

NETSCOUT SYSTEMS INC  
Form 10-K  
May 28, 2010  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

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

For the fiscal year ended March 31, 2010

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 0000-26251

**NETSCOUT SYSTEMS, INC.**

(Exact name of registrant as specified in its charter)

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

**310 Littleton Road, Westford, MA 01886**

**(978) 614-4000**

**04-2837575**  
(IRS Employer  
Identification No.)

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

**Common Stock, \$0.001 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 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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  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  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a 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

## Edgar Filing: NETSCOUT SYSTEMS INC - Form 10-K

The aggregate market value of common stock held by non-affiliates of the registrant as of September 30, 2009 (based on the last reported sale price on the Nasdaq Global Market as of such date) was approximately \$490,264,715. As of May 26, 2010, there were 41,827,700 shares of the registrant's common stock outstanding.

### **DOCUMENTS INCORPORATED BY REFERENCE**

(1) Portions of the Registrant's Proxy Statement for the fiscal year 2010 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K. Except as expressly incorporated by reference, the proxy statement is not deemed to be part of this report.

**Table of Contents**

**NETSCOUT SYSTEMS, INC.**

*FORM 10-K*

**FOR THE FISCAL YEAR ENDED MARCH 31, 2010**

**TABLE OF CONTENTS**

**PART I**

|          |   |    |
|----------|---|----|
| Item 1.  | <u>Corporate Background</u>                   | 4  |
|          | <u>General</u>                                | 4  |
|          | <u>Industry Background</u>                    | 6  |
|          | <u>Products &amp; Technology Overview</u>     | 7  |
|          | <u>nGenius Service Assurance Solution</u>     | 8  |
|          | <u>Integration with Third-Party Solutions</u> | 10 |
|          | <u>Product Enhancements and New Products</u>  | 10 |
|          | <u>Strategy</u>                               | 11 |
|          | <u>Sales and Marketing</u>                    | 13 |
|          | <u>Seasonality</u>                            | 13 |
|          | <u>Support Services</u>                       | 14 |
|          | <u>Research and Development</u>               | 14 |
|          | <u>Manufacturing</u>                          | 14 |
|          | <u>Customers</u>                              | 15 |
|          | <u>Backlog</u>                                | 15 |
|          | <u>Channels</u>                               | 15 |
|          | <u>Competition</u>                            | 16 |
|          | <u>Intellectual Property Rights</u>           | 16 |
|          | <u>Employees</u>                              | 17 |
| Item 1A. | <u>Risk Factors</u>                           | 17 |
| Item 1B. | <u>Unresolved Staff Comments</u>              | 26 |
| Item 2.  | <u>Properties</u>                             | 26 |
| Item 3.  | <u>Legal Proceedings</u>                      | 26 |

**PART II**

|         |   |    |
|---------|---|----|
| Item 5. | <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 27 |
| Item 6. | <u>Selected Financial Data</u>  | 30 |
| Item 7. | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                        | 31 |
|         | <u>Overview</u>   | 31 |
|         | <u>Critical Accounting Policies</u>   | 33 |

**Table of Contents**

|                 |   |     |
|-----------------|---|-----|
|                 | <u>Comparison of Years Ended March 31, 2010 and March 31, 2009</u>                                    | 39  |
|                 | <u>Comparison of Years Ended March 31, 2009 and March 31, 2008</u>                                    | 44  |
|                 | <u>Contractual Obligations</u>  | 48  |
|                 | <u>Off-Balance Sheet Arrangements</u>   | 49  |
|                 | <u>Warranty and Indemnification</u>   | 49  |
|                 | <u>Liquidity and Capital Resources</u>  | 50  |
|                 | <u>Recent Accounting Standards</u>  | 52  |
| Item 7A.        | <u>Quantitative and Qualitative Disclosures About Market Risk</u>                                     | 53  |
| Item 8.         | <u>Financial Statements and Supplementary Data</u>  | 54  |
| Item 9.         | <u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>           | 54  |
| Item 9A.        | <u>Controls and Procedures</u>  | 55  |
| Item 9B.        | <u>Other Information</u>  | 55  |
| <b>PART III</b> |   |     |
| Item 10.        | <u>Directors and Executive Officers of the Registrant</u>   | 56  |
| Item 11.        | <u>Executive Compensation</u>   | 56  |
| Item 12.        | <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | 56  |
| Item 13.        | <u>Certain Relationships and Related Transactions</u>   | 56  |
| Item 14.        | <u>Principal Accountant Fees and Services</u>   | 56  |
| <b>PART IV</b>  |   |     |
| Item 15.        | <u>Exhibits and Financial Statement Schedule</u>  | 57  |
|                 | <u>Signatures</u>   | 58  |
|                 | <u>Index to Consolidated Financial Statements</u>   | F-1 |
|                 | <u>Index to Exhibits</u>  |     |
| Exhibit 21      | Subsidiaries of NetScout.   |     |
| Exhibit 23      | Consent of PricewaterhouseCoopers LLP   |     |
| Exhibit 31.1    | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                              |     |
| Exhibit 31.2    | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                              |     |
| Exhibit 32.1    | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                              |     |
| Exhibit 32.2    | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                              |     |

