventories and related reserves	417	210	198
Other accruals and reserves	6,097	2,248	1,773
Depreciation	462	838	831
Tax credit carry-forwards	7,631	5,552	4,156
	41,664	36,775	30,711
Valuation allowance		(2,649)	(30,711)
Deferred tax liabilities			
Purchased intangibles and other	(1,277)	(2,506)	(151)
Net deferred tax assets (liabilities)	\$ 40,387	\$ 31,620	\$ (151)

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

During the fourth quarter of fiscal year 2005 the Company determined, based on an evaluation of current operating results and projected future taxable income that the valuation allowance of \$2.6 million pertaining to net operating loss carry-forwards in the United Kingdom was no longer needed and as a result the related valuation allowance was reversed. In the prior year, the Company determined that the U.S. deferred tax assets were more likely than not to be realizable and reversed the related valuation allowance during the fourth quarter of fiscal 2004. The Company had provided for a full valuation allowance against the deferred tax assets at the end of fiscal year 2003. If the estimates and assumptions used in the Company's determination change in the future, the Company could be required to revise the Company's estimates of the valuation allowances against the Company's deferred tax assets and adjust the Company's provisions for additional income taxes.

At September 30, 2005, the Company had approximately \$64.3 million of U.S. net operating loss carry-forwards resulting from tax benefits associated with employee stock option plans, a portion of which begins to expire in 2011. The Company also had net operating loss carry-forwards of approximately \$7.4 million related to operations in the United Kingdom that carry-forward indefinitely. At September 30, 2005, the Company also has federal research credit carry-forwards of approximately \$7.2 million which, if not utilized, will begin to expire in fiscal year 2011 and state research credit carry-forwards of \$349,000 which will begin to expire in fiscal year 2025.

United States income and foreign withholding taxes have not been provided on approximately \$1.8 million of undistributed earnings from the Company's international subsidiaries. The Company has not recognized a deferred tax liability for the undistributed earnings of its foreign subsidiaries because the Company currently does not expect to remit those earnings in the foreseeable future. Determination of the amount of unrecognized deferred tax liability related to undistributed earnings of foreign subsidiaries is not practicable because such liability, if any, is dependent on circumstances existing if and when remittance occurs.

On October 22, 2004, the American Jobs Creation Act of 2004 (AJCA) was signed into law. The AJCA provides for a temporary 85% dividends received deduction on certain earnings repatriated during either fiscal year 2005 or fiscal year 2006. The deduction would result in an approximate 5.25% federal tax rate on the repatriated earnings. To qualify for the deduction, the earnings must be reinvested in the U.S. pursuant to a domestic reinvestment plan established by a company's chief executive officer and approved by the company's board of directors. Additionally, certain other significant criteria, as outlined in the AJCA, must also be met. F5 Networks did not elect this provision in fiscal year 2005, and does not intend to make an election in fiscal year 2006.

7. Shareholders' Equity

Common Stock

In November 2003, the Company sold 5,175,000 shares, including 675,000 shares sold upon the exercise of the underwriters' over-allotment option, of its common stock in a public offering at a price of \$23.25 per share. The proceeds to the Company were \$113.6 million, net of offering costs of \$6.7 million.

Table of Contents**Equity Incentive Plans**

In fiscal 2005, the Company modified the method in which it issues incentive awards to its employees through stock-based compensation. In prior years, stock-based compensation consisted only of stock options. In 2005, the majority of awards consisted of restricted stock unit awards and to a lesser degree stock options. Employees vest in restricted stock units and stock options ratably over the corresponding service term, generally one to four years. The Company's stock options expire 10 years from the date of grant. Restricted stock units are payable in shares of the Company's common stock as the periodic vesting requirements are satisfied. The value of a restricted stock unit is based upon the fair market value of the Company's common stock on the date of grant. The value of restricted stock units is determined using the intrinsic value method and is based on the number of shares granted and the quoted price of the Company's common stock on the date of grant. Alternatively, the Company uses the Black-Scholes option pricing model to determine the fair value of its stock options. Compensation expense related to restricted stock units and stock options is recognized over the vesting period. The Company has adopted a number of stock-based compensation plans as discussed below.

1998 Equity Incentive Plan. In November 1998, the Company adopted the 1998 Equity Incentive Plan, or the 1998 Plan, which provides for discretionary grants of non-qualified and incentive stock options, stock purchase awards and stock bonuses for employees and other service providers. Upon certain changes in control of the Company, all outstanding and unvested options or stock awards under the 1998 Plan will vest at the rate of 50%, unless assumed or substituted by the acquiring entity. As of September 30, 2005, there were options to purchase 1,663,983 shares outstanding and 58,934 shares available for awards under the 1998 Plan.

