F5 NETWORKS INC
Form 10-Q
May 07, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2012

OR

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

For the transition period from to

Commission File Number 000-26041

F5 NETWORKS, INC.

(Exact name of registrant as specified in its charter)

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

401 Elliott Avenue West

Seattle, Washington 98119

(Address of principal executive offices and zip code)

(206) 272-5555

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

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

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

The number of shares outstanding of the registrant s common stock as of May 3, 2012 was 79,392,118.

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F5 NETWORKS, INC.

QUARTERLY REPORT ON FORM 10-Q

For the Quarter Ended March 31, 2012

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

F5 NETWORKS, INC.

CONSOLIDATED BALANCE SHEETS

(unaudited, in thousands)

	March 31, 2012	September 30, 2011
ASSETS		
Current assets		
Cash and cash equivalents	$ 209,459	$ 216,784
Short-term investments	280,152	325,766
Accounts receivable, net of allowances of $3,121 and $2,898	184,043	165,676
Inventories	17,023	17,149
Deferred tax assets	8,612	8,391
Other current assets	47,229	29,907
Total current assets	746,518	763,673
Property and equipment, net	52,279	47,998
Long-term investments	543,932	470,203
Deferred tax assets	35,872	34,762
Goodwill	347,901	234,691
Other assets, net	31,769	17,222
Total assets	$ 1,758,271	$ 1,568,549
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 29,904	$ 33,525
Accrued liabilities	78,618	67,902
Deferred revenue	325,364	270,880
Total current liabilities	433,886	372,307
Other long-term liabilities	19,683	18,388
Deferred revenue, long-term	87,484	72,418
Total long-term liabilities	107,167	90,806
Commitments and contingencies (Note 5)		
Shareholders equity		
Preferred stock, no par value; 10,000 shares authorized, no shares outstanding		
Common stock, no par value; 200,000 shares authorized, 79,035 and 79,145 shares issued and outstanding	357,026	380,737
Accumulated other comprehensive loss	(6,062)	(6,422)
Retained earnings	866,254	731,121
Total shareholders equity	1,217,218	1,105,436

Total liabilities and shareholders equity	$ 1,758,271	$ 1,568,549

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

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F5 NETWORKS, INC.

CONSOLIDATED INCOME STATEMENTS

(unaudited, in thousands, except per share data)

	Three months ended March 31,		Six months ended March 31,	
	2012	**2011**	**2012**	**2011**
Net revenues				
Products	$ 205,165	$ 173,710	$ 401,719	$ 345,202
Services	134,457	103,862	260,335	201,304
Total	339,622	277,572	662,054	546,506
Cost of net revenues				
Products	33,668	31,423	66,868	63,037
Services	23,926	19,250	46,332	36,599
Total	57,594	50,673	113,200	99,636
Gross profit	282,028	226,899	548,854	446,870
Operating expenses				
Sales and marketing	110,995	89,332	217,233	176,157
Research and development	43,568	34,507	82,690	67,113
General and administrative	22,785	19,846	44,462	40,530
Total	177,348	143,685	344,385	283,800
Income from operations	104,680	83,214	204,469	163,070
Other income, net	1,428	1,568	3,289	4,113
Income before income taxes	106,108	84,782	207,758	167,183
Provision for income taxes	37,467	29,207	72,625	55,945
Net income	$ 68,641	$ 55,575	$ 135,133	$ 111,238
Net income per share basic	$ 0.87	$ 0.69	$ 1.71	$ 1.38
Weighted average shares basic	79,156	80,809	79,214	80,726
Net income per share diluted	$ 0.86	$ 0.68	$ 1.69	$ 1.36
Weighted average shares diluted	79,775	81,622	79,853	81,670

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

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F5 NETWORKS, INC.

CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY AND

COMPREHENSIVE INCOME

(unaudited, in thousands)

	Six months ended March 31, 2012				
	Common Stock		Accumulated Other Comprehensive	Retained	Total Shareholders
	Shares	Amount	Income/(Loss)	Earnings	Equity
Balance, September 30, 2011	79,145	$ 380,737	$ (6,422)	$ 731,121	$ 1,105,436
Exercise of employee stock options	67	663			663
Issuance of stock under employee stock purchase plan	110	9,429			9,429
Issuance of restricted stock	437				
Repurchase of common stock	(724)	(84,776)			(84,776)
Tax benefit from employee stock transactions		5,505			5,505
Stock-based compensation		45,468			45,468
Comprehensive income:					
Net income				135,133	
Foreign currency translation adjustment			(173)		
Unrealized gain on securities, net of tax			533		
Comprehensive income					135,493
Balance, March 31, 2012	79,035	$ 357,026	$ (6,062)	$ 866,254	$ 1,217,218

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

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F5 NETWORKS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, in thousands)

	Six months ended March 31, 2012	2011
Operating activities		
Net income	$ 135,133	$ 111,238
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized loss (gain) on disposition of assets and investments	457	(182)
Stock-based compensation	45,468	44,706
Provisions for doubtful accounts and sales returns	633	(14)
Depreciation and amortization	14,935	10,536
Deferred income taxes	(1,645)	(1,080)
Changes in operating assets and liabilities, net of amounts acquired:		
Accounts receivable	(18,139)	(30,757)
Inventories	125	661
Other current assets	(17,252)	(7,798)
Other assets	688	(140)
Accounts payable and accrued liabilities	3,933	13,253
Deferred revenue	69,147	53,945
Net cash provided by operating activities	233,483	194,368
Investing activities		
Purchases of investments	(482,403)	(441,160)
Maturities of investments	427,671	261,230
Sales of investments	24,519	80,977
(Increase) decrease in restricted cash	(25)	38
Acquisition of intangible assets	(250)	(80)
Acquisition of businesses, net of cash acquired	(128,335)	
Purchases of property and equipment	(12,818)	(11,704)
Net cash used in investing activities	(171,641)	(110,699)
Financing activities		
Excess tax benefit from stock-based compensation	5,456	16,286
Proceeds from the exercise of stock options and purchases of stock under employee stock purchase plan	10,093	9,218
Repurchase of common stock	(84,776)	(71,526)
Net cash used in financing activities	(69,227)	(46,022)
Net (decrease) increase in cash and cash equivalents	(7,385)	37,647
Effect of exchange rate changes on cash and cash equivalents	60	(186)
Cash and cash equivalents, beginning of period	216,784	168,754
Cash and cash equivalents, end of period	$ 209,459	$ 206,215

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

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F5 NETWORKS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1. Summary of Significant Accounting Policies

Description of Business

F5 Networks, Inc. (the Company) provides products and services to help companies manage their Internet Protocol (IP) traffic and file storage infrastructure efficiently and securely. The Company s application delivery networking products improve the performance, availability and security of applications on Internet-based networks. Internet traffic between network-based applications and clients passes through these devices where the content is inspected to ensure that it is safe and modified as necessary to ensure that it is delivered securely and in a way that optimizes the performance of both the network and the applications. The Company s storage virtualization products simplify and reduce the cost of managing files and file storage devices, and ensure fast, secure, easy access to files for users and applications. With the purchase of Traffix Communication Systems Ltd. (Traffix Systems) in February 2012, the Company acquired a line of Diameter signaling products that enable full connectivity, unlimited scalability, and comprehensive control for telecommunications operators. These products enable operators to control their signaling networks effectively in the migration to next-generation networks and in future expansion of their subscriber bases and service portfolios. The Company also offers a broad range of services that include consulting, training, maintenance and other technical support services.

Basis of Presentation

The year end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. In the opinion of management, the unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for their fair statement in conformity with accounting principles generally accepted in the United States of America. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted in accordance with the rules and regulations of the Securities and Exchange Commission. The information included in this Form 10-Q should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2011.

Certain reclassifications have been made to the prior year s financial statements to conform to the fiscal year 2012 presentation. Such reclassifications did not affect total revenues, operating income or net income.

Revenue Recognition

The Company sells products through distributors, resellers, and directly to end users. Revenue is recognized provided that all of the following criteria have been met:

Persuasive evidence of an arrangement exists. Evidence of an arrangement generally consists of a purchase order issued pursuant to the terms and conditions of a distributor, reseller or end user agreement.