**Table of Contents**

**PART I**

***Item 1. Business***

**Corporate Background**

NetScout Systems, Inc., or we, NetScout or the Company, designs, develops, manufactures, markets, sells and supports market leading unified service delivery management, service assurance and application and network performance management solutions focused on assuring service delivery for the world's largest, most demanding and complex internet protocol, or IP, based service delivery environments. We manufacture and market these products in integrated hardware and software solutions that are used by commercial enterprises, large governmental agencies and telecommunication service providers worldwide. We have a single operating segment and substantially all of our identifiable assets are located in the United States.

We conduct our business globally and our sales force is managed in four main geographic teams: United States, Europe (including the United Kingdom, Germany, France, Spain, Italy and Norway), Asia (including China, Hong Kong, Japan, Korea, Malaysia, Singapore and Taiwan) and Rest of World (including South Africa, Australia, Canada, India, Brazil and Mexico).

In November 2007, we acquired Network General Central Corporation, or Network General, to expand our product line and customer base. Network General was the developer of the Sniffer® branded products which for many years have been a leading brand with substantial market and mind share in the network management market. Prior to the acquisition, Network General introduced the InfiniStream product line, based on the Sniffer® technology. The acquisition more than doubled our pre-acquisition revenue rate and doubled the employee population, securing our position as a leader in the application and network performance service assurance market.

We are a Delaware corporation founded in 1984 and our principal executive offices are located at 310 Littleton Road, Westford, Massachusetts, and our telephone number is (978)614-4000. NetScout's internet address is <http://www.netscout.com>. Information contained or referenced on our website is not incorporated by reference in and does not form a part of this Annual Report on Form 10-K. NetScout makes available, free of charge, on our website our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission.

**General**

With a sustained history of 25 years of technology innovation NetScout continues to lead the market and has changed how organizations assure service delivery across modern IP networks. NetScout has continually aligned its product portfolio to meet the needs of organizations to provide solutions that enable the efficient and effective management of dynamic network and application environments. Our product portfolio has been architected to help organizations improve service availability and reliability with highly scalable and flexible real-time service delivery management capabilities that support a wide-range of enterprise information technology, or IT, operational teams including network managers, datacenter operations, application management, network operations centers, network engineering and IT operations. In addition, our solutions are deployed by telecommunication service providers where they support a broad range of users including the network operations, network engineering, service operations, application groups, customer care, marketing, chief technology officer and advance engineering groups.

NetScout solutions, leveraging advanced packet flow technologies, enable organizations to gain greater visibility to effectively monitor, analyze and assure the end-to-end performance of applications and services. NetScout's value proposition to our customers is to leverage our technology to deliver better business value.

## Table of Contents

enhance the user experience, increase the return on investment from existing technology purchases and simplify the management of IP service delivery. Within our unified service delivery management framework, organizations gain unprecedented visibility to better understand their service delivery environment. This significantly enhances operational agility and enables the organization to:

Assure business service continuity;

Improve user experience;

Optimize service delivery performance;

Increase efficiency and utilization of existing infrastructure;

Simplify managing service delivery;

Reduce operations and support complexity and costs; and

Lower the overall total cost of IT operations

NetScout is in a unique position addressing both the enterprise and service provider markets. Leveraging our common packet-flow technology foundation, we have developed substantial expertise in assuring IP service delivery that has enabled us to build a highly scalable and extensible solution offering that not only addresses the unique needs of both the enterprise and the service provider markets, but also allows us to cross-leverage this knowledge and technology development to benefit and complement of each of these market segments.