1999 Employee Stock Purchase Plan. In May 1999, the board of directors approved the adoption of the 1999 Employee Stock Purchase Plan, or the Employee Stock Purchase Plan. A total of 2,000,000 shares of common stock have been reserved for issuance under the Employee Stock Purchase Plan. The Employee Stock Purchase Plan permits eligible employees to acquire shares of the Company's common stock through periodic payroll deductions of up to 15% of base compensation. No employee may purchase more than \$25,000 worth of stock, determined at the fair market value of the shares at the time such option is granted, in one calendar year. The Employee Stock Purchase Plan has been implemented in a series of offering periods, each 6 months in duration. The price at which the common stock may be purchased is 85% of the lesser of the fair market value of the Company's common stock on the first day of the applicable offering period or on the last day of the respective purchase period. As of September 30, 2005 there were 1,012,549 shares available for awards under the Employee Stock Purchase Plan.

2000 Equity Incentive Plan. In July 2000, the Company adopted the 2000 Employee Equity Incentive Plan, or the 2000 Plan, which provides for discretionary grants of non-qualified stock options, stock purchase awards and stock bonuses for non-executive employees and other service providers. A total of 3,500,000 shares of common stock have been reserved for issuance under the 2000 Plan. Upon certain changes in control of the Company, all outstanding and unvested options or stock awards under the 2000 Plan will vest at the rate of 50%, unless assumed or substituted by the acquiring entity. As of September 30, 2005, there were options to purchase 1,144,991 shares outstanding and 55,853 shares available for awards under the 2000 Plan.

New Hire Incentive Plans. In October 2000, the Company adopted a non-qualified stock option plan, or the Pancottine Plan, in connection with the hiring of Jeff Pancottine, the Company's Senior Vice President and General Manager, Security Business Unit. The Pancottine Plan provided for a grant of 200,000 non-qualified stock options for Mr. Pancottine. As of September 30, 2005, there were no options outstanding and no shares available for awards under the Pancottine Plan. In May 2001, the Company adopted a non-qualified stock option plan, or the Coburn Plan, in connection with the hiring of Steve Coburn, the Company's former Senior Vice President of Finance and Chief Financial Officer. The Coburn Plan provided for a grant of 200,000 non-qualified stock options for Mr. Coburn. As of September 30, 2005, there were no options outstanding and no shares available for awards under the Coburn Plan. In October 2003, the company adopted a non-qualified stock option plan, or the Hull Plan, in connection with the hiring of Thomas Hull, the Company's Senior Vice President of Worldwide Sales. The Hull plan provided for a grant of 225,000 non-qualified stock options for Mr. Hull. As of September 30, 2005, there were options to purchase 170,000 shares outstanding and no shares available for awards under the Hull Plan. In August 2004, the Company adopted a non-qualified stock option plan, or the Triebes Plan, in connection with the hiring of Karl Triebes, the Company's

Senior Vice President of Product Development and Chief Technology Officer. The Triebes Plan provided for a grant of 300,000 non-qualified stock options for Mr. Triebes. As of September 30, 2005, there were options to purchase 250,000 shares outstanding and no shares available for awards under the Triebes Plan. Upon certain changes in control of the Company, 100% of all outstanding and unvested options remaining under the Hull Plan and the Triebes Plan will vest and become immediately exercisable.

Acquisition Incentive Plans. In July 2003, the Company adopted the uRoam Acquisition Equity Incentive Plan, or the uRoam Plan, in connection with the hiring of the former employees of uRoam, Inc. A total of 250,000 shares of common stock were reserved

Table of Contents

for issuance under the uRoam Plan. The plan provided for discretionary grants of non-qualified and incentive stock options, stock purchase awards and stock bonuses. The Company has not granted any stock purchase awards or stock bonuses under this plan. As of September 30, 2005 there were options to purchase 38,044 shares outstanding and no shares available for awards under the uRoam Plan. In July 2004, the Company adopted the MagniFire Acquisition Equity Incentive Plan, or the MagniFire Plan, in connection with the hiring of the former employees of MagniFire Websystems, Inc. A total of 415,000 shares of common stock were reserved for issuance under the MagniFire Plan. The plan provides for discretionary grants of non-qualified and incentive stock options, stock purchase awards and stock bonuses. The Company has not granted any stock purchase awards or stock bonuses under this plan. As of September 30, 2005 there were options to purchase 234,606 shares outstanding and no shares available for awards under the MagniFire Plan. Options that expire under the uRoam Plan or the MagniFire Plan, whether due to termination of employment or otherwise, are not available for future grant.

2005 Equity Incentive Plan. In December 2004, the Company adopted the 2005 Equity Incentive Plan, or the 2005 Plan, which provides for discretionary grants of non-statutory stock options and stock units for employees, including officers, and other service providers. A total of 1,700,000 shares of common stock have been reserved for issuance under the 2005 Plan. Upon certain changes in control of the Company, the surviving entity will either assume or substitute all outstanding Stock Awards under the 2005 Plan. During the fiscal year 2005, the Company issued 37,500 stock options and 721,184 stock units under the 2005 Plan. As of September 30, 2005, there were options to purchase 37,500 shares outstanding and 944,316 shares available for awards under the 2005 Plan.