Delivery has occurred. The Company uses shipping or related documents, or written evidence of customer acceptance, when applicable, to verify delivery or completion of any performance terms.

The sales price is fixed or determinable. The Company assesses whether the sales price is fixed or determinable based on payment terms associated with the transaction and whether the sales price is subject to refund or adjustment.

Collectability is reasonably assured. The Company assesses collectability primarily based on the creditworthiness of the customer as determined by credit checks and related analysis, as well as the Customer s payment history.

In certain regions where the Company does not have the ability to reasonably estimate returns, the Company defers revenue on sales to its distributors until they have received information from the channel partner indicating that the product has been sold to the end-user customer. Payment terms to domestic customers are generally net 30 days to net 45 days. Payment terms to international customers range from net 30 days to net 120 days based on normal and customary trade practices in the individual markets. The Company offers extended payment terms to certain customers, in which case, revenue is recognized when payments are due.

Whenever product, training services and post-contract customer support (PCS) elements are sold together, a portion of the sales price is allocated to each element based on their respective fair values as determined when the individual elements are sold separately. Revenue from the sale of products is recognized when the product has been shipped and the customer is obligated to pay for the product. When rights of return are present and the Company cannot estimate returns, it recognizes revenue when such rights of return lapse. Revenues for PCS are recognized on a straight-line basis over the service contract term. PCS includes a limited period of telephone support updates, repair or replacement of any failed product or component that fails during the term of the agreement, bug fixes and rights to upgrades, when and if available. Consulting services are customarily billed at fixed hourly 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.

In October 2009, the Financial Accounting Standards Board (FASB) amended the accounting standards for revenue recognition to remove from the scope of industry-specific software revenue recognition guidance any tangible products containing software components and non-software components that operate together to deliver the products essential functionality. In addition, the FASB amended the accounting standards for certain multiple element revenue arrangements to:

Provide updated guidance on whether multiple elements exist, how the elements in an arrangement should be separated, and how the arrangement consideration should be allocated to the separate elements;

Require an entity to allocate arrangement consideration to each element based on a selling price hierarchy, where the selling price for an element is based on vendor-specific objective evidence (VSOE), if available, third-party evidence (TPE), if available and VSOE is not available; or the best estimate of selling price (BESP), if neither VSOE or TPE is available; and

Eliminate the use of the residual method and require an entity to allocate arrangement consideration using the selling price hierarchy.

The majority of the Company s products are hardware appliances which contain software essential to the overall functionality of the products. Accordingly, the Company no longer recognizes revenue on sales of these products in accordance with the industry-specific software revenue recognition guidance.

For all transactions entered into prior to the first quarter of fiscal year 2011 and for sales of nonessential and stand-alone software after October 1, 2010, the Company allocates revenue for arrangements with multiple elements based on the software revenue recognition guidance. Software revenue recognition guidance requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair values of those elements. The fair value of an element must be based on VSOE. Where fair value of certain elements is not available, revenue is recognized on the residual method based on the fair value of undelivered elements. If evidence of the fair value of one or more undelivered elements does not exist, all revenue is deferred and recognized at the earlier of the delivery of those elements or the establishment of fair value of the remaining undelivered elements.

For transactions entered into subsequent to the adoption of the amended revenue recognition standards that are multiple-element arrangements, the arrangement consideration is allocated to each element based on the relative selling prices of all of the elements in the arrangement using the fair value hierarchy in the amended revenue recognition guidance.

Consistent with the methodology used under the previous accounting guidance, the Company establishes VSOE for its products, training services, PCS and consulting services based on the sales price charged for each element when sold separately. The sales price is discounted from the applicable list price based on various factors including the type of customer, volume of sales, geographic region and program level. The Company s list prices are generally not fair value as discounts may be given based on the factors enumerated above. The Company believes that the fair value of its consulting services is represented by the billable consulting rate per hour, based on the rates they charge customers when they purchase standalone consulting services. The price of consulting services is not based on the type of customer, volume of sales, geographic region or program level.