Within the enterprise environment, the value of NetScout Sniffer<sup>®</sup> and nGenius<sup>®</sup> technology enables IT organizations to protect and improve service quality while evolving their service management model from a reactive approach that responds to user complaints to a more proactive model that is able to address service delivery performance issues before they become serious. Organizations can quickly assure service delivery consistently from the datacenter to the user and over the wide area network, or WAN, to the branch office freeing up scarce IT resources to spend time on more strategic initiatives. Some of the more common enterprise IT initiatives our solutions support include:

**Data Center Upgrades & Virtualization** Manage service delivery across virtual and physical environments for a comprehensive, unified view of application and network performance. Proactive monitoring and analysis of physical and virtual services in the data center enables organizations to optimize datacenter infrastructure investments, protect against service degradations, and simplify the operation of complex, multi-tier application environments.

**Unified Communications** Deliver unified visibility to view voice, data and video services side-by-side in order to understand the interrelationships of all services that traverse the network infrastructure.

**Branch Office & WAN** Bring extended visibility into the performance of applications and networks at and between locations, including cloud-based services, with a unified view of end-to-end service delivery enabling collaborative problem-solving and uniform planning.

## Edgar Filing: NETSCOUT SYSTEMS INC - Form 10-K

**Enterprise Mobility** Provide service assurance across the infrastructure and applications supporting wireless service delivery, and rapid-response network troubleshooting, integrated with Cisco® wireless networks.

**Process Improvement & ITIL Initiatives** Deliver real-time and historical information which provides the necessary insight to restore service, manage capacity, and understand the users' quality of experience as well as streamline workflow in support of Information Technology Infrastructure Library, or ITIL, process improvements.

**Service Assurance & Troubleshooting** Provide real-time enterprise-wide views, backed up by high-definition, actionable information on all network traffic, including individual applications, segments and end-users, for rapid isolation of network issues, quick service restoration, and a minimization of business impact.



## **Table of Contents**

As service providers transform their operations to leverage the power of the modern IP network, they are confronted with new challenges in assuring services over an increasingly dynamic operating environment. New multimedia applications, migration from time division multiplexing technology, or TDM, or asynchronous transfer mode technology, or ATM, transport to IP, introduction of Voice over IP, or VoIP, and the transition to IP multimedia sub-systems, or IMS, require a new and innovative approach to assuring the delivery of next-generation broadband IP services.

Today's service providers are focused on creating a compelling set of services, with a high quality user experience, while also keeping an eye on reducing operational complexity and costs. This coupled with the complexity of IP transformation activities and emerging new technologies like long-term evolution, or LTE, internet protocol television, or IPTV, and cloud services drives the need for more of an automated and unified approach to managing service delivery and the subscriber experience. Service providers must reduce the cost of service delivery, address increasing complexity, scale globally and adapt to emerging technologies such as cloud services, virtualization and unified communication services while assuring their users' experiences to retain their revenue base.

**For Mobile Operators** The fundamental transformation of the mobile network to all-IP enables mobile operators to build highly-scalable service delivery environments to offer new dynamic services to meet the growing subscriber demand for data, voice and video centric services and to consolidate and dramatically simplify network operations. However, to capitalize fully on the value of IP and the significant market opportunities, mobile operators need detailed IP packet-level insight and core-to-access visibility into the service, subscriber and network domains.

**For Fixed-line Operators** The growing demand for high-bandwidth triple-play services, broadband connectivity, IPTV, on-demand video traffic and carrier Ethernet services presents carriers with significant revenue opportunities. IP has become the de-facto convergence mechanism for access, distribution and core networks, enabling new service offerings, simplifying network operations while reducing total cost of operations. To realize these benefits, operators need comprehensive insight into IP services, service usage, service availability, application awareness, user profiles, traffic load, network availability and network performance.