The restricted stock units were granted during the fourth quarter of fiscal 2005 with a per share weighted average fair value of \$44.60. The restricted stock units granted in fiscal 2005 vest quarterly over a two year period. A summary of restricted stock unit activity under the 2005 Plan is as follows:

	Outstanding Stock Units
Balance, September 30, 2004	
Units granted	721,184
Units vested	
Units cancelled	(3,000)
Balance, September 30, 2005	718,184

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

	Options Outstanding Weighted Average Exercise Price Per Share
	Number of Shares
Balance, September 30, 2002	7,240,850
Options granted	2,195,300
Options exercised	(1,423,550)
Options cancelled	(504,771)
Balance, September 30, 2003	7,507,829
Options granted	2,230,515
Options exercised	(2,031,552)
Options cancelled	(353,232)

Edgar Filing: F5 NETWORKS INC - Form 10-K/A

Balance, September 30, 2004	7,353,560		21.52
Options granted	224,100		43.73
Options exercised	(3,684,558)		17.66
Options cancelled	(297,786)		34.08
Balance at September 30, 2005	3,595,316	\$	25.82

70

Table of Contents

The weighted-average fair values per share at the date of grant for options granted with exercise prices equal to market for were \$18.68, \$9.36, and \$7.67 for the fiscal year 2005, 2004, and 2003, respectively. The weighted-average fair values per share at the date of grant for options granted with exercise prices less than market were, \$7.41 and \$8.05 for the fiscal years 2004 and 2003, respectively. The total intrinsic value for options outstanding at September 30, 2005 was \$63.5 million, representing the difference between the fair value of the Company's common stock underlying these options at September 30, 2005 and the related exercise prices.

	Options Outstanding			Options Exercisable	
	Number of Shares	Weighted Average Remaining Contractual Life (In Years)	Weighted Average Exercise Price per Share	Number of Shares	Weighted Average Price per Share
Range of Exercise Prices					
\$0.25 - \$12.79	546,577	5.58	\$ 8.57	523,220	\$ 8.49
\$12.84 - \$22.17	1,024,994	7.64	\$ 17.27	701,237	\$ 15.72
\$22.43 - \$24.75	475,736	8.49	\$ 23.24	108,153	\$ 23.47
\$25.01 - \$33.20	907,854	8.16	\$ 27.38	732,558	\$ 26.57
\$33.34 - \$120.88	640,155	5.90	\$ 53.96	476,846	\$ 56.16
\$0.25 - \$120.88	3,595,316	7.26	\$ 25.82	2,542,014	\$ 25.28

Table of Contents

The total intrinsic value for options exercisable at September 30, 2005 was \$46.2 million, representing the difference between the fair value of the Company's common stock underlying these options at September 30, 2005 and the related exercise prices.

As of September 30, 2005, equity based awards (including stock option and stock units) available for future issuance is as follows:

	Awards Available for Grant
Balance, September 30, 2002	1,714,262
Granted	(2,195,300)
Exercised	
Cancelled	504,771
Additional shares reserved (terminated), net	1,155,000
Balance, September 30, 2003	1,178,733
Granted	(2,230,515)
Exercised	
Cancelled	353,232
Additional shares reserved (terminated), net	820,070
Balance, September 30, 2004	121,520
Granted	(945,284)
Exercised	
Cancelled	300,786
Additional shares reserved (terminated), net	1,582,081
Balance at September 30, 2005	1,059,103

The Company recognized \$4.6 million of pre-tax stock compensation expense following the early adoption of FAS 123R in the fourth quarter of fiscal year 2005. As of September 30, 2005, there was \$32.7 million of total unrecognized compensation cost, related to unvested stock options and restricted stock units, the majority of which will be recognized ratably over the next two years. An assumption of a five percent forfeiture rate is utilized when arriving at the amount of stock compensation expense.

8. Commitments and Contingencies**Operating Leases**

The majority of the Company's operating lease payments relate to the Company's two building corporate headquarters in Seattle, Washington. The lease on the first building commenced in July 2000; and the lease on the second building commenced in September 2000. The lease for both buildings expire in 2012. The second building has been fully subleased until 2012. The Company also leases additional office space for product development and sales and support personnel in the United States and internationally.

Table of Contents

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

	Gross Lease Payments	Sublease Income	Net Lease Payments
2006	\$ 7,647	\$ 3,350	\$ 4,297
2007	7,341	3,460	3,881
2008	6,700	3,570	3,130
2009	6,853	3,681	3,172
2010	6,831	3,791	3,040
Thereafter	11,915	7,239	4,676
	\$ 47,287	\$ 25,091	\$ 22,196

Rent expense under non-cancelable operating leases amounted to approximately \$5.6 million, \$4.8 million, and \$4.5 million for the fiscal years ended September 30, 2005, 2004, and 2003, respectively.