The Company uses historical sales transactions to determine whether VSOE can be established for each of the elements. In most instances, VSOE of fair value is the sales price of actual standalone (unbundled) transactions within the past 12 month period that are priced within a reasonable range, which the Company has determined to be plus or minus 15% of the median sales price of each respective price list.

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VSOE of PCS is based on standalone sales since the Company does not provide stated renewal rates to its customers. In accordance with the Company s PCS pricing practice (supported by standalone renewal sales), renewal contracts are priced as a percentage of the undiscounted product list price. The PCS renewal percentages may vary, depending on the type and length of PCS purchased. The Company offers standard and premium PCS, and the term generally ranges from one to three years. The Company employs a bell-shaped-curve approach in evaluating VSOE of fair value of PCS. Under this approach, the Company considers VSOE of the fair value of PCS to exist when a substantial majority of its standalone PCS sales fall within a narrow range of pricing.

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

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

The Company has established and regularly validates the VSOE of fair value and BESP for elements in its multiple element arrangements. The Company accounts for taxes collected from customers and remitted to governmental authorities on a net basis and excluded from revenues.

Goodwill

Goodwill represents the excess purchase price over the estimated fair value of net assets acquired as of the acquisition date. The Company tests goodwill for impairment on an annual basis and between annual tests when impairment indicators are identified, and goodwill is written down when impaired. Goodwill was recorded in connection with the acquisition of Traffix Systems in fiscal year 2012, Acopia Networks, Inc. in fiscal year 2007, Swan Labs, Inc. in fiscal year 2006, MagniFire Websystems, Inc. in fiscal year 2004 and uRoam, Inc. in fiscal year 2003. The Company performs its annual goodwill impairment test during the second fiscal quarter.

In September 2011, the FASB approved changes to the goodwill impairment guidance which are intended to reduce the cost and complexity of the annual impairment test. The changes provide entities the option to perform a qualitative assessment to determine whether further impairment testing is necessary. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not (i.e. greater than 50% chance) that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test will be required. Otherwise, no further testing will be required.

The revised guidance includes examples of events and circumstances that might indicate that a reporting unit s fair value is less than its carrying amount. These include macro-economic conditions such as deterioration in the entity s operating environment or industry or market considerations; entity-specific events such as increasing costs, declining financial performance, or loss of key personnel; or other events such as an expectation that a reporting unit will be sold or a sustained decrease in the stock price on either an absolute basis or relative to peers.

The changes are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. However, earlier adoption is permitted. The Company opted to early adopt this guidance for its annual goodwill impairment test performed in the second quarter of fiscal 2012.

If it is determined, as a result of the qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the provisions of authoritative guidance require that the Company perform a two-step impairment test on goodwill. The first step of the test identifies whether potential impairment may have occurred, while the second step of the test measures the amount of the impairment, if any. Impairment is recognized when the carrying amount of goodwill exceeds its fair value. For its annual goodwill impairment analysis, the Company operates under one reporting unit and determines the fair value of its

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reporting unit based on the Company s enterprise value. In March 2012, the Company completed a qualitative assessment of potential impairment indicators and concluded that it was more-likely-than-not that the fair value of its reporting unit exceeded its carrying amount.

Stock-Based Compensation

The Company accounts for stock-based compensation using the straight-line attribution method for recognizing compensation expense. The Company recognized $23.3 million and $21.8 million of stock-based compensation expense for the three months ended March 31, 2012 and 2011, respectively, and $45.5 million and $44.7 million for the six months ended March 31, 2012 and 2011, respectively. As of March 31, 2012, there was $96.2 million of total unrecognized stock-based compensation cost, the majority of which will be recognized over the next two years. Going forward, stock-based compensation expenses may increase as the Company issues additional equity-based awards to continue to attract and retain key employees.

The Company issues incentive awards to its employees through stock-based compensation consisting of restricted stock units (RSUs). On July 29, 2011, the Company s Compensation Committee approved 833,739 RSUs to employees and executive officers pursuant to the Company s annual equity awards program. The value of RSUs is determined using the fair value method, which in this case, is based on the number of shares granted and the quoted price of the Company s common stock on the date of grant.