### **Industry Background**

Large enterprises, public sector agencies, and telecommunication service providers are critically dependent upon their data networks and on the Internet to generate and deliver information and business services to their customers, suppliers, investors, employees, and citizens. Simultaneously, these data networks are taking on new roles: including the role of the voice network and serving as the platform for the next generation of massively distributed, virtualized, service-oriented application architectures. Furthermore, rapidly advancing server technology and exploding multimedia applications continue to drive growth in traffic levels and have spawned a new wave of infrastructure upgrades. In parallel, the service provider market continues to undergo fundamental changes with the accelerating transition to IP based services, requiring new network infrastructures and presenting new and daunting challenges for assessing and assuring service quality. The combination of these fundamental trends produces unprecedented complexity coupled with unparalleled business impact requiring capable management technology.

We market and distribute our products globally through our own direct sales force and through strategic channel partners that include distributors, value added resellers and systems integrators. We have a dual market strategy that includes both the enterprise and service provider markets. For our enterprise markets, we focus on the Global 5000, which includes industry segments such as financial, healthcare, manufacturing, retail, technology, utilities, education and the public sector, which includes many large agencies of federal, state and local governments. In the service provider segment, we sell focused solutions to mobile operators, wireline operators and cable operators globally. We had no single customer or channel partner representing more than 10% of revenues in fiscal years 2010, 2009 or 2008.

## **Table of Contents**

### ***Enterprise Markets***

In today's dynamic business environment, the IP network has emerged as a critical success factor for many organizations. The IT organization is under increasing pressure to orchestrate the seamless and reliable delivery of services to meet increasing user expectations. IT must provide more services and greater business value with fewer resources and lower operating budgets than ever before. The IT mission is focused on reducing the cost of IT while increasing IT performance, improving operational efficiencies and delivering the highest quality and availability of IT services possible. The lack of unified and consistent visibility into network and application performance with dynamic correlation to services, the business and user experience is no longer acceptable. This, coupled with the ever changing technology landscape and the continued increasing complexity of IT infrastructure, drives the need for a more automated and unified approach to managing service delivery. IT management must reduce the cost of service delivery, address increasing complexity, scale globally and adapt to emerging technologies such as cloud services, virtualization and unified communication services.

The result is increasingly large, geographically dispersed, and complex networks and infrastructures that are challenging to manage and make service performance levels difficult to assure. Application and network malfunctions, resource contention, and infrastructure and application mis-configurations can all cause service disruptions, lost revenue and customer dissatisfaction. Consequently, network operators are recognizing the critical importance of addressing customer service performance problems quickly and proactively. The NetScout suite of products is designed for this rapidly growing market of organizations running complex, widely-distributed networks that are built for always-on service delivery environments.

### ***Telecommunication Service Provider Markets***

Our unique opportunity in the service provider market stems from the industry's transformation to IP-based networks. This move to IP has touched every single segment of the wireless service provider environment. IP enables service providers to optimize their operating environment, converge and consolidate multiple networks and gain a high degree of flexibility in service offerings due to the dynamic nature of modern IP technology. Most carriers are moving from traditional (or legacy) circuit switched environments, where each user connection or service is using a dedicated circuit with dedicated bandwidth, to packet switched, IP-based environments. The value of IP is that service providers gain a high degree of efficiency and provisioning flexibility for services over common connections with security and service quality capabilities coming from the underlying network equipment technology rather than through dedicated connections. As a result, service providers now require a much higher level of understanding of the traffic flows into a true multi-service delivery environment. Additionally, carriers are faced with creating new ways of operating their networks.

Although the intrinsic need for better network, application, and service management solutions is growing, successful vendors must demonstrate not only technical superiority and scalability, but also a sound understanding of the implications of the current and future transformational changes in the industry, as well as the ability to deliver new solutions to match evolving customer needs. These vendors must also prove their staying power and stability, and demonstrate the ability to partner successfully with industry leaders.

### **Products & Technology Overview**

NetScout has developed three distinct product families that range from portable field service tools, to dedicated hot-spot deep packet analysis and forensics, to end-to-end always-on service assurance with intelligent early warning capabilities. This comprehensive range of dynamic tools leverages the power of packet-flow knowledge to support both strategic and tactical approaches to managing the performance of applications and networks. NetScout products enable enterprise and service provider organizations to meet the challenges and demands associated with managing performance and service levels associated with modern-day service delivery.