Litigation

In July and August 2001, a series of putative securities class action lawsuits were filed in United States District Court, Southern District of New York against certain investment banking firms that underwrote the Company's initial and secondary public offerings, the Company and some of the Company's officers and directors. These cases, which have been consolidated under *In re F5 Networks, Inc. Initial Public Offering Securities Litigation*, No. 01 CV 7055, assert that the registration statements for the Company's June 4, 1999 initial public offering and September 30, 1999 secondary offering failed to disclose certain alleged improper actions by the underwriters for the offerings. The consolidated, amended complaint alleges claims against the Company and those of its officers and directors named in the complaint under Sections 11 and 15 of the Securities Act of 1933, and under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. Other lawsuits have been filed making similar allegations regarding the public offerings of more than 300 other companies. All of these various consolidated cases have been coordinated for pretrial purposes as *In re Initial Public Offering Securities Litigation*, Civil Action No. 21-MC-92. In October 2002, the directors and officers were dismissed without prejudice. The issuer defendants filed a coordinated motion to dismiss these lawsuits in July 2002, which the Court granted in part and denied in part in an order dated February 19, 2003. The Court declined to dismiss the Section 11 and Section 10(b) and Rule 10b-5 claims against the Company. In June 2004, a stipulation of settlement for the claims against the issuer defendants, including the Company, was submitted to the Court. On August 31, 2005, the Court granted preliminary approval of the settlement. The settlement is subject to a number of conditions, including final approval by the Court. If the settlement does not occur, and litigation against the Company continues, the Company believes it has meritorious defenses and intend to defend the case vigorously. Securities class action litigation could result in substantial costs and divert our management's attention and resources. Due to the inherent uncertainties of litigation, the Company cannot accurately predict the ultimate outcome of the litigation, and any unfavorable outcome could have a material adverse impact on the Company's business, financial condition and operating results.

As of September 30, 2005, the Company was not aware of any additional pending legal proceedings that, individually or in the aggregate, would have had a material adverse effect on the Company's business, operating results, or financial condition. The Company may in the future be party to litigation arising in the ordinary course of business, including claims that the Company allegedly infringes upon third-party trademarks or other intellectual property rights. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

9. Employee Benefit Plans

The Company has a 401(k) savings plan whereby eligible employees may voluntarily contribute a percentage of their compensation. The Company may, at its discretion, match a portion of the employees' eligible contributions. Contributions by the Company to the plan during the years ended September 30, 2005, 2004, and 2003 were

approximately \$1.2 million, \$1.0 million and \$0.9 million, respectively. Contributions made by the Company vest over four years.

10. Geographic Sales and Significant Customers

Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company is organized as, and operates in, one reportable segment: the development, marketing and selling of a comprehensive suite of application networking solutions that helps customers efficiently and securely manage application traffic on

Table of Contents

their Internet-based networks. The Company manages its business based on four geographic regions: the Americas (primarily the United States); Europe, the Middle East, and Africa (EMEA); Japan; and Asia Pacific. 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. The Company's management evaluates performance based primarily on revenues in the geographic locations in which the Company operates. Revenues are attributed by geographic location based on the location of the customer. The Company's assets are primarily located in the United States and not allocated to any specific region. Therefore, geographic information is presented only for net product revenue.

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

	Years Ended September 30,		
	2005	2004	2003
Americas	\$ 167,322	\$ 103,603	\$ 75,409
EMEA	47,198	25,606	16,880
Japan	38,435	26,801	16,039
Asia Pacific	28,455	15,180	7,567
	\$ 281,410	\$ 171,190	\$ 115,895

Net revenues from international customers are primarily denominated in U.S. dollars and totaled \$114.1 million, \$67.6 million, and \$40.5 million for the years ended September 30, 2005, 2004 and 2003, respectively. One domestic distributor accounted for 18.6%, 19.1% and 12.6% of total net revenue for the fiscal years 2005, 2004 and 2003, respectively. This distributor accounted for 26.2%, 26.9% and 17.8% of accounts receivable as of September 30, 2005, 2004 and 2003, respectively.

11. Subsequent Events

On October 4, 2005, the Company acquired all of the capital stock of Swan Labs, Inc. (Swan Labs), a privately held Delaware corporation headquartered in San Jose, California for \$43.0 million in cash. The Company also incurred \$3.2 million of direct transaction costs for a total purchase price of approximately \$46.2 million. Swan Labs provides WAN (Wide Area Network) optimization and application acceleration products and services. The addition of Swan Labs is intended to allow the Company to quickly enter the WAN optimization market, broaden the Company's customer base, and augment its existing product line.

12. Subsequent Events Related to the Special Committee and Company Investigations and the Restatement

On May 16, 2006, the CFRA issued the CFRA Report, in which CFRA reviewed the option prices of 100 public companies and, based upon an analysis of the exercise prices of option grants with reference to the companies' stock prices, concluded that 17% of the subject companies were, in CFRA's view, at risk for having backdated option grants during the period 1997 to 2002. The Company was among the 17 companies so identified.

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

On May 22, 2006, the Board of Directors formed the Special Committee with broad authority to investigate and address the Company's stock option practices. The Special Committee was originally composed of three members of the Board of Directors, one of which was also on the Audit Committee, Karl Guelich, Rich Malone and Gary Ames. In July 2006, the Special Committee was reconstituted to consist of two independent members of the Board of Directors, Gary Ames and Deborah Bevier (who joined the Company's Board of Directors on July 14, 2006). The Company continues to fully cooperate with the SEC and the Department of Justice, and has provided such agencies with extensive documentation relating to the Special Committee's and the Company's inquiries as discussed in Note 2 to these Consolidated Financial Statements. The SEC and the Department of Justice inquiries are ongoing. The

Company does not know the remedial, civil or criminal penalties or monetary terms that either the SEC or the Department of Justice may seek.