The Company recognizes compensation expense for only the portion of restricted stock units that are expected to vest. Therefore, the Company applies estimated forfeiture rates that are derived from historical employee termination behavior. Based on historical differences with forfeitures of stock-based awards granted to the Company s executive officers and Board of Directors versus grants awarded to all other employees, the Company has developed separate forfeiture expectations for these two groups. The Company s estimated forfeiture rate in the second quarter of fiscal year 2012 is 5.5% for grants awarded to the Company s executive officers and Board of Directors, and 8.7% for grants awarded to all other employees. If the actual number of forfeitures differs from those estimated by management, additional adjustments to compensation expense may be required in future periods.

In November 2011, as part of the annual review of executive compensation by the Compensation Committee of the Board of Directors and a change in the grant date for the Company s annual equity awards program for the executive officers, the Company granted 82,968 RSUs to certain current executive officers. Fifty percent of the aggregate number of RSUs vest in equal quarterly increments over three years, until such portion of the grant is fully vested on November 1, 2014. One-sixth of the RSU grant, or a portion thereof, is subject to the Company achieving specified quarterly revenue and EBITDA goals during fiscal year 2012. In each case, 50% of the quarterly performance stock grant is based on achieving at least 80% of the quarterly revenue goal and the other 50% is based on achieving at least 80% of the quarterly EBITDA goal. The quarterly performance stock grant is paid linearly above 80% of the targeted goals. At least 100% of both goals must be attained in order for the quarterly performance stock grant to be awarded over 100%. Each goal is evaluated individually and subject to the 80% achievement threshold and 100% over-achievement threshold. The remaining 33.33% of this annual equity awards RSU grant shall be subject to quarterly performance based vesting for fiscal years 2013 and 2014 (16.66% in each period). The Compensation Committee of the Board of Directors will set applicable performance targets and vesting formulas for each of these periods.

In August 2011, the Company granted 170,390 RSUs to certain current executive officers as part of the annual equity awards program. Fifty percent of the aggregate number of RSUs granted as part of the annual equity awards program vest in equal quarterly increments over three years, until such portion of the grant is fully vested on August 1, 2014. One-sixth of the annual equity awards RSU grant, or a portion thereof, is subject to the Company achieving specified quarterly revenue and EBITDA goals during the period beginning in the fourth quarter of fiscal year 2011 through the third quarter of fiscal year 2012. In each case, 50% of the quarterly performance stock grant is based on achieving at least 80% of the quarterly revenue goal and the other 50% is based on achieving at least 80% of the quarterly EBITDA goal. The quarterly performance stock grant is paid linearly above 80% of the targeted goals. At least 100% of both goals must be attained in order for the quarterly performance stock grant to be awarded over 100%. Each goal is evaluated individually and subject to the 80% achievement threshold and 100% over-achievement threshold. The remaining 33.33% of this annual equity awards RSU grant shall be subject to performance based vesting for each of the four quarter periods beginning with the fourth quarters of fiscal years 2012 and 2013 (16.66% in each period). The Compensation Committee of the Board of Directors will set applicable performance targets and vesting formulas for each of these periods.

In August 2010, the Company granted 181,334 and 83,000 RSUs to certain current executive officers as part of the annual equity and retention awards programs, respectively. Fifty percent of the aggregate number of RSUs granted as part of the annual equity awards program vest in equal quarterly increments over three years, until such portion of the grant is fully vested on August 1, 2013. One-sixth of the annual equity awards RSU grant, or a portion thereof, was subject to the Company achieving specified quarterly

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revenue and EBITDA goals during the period beginning in the fourth quarter of fiscal year 2010 through the third quarter of fiscal year 2011. In each case, 50% of the quarterly performance stock grant is based on achieving at least 80% of the quarterly revenue goal and the other 50% is based on achieving at least 80% of the quarterly EBITDA goal. The quarterly performance stock grant is paid linearly above 80% of the targeted goals. At least 100% of both goals must be attained in order for the quarterly performance stock grant to be awarded over 100%. Each goal is evaluated individually and subject to the 80% achievement threshold and 100% over-achievement threshold. The remaining 33.33% of this annual equity awards RSU grant shall be subject to performance based vesting for each of the four quarter periods beginning with the fourth quarters of fiscal years 2011 and 2012 (16.66% in each period). The Compensation Committee of the Board of Directors will set applicable performance targets and vesting formulas for each of these periods. All RSUs granted as part of the retention awards program fully vest on August 1, 2013.