**nGenius Service Assurance Solution** delivers comprehensive visibility into end-to-end performance of the network, applications, services and users. Leveraging a family of unified software modules and

## **Table of Contents**

rich packet-flow based metadata, the nGenius solution delivers unprecedented visibility into the end-to-end service delivery environment. Leveraging a robust range of intelligent data sources, the nGenius solution provides unified visibility from virtually any place in the network – extending from the datacenter infrastructure and virtualized servers to the network core, edge and branch office to deliver highly accurate and flexible visibility into the user’s experience for application and network performance. This highly scalable network-wide solution provides IT organizations the tools and streamlined workflows needed to significantly improve the quality of services delivered, and dramatically reduce the time required to identify and resolve performance problems by enabling a more predictive and preventative approach to managing service delivery.

**Sniffer Analysis Software Suite** provides a direct connection to nGenius InfiniStream® appliances for highly optimized forensic analysis and packet data mining to exploit fully the valuable information contained within network packets. The Sniffer Analysis software suite can be deployed on a stand-alone basis or in concert with the comprehensive nGenius Service Assurance Solution. When deployed in a stand-alone mode, Sniffer Analysis provides segment-by-segment deep packet analysis and troubleshooting capabilities by leveraging any number of nGenius InfiniStream appliances deployed across the network. The Sniffer Analysis software suite provides a powerful view deep into IP network packets revealing granular information about network and application interactions and response time and latency metrics.

**Sniffer Portable Analyzer Product Family** provides portable network and application analysis capabilities for plug-and-play, on-demand field deployments. Built on widely deployed Sniffer technology, the software is deployed on individual laptops for portable analysis and troubleshooting to enable rapid isolation of issues for wired and wireless networks.

### **nGenius Service Assurance Solution**

The nGenius Service Assurance Solution is a tightly integrated unified service delivery management platform that provides comprehensive, real-time network, application and service performance intelligence to enable organizations to assure optimized network and application performance and quality of user experience. The nGenius Service Assurance Solution provides always-on network and application visibility with a common and consistent view of service-oriented analysis and reporting functions that enables increased productivity and collaboration across the IT organization with team-oriented workflows. Solution capabilities include:

**Unified aggregate service views** with intelligent automated anomaly detection to understand service-level performance and predict network, application, and service performance degradations to minimize or avoid service impacting degradations.

**Network, application and service performance management** with unified real-time and historical views, for critical visibility into today’s most complex service delivery environments.

**Packet-level forensic analysis** enabling deep-packet visibility and granular back-in time historical analysis to resolve the most difficult application and service delivery problems.

**Planning and optimization capabilities** showing how resources are being consumed and revealing capacity shortfalls to keep service delivery environments running at peak efficiency and performance levels and to best leverage existing IT technology investments.

**Service and Policy validation** delivers key metrics and insight into the service delivery environment to validate the impact of the implementation of new network optimization, policies for applications and services.

The nGenius Service Assurance Solution brings a unified approach to managing service delivery that enables organizations to dramatically improve the overall quality of service for applications and service delivered across the entire organization with greater service reliability and availability with improved network performance



---

## **Table of Contents**

and responsiveness. We believe that a unified framework for service delivery management helps organizations lower the total cost of IT operations by enabling them to consolidate operations into a single unified tool set that can then be leveraged across the entire organization. This improves IT staff productivity, collaboration and enables better cross-functional leverage of management tool investments. Consequently, the IT organization gains better insight into the real-time operation of the service delivery environment and is able to reduce the overall total cost of ownership and maximize the return on network and application investments.

The nGenius Service Assurance Solution is a unified platform that leverages a number of specialized modules and intelligent data sources and consists of:

**nGenius Performance Manager** Analyzes and correlates the meta-data delivered by a comprehensive range of intelligent data sources (hardware appliances and software-based agents) for integrated network, application and service performance monitoring, response time analysis, troubleshooting, capacity planning and trending and long-term reporting enabling end-to-end assurance and visibility of service delivery.