The Company received a notice from the Internal Revenue Service (IRS) indicating the IRS would be auditing its tax returns for the 2002, 2003, and 2004. The Company has produced documents and other information to the IRS and is currently in discussions

Table of Contents

with the IRS to resolve all issues arising from this audit. The Company does not believe this audit and any settlement with the IRS will have a material adverse impact on its consolidated financial position or results of operations.

On May 24, 2006, a shareholder action captioned Adams v. Amdahl et al. was filed against certain of the Company's current and former officers and directors in the King County Superior Court in Washington. The complaint generally alleges that the defendants breached their fiduciary duties to the Company in connection with the granting of certain stock options. Five additional shareholder derivative complaints, based on substantially the same allegations, were subsequently filed in the Washington federal and state courts. Although litigation is subject to inherent uncertainties, the Company does not believe the results of these pending actions will, individually or in the aggregate, have a material adverse impact on its consolidated financial position or results of operations.

Table of Contents**13. Quarterly Results of Operations**

The following table presents the Company's selected unaudited quarterly results of operations restated for the eight quarters ended September 30, 2005 from previously reported information filed on Form 10-Q and Form 10-K, as a result of the Restatement of our financial results discussed in this Form 10-K/A.

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

	Three Months Ended											
	Sept 30, 2005			June 30, 2005			March 31, 2005			Dec. 31, 2004		
	(In thousands, except per share data)											
	As reported	Adjustment	As restated	As reported	Adjustment	As restated	As reported	Adjustment	As restated	As reported	Adjustment	As restated
Net revenues												
Products	\$ 62,762	\$	\$ 62,762	\$ 57,112	\$	\$ 57,112	\$ 53,332	\$	\$ 53,332	\$ 46,397	\$	\$ 46,397
Services	17,845		17,845	15,952		15,952	14,398		14,398	13,612		13,612
Total	80,607		80,607	73,064		73,064	67,730		67,730	60,009		60,009
Cost of net revenues												
Products	13,886		13,886	12,751	1	12,752	11,820	2	11,822	10,528	2	10,530
Services	4,572		4,572	4,306	6	4,312	3,908	7	3,915	3,386	9	3,395
Total	18,458		18,458	17,057	7	17,064	15,728	9	15,737	13,914	11	13,925
Gross profit	62,149		62,149	56,007	(7)	56,000	52,002	(9)	51,993	46,095	(11)	46,084
Operating expenses												
Sales and marketing	25,521	54	25,575	23,207	12	23,219	20,885	103	20,988	19,640	444	20,084
Research and development	9,039	27	9,066	7,547	37	7,584	7,789	45	7,834	6,974	58	7,032
General and administrative	7,067	271	7,338	5,833	483	6,316	5,854	487	6,341	5,006	485	5,491
Total	41,627	352	41,979	36,587	532	37,119	34,528	635	35,163	31,620	987	32,607
Income (loss) from operations	20,522	(352)	20,170	19,420	(539)	18,881	17,474	(644)	16,830	14,475	(998)	13,477
Other income, net	2,925		2,925	2,123		2,123	1,641		1,641	1,387		1,387
Income (loss) before income taxes	23,447	(352)	23,095	21,543	(539)	21,004	19,115	(644)	18,471	15,862	(998)	14,864
Provision (benefit) for	7,796	392	8,188	7,566	745	8,311	7,003	504	7,507	5,869	657	6,526

Income taxes												
Net income												
loss)	\$ 15,651	\$ (744)	\$ 14,907	\$ 13,977	\$ (1,284)	\$ 12,693	\$ 12,112	\$ (1,148)	\$ 10,964	\$ 9,993	\$ (1,655)	\$ 8,338
Net income												
loss) per												
share basic	\$ 0.41	\$ (0.02)	\$ 0.39	\$ 0.37	\$ (0.04)	\$ 0.33	\$ 0.33	\$ (0.03)	\$ 0.30	\$ 0.28	\$ (0.05)	\$ 0.23
Weighted												
average shares												
basic	38,479		38,479	37,918		37,918	36,905		36,905	35,577		35,577
Net income												
loss) per												
share diluted	\$ 0.39	\$ (0.02)	\$ 0.37	\$ 0.35	\$ (0.03)	\$ 0.32	\$ 0.31	\$ (0.03)	\$ 0.28	\$ 0.26	\$ (0.04)	\$ 0.22
Weighted												
average shares												
diluted	40,015	(1)	40,014	39,418	15	39,433	38,921	18	38,939	37,818	30	37,848