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

Common Stock Repurchase

On October 25, 2011, the Company announced that its Board of Directors authorized an additional $200 million for its common stock share repurchase program. This new authorization is incremental to the existing $400 million program, initially approved in October 2010 and expanded in August 2011. Acquisitions for the share repurchase programs will be made from time to time in private transactions or open market purchases as permitted by securities laws and other legal requirements. The programs can be terminated at any time. As of May 3, 2012, the Company had repurchased and retired 8,249,537 shares at an average price of $62.93 per share and the Company had $280.5 million remaining to purchase shares as part of its repurchase programs.

Earnings Per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income by the weighted average number of common and dilutive common stock equivalent shares outstanding during the period. The Company s nonvested restricted stock awards and restricted stock units do not have nonforfeitable rights to dividends or dividend equivalents.

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

	Three months ended March 31,		Six months ended March 31,	
	2012	**2011**	**2012**	**2011**
Numerator				
Net income	$ 68,641	$ 55,575	$ 135,133	$ 111,238
Denominator				
Weighted average shares outstanding basic	79,156	80,809	79,214	80,726
Dilutive effect of common shares from stock options and restricted stock units	619	813	639	944
Weighted average shares outstanding diluted	79,775	81,622	79,853	81,670
Basic net income per share	$ 0.87	$ 0.69	$ 1.71	$ 1.38
Diluted net income per share	$ 0.86	$ 0.68	$ 1.69	$ 1.36

An immaterial amount of common shares potentially issuable from stock options for the three and six months ended March 31, 2012 and 2011, are excluded from the calculation of diluted earnings per share because the exercise price was greater than the average market price of common stock for the respective period.

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Comprehensive Income

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

	Three months ended March 31,		Six months ended March 31,	
	2012	2011	2012	2011
Net Income	$ 68,641	$ 55,575	$ 135,133	$ 111,238
Unrealized gain (loss) on securities, net of tax	620	(309)	533	(963)
Foreign currency translation adjustment	90	159	(173)	(428)
Total comprehensive income	$ 69,351	$ 55,425	$ 135,493	$ 109,847

Recent Accounting Pronouncements

In May 2011, the FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS* (ASU 2011-04), which amends current fair value measurement and disclosure guidance to converge with International Financial Reporting Standards (IFRS) and provides increased transparency around valuation inputs and investment categorization. The Company adopted ASU 2011-04 in the second quarter of fiscal 2012. The adoption of ASU 2011-04 did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income, Presentation of Comprehensive Income* (ASU 2011-05), which eliminates the option of presenting other comprehensive income as part of the statement of changes in stockholders equity and instead requires the entity to present other comprehensive income as either a single statement of comprehensive income combined with net income or as two separate but continuous statements. The amendments in this standard are to be applied retrospectively and are effective for fiscal years, and interim periods within those years beginning after December 15, 2011. The Company will adopt ASU 2011-05 in the first quarter of fiscal 2013 and does not expect the adoption of this standard to have an impact on its consolidated financial statements.

In December 2011, the FASB issued ASU 2011-12, *Comprehensive Income, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05* (ASU 2011-12), which defers the changes in ASU 2011-05 that relate to the presentation of reclassification adjustments to other comprehensive income. No other requirements in ASU 2011-05 are affected by this deferral. Similar to ASU 2011-05, the Company will adopt ASU 2011-12 in the first quarter of fiscal 2013 and does not expect the adoption of this standard to have an impact on its consolidated financial statements.

2. Fair Value Measurements

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

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

The levels of fair value hierarchy are:

Level 1: Quoted prices in active markets for identical assets and liabilities at the measurement date.