Table of Contents

Sept 30, 2004		Three Months Ended						Dec. 31,								
		June 30, 2004		March 31, 2004												
(In thousands, except per share data)																
As reported	Adjustment	As restated	As reported	Adjustment	As restated	As reported	Adjustment	As restated	As reported	Adjustment						
7,536	\$	\$	37,536	\$	32,537	\$	\$	32,537	\$	29,720	\$	\$	29,720	\$	26,376	\$
2,683			12,683		11,706			11,706		10,927			10,927		9,705	
0,219			50,219		44,243			44,243		40,647			40,647		36,081	
8,489	2		8,491		7,267			7,267		6,799			6,799		5,849	
3,055	9		3,064		2,832	4		2,836		2,626	2		2,628		2,462	
1,544	11		11,555		10,099	4		10,103		9,425	2		9,427		8,311	
8,675	(11)		38,664		34,144	(4)		34,140		31,222	(2)		31,220		27,770	
7,597	207		17,804		16,907	(37)		16,870		15,920	433		16,353		14,954	40
6,764	51		6,815		6,253	12		6,265		5,900	6		5,906		5,444	
4,463	10		4,473		4,069	4		4,073		3,855	1		3,856		3,357	
8,824	268		29,092		27,229	(21)		27,208		25,675	440		26,115		23,755	47
9,851	(279)		9,572		6,915	17		6,932		5,547	(442)		5,105		4,015	(47)
891			891		848			848		808			808		184	
0,742	(279)		10,463		7,763	17		7,780		6,355	(442)		5,913		4,199	(47)
5,039	(4,559)		(9,598)		347			347		400			400		398	
5,781	\$ 4,280	\$	20,061	\$	7,416	\$ 17	\$	7,433	\$	5,955	\$ (442)	\$	5,513	\$	3,801	\$ (48)
0.46	\$ 0.12	\$	0.58	\$	0.22	\$	\$	0.22	\$	0.18	\$ (0.02)	\$	0.16	\$	0.13	\$ (0.0)

4,593		34,593		34,382		34,382		33,768		33,768		30,159					
0.43	\$	0.12	\$	0.55	\$	0.20	\$0.00	\$	0.20	\$	0.16	\$(0.01)	\$	0.15	\$	0.11	\$(0.0)
6,779		(21)		36,758		36,969	(37)		36,932		36,946	(29)		36,917		33,121	(4)

(1) The Company adopted FAS123R on July 1, 2005, and as a result recognized \$4.6 million of compensation expense related to stock-based compensation charges included in operating expenses in the fourth quarter of fiscal 2005.

(2) During the fourth quarter of fiscal 2004, the Company reversed the valuation allowance on U.S. deferred tax assets and as a result realized an income tax benefit of \$11.9 million. The credit from the reversal of the valuation

allowance was
partially offset
by actual U.S.
and
international tax
expenses during
the period.

Table of Contents

F5 NETWORKS, INC.
SUPPLEMENTARY DATA
VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

Description	Balance at Beginning of Period	Charges to Costs and Expenses	Charges to Other Accounts (In thousands)	Deductions	Balance at End of Period
Year Ended September 30, 2005					
Allowance for doubtful accounts	\$ 1,594	\$ 653	\$	\$ (500)	\$ 1,747
Allowance for sales returns	\$ 1,567	\$ 766	\$ 626	\$ (1,737)	\$ 1,222
Income tax valuation allowance	\$ 2,649	\$	\$	\$ (2,649)	\$
Year Ended September 30, 2004					
Allowance for doubtful accounts	\$ 1,524	\$ 150	\$	\$ (80)	\$ 1,594
Allowance for sales returns	\$ 1,525	\$1,009	\$1,566	\$ (2,533)	\$ 1,567
Income tax valuation allowance	\$30,711	\$	\$	\$ (28,062)	\$ 2,649
Year Ended September 30, 2003					
Allowance for doubtful accounts	\$ 3,836	\$ (650)	\$	\$ (1,662)	\$ 1,524
Allowance for sales returns	\$ 1,616	\$ 347	\$ 745	\$ (1,183)	\$ 1,525
Income tax valuation allowance	\$26,329	\$	\$4,382	\$	\$30,711

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

None.

Item 9A. Controls and Procedures**Evaluation of Disclosure Controls and Procedures**

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

Our management, with the participation of our Chief Executive Officer and Chief Accounting Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2005 and, based on this evaluation, the CEO and CAO had previously concluded that our disclosure controls and procedures were effective as of September 30, 2005. As a result of the findings of the Special Committee as well as our internal review of our historical stock option practices and our need to restate the 2005, 2004 and 2003 annual consolidated financial statements and the interim consolidated financial statements for the first and second quarters of 2006 and all quarters of 2005, as described in Note 2 to our consolidated financial statements, we determined that there was a material weakness in our internal control over financial reporting as of September 30, 2005, as more fully described below in

Management's Report on Internal Control over Financial Reporting (restated). For these reasons, we have now concluded that our disclosure controls and procedures were not effective as of September 30, 2005.

Management's Report on Internal Control over Financial Reporting (restated)

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

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

Management conducted an assessment of the effectiveness of our internal control over financial reporting as of September 30, 2005 based on the framework established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Management identified the following material weakness in our internal control over financial reporting as of September 30, 2005:

We did not maintain effective controls over our granting and modification of stock options and the related accounting for and disclosure of stock-based compensation expense. Specifically, effective controls, including monitoring, were not designed and in place to ensure the existence, completeness, accuracy, valuation and presentation of activity related to our granting and modification of stock options. This control deficiency resulted in the misstatement of our stock-based compensation expense, additional paid-in capital and related income tax accounts and related disclosures, and in the restatement of our 2005, 2004 and 2003 annual consolidated financial statements and the interim consolidated financial statements for the first and second quarters of 2006 and all quarters of 2005 and 2004 and an audit adjustment to the interim consolidated financial statements

Table of Contents

for the third quarter of 2006. Further, this control deficiency could result in misstatements of the aforementioned accounts and disclosures that would result in a material misstatement of our annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, management has determined this control deficiency constitutes a material weakness.

In Management's Report on Internal Control over Financial Reporting included in the Annual Report on Form 10-K for the year ended September 30, 2005, our management had previously concluded that we maintained effective internal control over financial reporting as of September 30, 2005. In connection with the restatement discussed under the heading "Restatement of Consolidated Financial Statements" in Note 2 to our consolidated financial statements, our management has subsequently concluded that the material weakness described above existed as of September 30, 2005. As a result, we have now concluded that we did not maintain effective internal control over financial reporting as of September 30, 2005, based on the criteria in *Internal Control - Integrated Framework* issued by the COSO. Accordingly, Management's Report on Internal Control over Financial Reporting has been restated.

Management's assessment of the effectiveness of our internal control over financial reporting as of September 30, 2005 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report appearing on page 41.

Remediation of Material Weakness

Management is committed to remediating the material weakness described above by implementing changes to our internal control over financial reporting.

On July 1, 2005, we adopted the fair value recognition provision of FAS 123(R). We also began granting restricted stock unit awards instead of stock- options in the fourth quarter of fiscal 2005 as our primary form of stock-based compensation. FAS 123(R) requires the recognition as expense of all stockbased compensation. In connection with the adoption of FAS 123(R) we revised certain of our policies, processes, procedures and controls relating to grants of stock-based compensation.

Although improvements were made to our internal control over financial reporting as they relate to the granting and modification of stock-based compensation, in connection with the adoption of FAS 123(R), as of September 30, 2005, we had not fully remediated the material weakness describe above.

Subsequent to the initiation of our investigation into our stock-option granting practices in May 2006, we considered the effectiveness of both the design and operation of our internal control over financial reporting, as they relate to the granting and modification of stock-based compensation. We implemented a number or significant improvements in our internal control over financial reporting during the fourth quarter of 2006. In particular, we developed and implemented the following policies, processes, procedures and controls over the granting and modification of stock-based compensation:

Review and approval of all stock-based compensation awards by the accounting and finance function.

Enhanced and standardized documentation required to be maintained for the granting of all such stock-based compensation awards.

Enhanced and standardized documentation required to be maintained for the exercise and/or cancellation of all such stock-based compensation awards.

A quarterly review and reconciliation of all such stock-based compensation awards by the accounting and finance function.

Formal communication to all relevant personnel involved in the stock-based compensation process regarding the importance of the accounting and legal implications of our stock-based compensation process.

As of September 30, 2006, management has implemented these additional policies, procedures and controls. Additionally, we have evaluated the design of these new controls, which have been placed into operation for a sufficient period of time, and tested their operating effectiveness. We consider that the steps identified and implemented above have improved the effectiveness of our internal control over financial reporting and, as of

September 30, 2006, have remediated the material weakness described above.

Table of Contents

On November 8, 2006, we announced the Special Committee had completed its review of our stock option practices and reported its findings to our Board of Directors. In connection with the conclusion of its review, the Special Committee recommended that our Board of Directors, and its compensation and audit committees, consider and adopt certain additional remedial measures and best practices related to the issues raised in the Special Committees investigation. We are in the process of implementing these recommendations.

Changes in Internal Control over Financial Reporting

As described above, there were no changes to our internal control over financial reporting during the fourth quarter of fiscal 2005 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

We filed a definitive Proxy Statement with the SEC on January 20, 2006 regarding our Annual Shareholders Meeting held on March 2, 2006 (the Proxy Statement). Certain information required by this item is incorporated herein by reference to the Proxy Statement. Also see Directors and Executive Officers of the Registrant in Part I of this Amendment.

Item 11. Executive Compensation

The information required by this item is incorporated herein by reference to the Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item is incorporated herein by reference to the Proxy Statement.

Item 13. Certain Relationships and Related Transactions

The information required by this item is incorporated herein by reference to the Proxy Statement.

Item 14. Principal Accountant Fees and Services

The information required by this item is incorporated herein by reference to the Proxy Statement.

PART IV

Item 15. Exhibits and Financial Statement Schedules

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

1. *Consolidated Financial Statements:*

See Index to Consolidated Financial Statements included under Item 8 in Part II of this Amendment.

2. *Exhibits:*

Amendment Annual Report on Form 10-K and are described in the Exhibit Index immediately preceding the first exhibit.

Table of Contents**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

F5 NETWORKS, INC.