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

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

Level 1 investments are valued based on quoted market prices in active markets and include the Company s cash equivalent investments. Level 2 investments, which include investments that are valued based on quoted prices in markets that are not active, broker or dealer quotations, actual trade data, benchmark yields or alternative pricing sources with reasonable levels of price transparency, include the Company s certificates of deposit, corporate bonds and notes, municipal bonds and notes, U.S. government

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securities and U.S. government agency securities. Fair values for the Company s level 2 investments are based on similar assets without applying significant judgments. In addition, all of the Company s level 2 investments have a sufficient level of trading volume to demonstrate that the fair values used are appropriate for these investments.

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

The Company s financial assets measured at fair value on a recurring basis subject to the disclosure requirements at March 31, 2012, were as follows (in thousands):

		Fair Value Measurements at Reporting Date Using			
		Quoted Prices in Active Markets for Identical Securities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value at March 31, 2012
Cash equivalents		$ 50,912	$	$	$ 50,912
Short-term investments					
Available-for-sale securities	certificates of deposit		3,545		3,545
Available-for-sale securities	corporate bonds and notes		135,658		135,658
Available-for-sale securities	municipal bonds and notes		60,319		60,319
Available-for-sale securities	U.S. government securities		800		800
Available-for-sale securities	U.S. government agency securities		79,830		79,830
Long-term investments					
Available-for-sale securities	corporate bonds and notes		171,824		171,824
Available-for-sale securities	municipal bonds and notes		40,710		40,710
Available-for-sale securities	U.S. government agency securities		318,205		318,205
Available-for-sale securities	auction rate securities			13,193	13,193
Total		$ 50,912	$ 810,891	$ 13,193	$ 874,996

The Company s financial assets measured at fair value on a recurring basis subject to the disclosure requirements at September 30, 2011, were as follows (in thousands):

		Fair Value Measurements at Reporting Date Using			
		Quoted Prices in Active Markets for Identical Securities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value at September 30, 2011
Cash equivalents		$ 33,740	$	$	$ 33,740
Short-term investments					
Available-for-sale securities	corporate bonds and notes		137,156		137,156
Available-for-sale securities	municipal bonds and notes		82,715		82,715
Available-for-sale securities	U.S. government securities		799		799
Available-for-sale securities	U.S. government agency securities		105,096		105,096
Long-term investments					
Available-for-sale securities	corporate bonds and notes		141,150		141,150
Available-for-sale securities	municipal bonds and notes		30,714		30,714

Available-for-sale securities	U.S. government agency securities		285,329		285,329
Available-for-sale securities	auction rate securities			13,010	13,010
Total		$ 33,740	$ 782,959	$ 13,010	$ 829,709

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Due to the auction failures of the Company s auction rate securities (ARS) that began in the second quarter of fiscal year 2008, there are still no quoted prices in active markets for similar assets as of March 31, 2012. Therefore, the Company has classified its ARS as level 3 financial assets. The following table provides a reconciliation between the beginning and ending balances of items measured at fair value on a recurring basis in the table above that used significant unobservable inputs (Level 3) (in thousands):

	Three months ended March 31,		Six months ended March 31,	
	2012	2011	2012	2011
Balance, beginning of period	$ 13,064	$ 16,260	$ 13,010	$ 16,043
Total gains realized or unrealized:				
Included in earnings (other income, net)				
Included in other comprehensive income	129	120	183	337
Recognition of put option to earnings				
Settlements				
Transfers into and/or out of level 3				
Balance, end of period	$ 13,193	$ 16,380	$ 13,193	$ 16,380
Gains attributable to assets still held as of end of period	129	120	183	337

Financial assets are considered Level 3 when their fair values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable or there is limited market activity such that the determination of fair value requires significant judgment or estimation. Level 3 investment securities primarily include certain ARS for which there was a decrease in the observation of market pricing. At March 31, 2012, the values of these securities were estimated primarily using discounted cash flow analysis that incorporated transaction details such as contractual terms, maturity, timing and amount of future cash flows, as well as assumptions about liquidity and credit valuation adjustments of marketplace participants at March 31, 2012. Significant fluctuations in any of these inputs in isolation would result in changes in the fair value of the Company s ARS.

The Company uses the fair value hierarchy for financial assets and liabilities. The Company s non-financial assets and liabilities, which include goodwill, intangible assets, and long-lived assets, are not required to be carried at fair value on a recurring basis. These non-financial assets and liabilities are measured at fair value on a non-recurring basis when there is an indicator of impairment, and they are recorded at fair value only when impairment is recognized. The Company reviews goodwill and intangible assets for impairment annually, during the second quarter of each fiscal year, or as circumstances indicate the possibility of impairment. The Company monitors the carrying value of long-lived assets for impairment whenever events or changes in circumstances indicate its carrying amount may not be recoverable. During the three months ended March 31, 2012, the Company did not recognize any impairment charges related to goodwill, intangible assets, or long-lived assets.

3. Short-Term and Long-Term Investments

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

March 31, 2012	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Certificates of deposit	$ 3,558	$	$ (13)	$ 3,545
Corporate bonds and notes	135,220	469	(31)	135,658
Municipal bonds and notes	60,243	90	(14)	60,319
U.S. government securities	800			800
U.S. government agency securities	79,784	46		79,830
	$ 279,605	$ 605	$ (58)	$ 280,152

September 30, 2011	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds and notes	$ 137,087	$ 251	$ (182)	$ 137,156
Municipal bonds and notes	82,687	62	(34)	82,715
U.S. government securities	799			799
U.S. government agency securities	105,050	55	(9)	105,096
	$ 325,623	$ 368	$ (225)	$ 325,766

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

March 31, 2012	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds and notes	$ 171,511	$ 556	$ (243)	$ 171,824
Municipal bonds and notes	40,593	147	(30)	40,710
Auction rate securities	15,000		(1,807)	13,193
U.S. government agency securities	318,411	72	(278)	318,205
	$ 545,515	$ 775	$ (2,358)	$ 543,932

September 30, 2011	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds and notes	$ 141,315	$ 415	$ (580)	$ 141,150
Municipal bonds and notes	30,575	151	(12)	30,714
Auction rate securities	15,000		(1,990)	13,010
U.S. government agency securities	285,334	164	(169)	285,329
	$ 472,224	$ 730	$ (2,751)	$ 470,203

The amortized cost and fair value of fixed maturities at March 31, 2012, by contractual years-to-maturity, are presented below (in thousands):

	Cost or Amortized Cost	Fair Value
One year or less	$ 279,605	$ 280,152
Over one year	545,515	543,932
	$ 825,120	$ 824,084

The cost or amortized cost values of the Company s fixed maturities include $15.0 million of available-for-sale ARS as of March 31, 2012 and September 30, 2011.

The following table summarizes investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for more than 12 months as of March 31, 2012 (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
March 31, 2012	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Certificates of deposit	$ 3,545	$ (13)	$	$	$ 3,545	$ (13)
Corporate bonds and notes	82,862	(244)	12,361	(30)	95,223	(274)
Municipal bonds and notes	21,080	(43)	2,014	(1)	23,094	(44)

Auction rate securities			13,193	(1,807)	13,193	(1,807)
U.S. government agency securities	181,132	(278)			181,132	(278)
Total	$ 288,619	$ (578)	$ 27,568	$ (1,838)	$ 316,187	$ (2,416)

The Company invests in securities that are rated investment grade or better. The unrealized losses on investments for the first six months of fiscal year 2012 were primarily caused by reductions in the values of the ARS due to the illiquid markets and were partially offset by unrealized gains related to interest rate decreases.

ARS are variable-rate debt securities. The Company limits its investments in ARS to securities that carry an AAA/A- (or equivalent) rating from recognized rating agencies and limits the amount of credit exposure to any one issuer. At the time of the Company s initial investment and at the date of this report, all ARS were in compliance with the Company s investment policy. In the past, the auction process allowed investors to obtain immediate liquidity if so desired by selling the securities at their face amounts. Liquidity for these securities has historically been provided by an auction process that resets interest rates on these investments on average every 7-35 days. However, as has been reported in the financial press, the disruptions in the credit markets adversely affected the auction market for these types of securities.

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4. Inventories

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