By: /s/ JOHN MCADAM

John McAdam
*Chief Executive Officer and
 President*

Dated: December 11, 2006

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

	Signature	Title	Date
By:	/s/ JOHN MCADAM	Chief Executive Officer, President, and Director	December 11, 2006
	John McAdam	(principal executive officer)	
By:	/s/ JOHN RODRIGUEZ	Senior Vice President, Chief Accounting Officer	December 11, 2006
	John Rodriguez	(principal financial officer)	
By:	/s/ GARY AMES	Director	December 11, 2006
	Gary Ames		
By:	/s/ KEITH D. GRINSTEIN	Director	December 11, 2006
	Keith D. Grinstein		
By:	/s/ KARL D. GUELICH	Director	December 11, 2006
	Karl D. Guelich		
By:	/s/ ALAN J. HIGGINSON	Director	December 11, 2006
	Alan J. Higginson		
By:	/s/ RICH MALONE	Director	December 11, 2006
	Rich Malone		

Table of Contents

EXHIBIT INDEX

Exhibit Number	Exhibit Description
2.1	Agreement and Plan of Merger dated as of May 31, 2004, by and among the Registrant, Fire5, Inc., a wholly owned subsidiary of the Registrant, MagniFire Websystems, Inc., and Lucent Venture Partners III LLC(1)
2.2	Agreement and Plan of Merger, dated September 6, 2005, among F5 Networks, Inc., Sparrow Acquisition Corp., Swan Labs Corporation and the other parties referred to therein.(2)
3.1	Second Amended and Restated Articles of Incorporation of the Registrant(3)
3.2	Amended and Restated Bylaws of the Registrant(3)
4.1	Specimen Common Stock Certificate(3)
10.1	Amended and Restated Office Lease Agreement dated April 3, 2000, between the Registrant and 401 Elliott West LLC(4)
10.2	Sublease Agreement dated March 30, 2001 between the Registrant and Cell Therapeutics, Inc.(5)
10.3	uRoam Acquisition Equity Incentive Plan(6)
10.4	Form of Indemnification Agreement between the Registrant and each of its directors and certain of its officers(3)
10.5	1998 Equity Incentive Plan, as amended(7)
10.6	Form of Option Agreement under the 1998 Equity Incentive Plan(3)
10.7	Amended and Restated Directors Nonqualified Stock Option Plan(3)
10.8	Form of Option Agreement under the Amended and Restated Directors Nonqualified Stock Option Plan(3)
10.9	Amended and Restated 1996 Stock Option Plan(3)
10.10	Form of Option Agreement under the Amended and Restated 1996 Stock Option Plan(3)
10.11	1999 Non-Employee Directors Stock Option Plan(3)
10.12	Form of Option Agreement under 1999 Non-Employee Directors Stock Option Plan(3)
10.13	NonQualified Stock Option Agreement between John McAdam and the Registrant dated July 24, 2000(8)
10.14	2000 Employee Equity Incentive Plan(9)

Edgar Filing: F5 NETWORKS INC - Form 10-K/A

10.15	Form of Option Agreement under the 2000 Equity Incentive Plan(10)
10.16	NonQualified Stock Option Agreement between M. Thomas Hull and the Registrant dated October 20, 2003(11)
10.17	1999 Employee Stock Purchase Plan, as amended(12)
10.18	MagniFire Acquisition Equity Incentive Plan(13)
10.19	NonQualified Stock Option Agreement between Karl Triebes and the Registrant dated August 16, 2004(13)
10.20	Incentive Compensation Plan for Executive Officers(13)
10.21	2005 Equity Incentive Plan(14)
10.22	Form of Restricted Stock Unit agreement under the 2005 Equity Incentive Plan (with acceleration upon change of control)(15)
10.23	Form of Restricted Stock Unit agreement under the 2005 Equity Incentive Plan (no acceleration upon change of control)(15)
21.1*	Subsidiaries of the Registrant

Table of Contents

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

* Filed herewith.

(1) Incorporated by reference from Current Report on Form 8-K dated May 31, 2004 and filed with the SEC on June 2, 2004.

(2) Incorporated by reference from Current Report on Form 8-K dated October 4, 2005 and filed with the SEC on October 5, 2005.

(3) Incorporated by reference from Registration Statement on Form S-1, File No. 333-75817.

(4) Incorporated by reference from Quarterly Report on Form 10-Q for the quarter ended June 30, 2003.

(5) Incorporated by reference from Quarterly Report on Form 10-Q for the quarter ended June 30, 2001.

- (6) Incorporated by reference from Registration Statement on Form S-8, File No. 333-109895.
- (7) Incorporated by reference from Registration Statement on Form S-8, File No. 333-104169.
- (8) Incorporated by reference from Annual Report on Form 10-K for the year ended September 30, 2000.
- (9) Incorporated by reference from Registration Statement on Form S-8, File No. 333-51878.
- (10) Incorporated by reference from Annual Report on Form 10-K for the year ended September 30, 2001.
- (11) Incorporated by reference from Registration Statement on Form S-8, File No. 333-112022.
- (12) Incorporated by reference from Registration Statement on Form S-8, File No. 333-116187.

- (13) Incorporated by reference from Annual Report on Form 10-K for the year ended September 30, 2004.
- (14) Incorporated by reference from Quarterly Report on Form 10-Q for the quarter ended March 31, 2005.
- (15) Incorporated by reference from Quarterly Report on Form 10-Q for the quarter ended June 30, 2005.