**nGenius K2 Service Delivery Manager** Used in conjunction with nGenius Performance Manager, nGenius K2 delivers service-oriented views and virtual topology maps to provide a high-level view of the health of applications and services, as well as automatically detect anomalous changes in network, application and service behavior.

**nGenius Subscriber Intelligence** designed for mobile operators, nGenius Subscriber Intelligence provides datacenter-to-core-to-access visibility for managing mobile data sessions in general packet radio service, or GPRS, and in universal mobile telecommunications systems, or UMTS networks. nGenius Subscriber Intelligence leverages NetScout extended data record, or xDR, technology built into the InfiniStream appliances to provide unmatched, real-time correlation with network, service and subscriber context of related user plane and control plane sessions across both the core and access portions of the network.

**Sniffer Analysis** Enables unrestricted packet mining, forensic analysis and decodes from the nGenius InfiniStream appliance storage to speed troubleshooting.

**Sniffer MultiSegment Analysis** Combines and correlates trace files from multiple nGenius InfiniStream appliances to enable multi-segment and multi-tier analysis, comparative session reporting and logical application/service mapping.

**nGenius Intelligent Data Sources** nGenius Intelligent data sources range from intelligent Deep Packet Capture appliances; to hardware probes; to software-based agents for virtual environments and deployment within network equipment; to NetFlow and sFlow data collection devices. Our intelligent data sources utilize a common framework that enables the disparate metrics collected to be displayed in comprehensive and unified views, with seamless workflows across the fully integrated and unified nGenius Service Assurance Solution.

**nGenius Performance Manager for Flows and nGenius Analytics for Flows** Performance Manager and Analytics for Flows use Cisco NetFlow, sFlow, IP service level agreement, or IP SLA, data for analysis and reporting of performance problems, analysis and reporting for application utilization and conversation-level statistics and management information base, or MIB II, data collected by nGenius Collectors.

Our unique and scalable approach to understanding the service delivery environment and the interdependencies of the network, application and users has allowed us to break new ground in the industry, offering superior visibility into service and application traffic.

---

## **Table of Contents**

### **Integration with third-party solutions**

To have the greatest operational impact on assuring performance of applications and service delivery, NetScout has integrated its technology with third-party management consoles and business service management systems. This integration allows organizations to receive alarms on impending performance problems and to seamlessly link into the nGenius solution in order to perform detailed problem analysis and troubleshooting. By providing seamless integration into element management platforms, NetScout fills a significant gap in our customers increasingly integrated operations: visibility into the interaction of applications, services and infrastructure resources from a network vantage point. NetScout collaborates with technology partners to provide integrated solutions and extend the value of the nGenius Service Assurance Solution for application and network performance management across the organization. Using packet-flow data, key performance indicators, or KPIs, and other sources of performance information derived from the nGenius Service Assurance Solution, integrated solutions enhance an organization's ability to optimize, simplify and protect the service delivery environment and consequently, the business.

**Cisco Systems** NetScout is a member of the Cisco Developer Network Program for Mobility, Unified Communications and Advanced Routing. NetScout has integrated its Sniffer Global product with the Cisco® 3300 Series Mobility Services Engine, or MSE, to provide contextual location information to simplify and improve management of wireless networks. We received certification of our compatibility and interoperability with Cisco's unified communications platform. We also have integrated our probe technology into the Cisco Integrated Services Router platform enabling our joint customers to more cost-effectively leverage the end-to-end capabilities of our service assurance solution from the datacenter to the branch office.

**Hewlett-Packard Company** NetScout is a Platinum Business Partner in HP's Enterprise Management Alliance Program, and provides integration between the nGenius Service Assurance Solution with HP Business Technology Optimization, or BTO, Software solutions including HP OpenView Network Node Manager, or HP NNMi, HP Business Availability Center and HP Operations Manager. Together the integrated solutions provide our joint customers a true single-pane-of-glass approach to troubleshooting to speed problem identification and resolution and assure users experience.

**IBM** NetScout is an IBM® PartnerWorld member, and has been awarded Ready for IBM Tivoli Software validation status to nGenius Performance Manager and nGenius K2 for its integration with IBM Tivoli® NetView®, IBM Tivoli Enterprise Console®, or TEC, and IBM Tivoli Netcool®/OMNIBus. The integration between NetScout and IBM platforms provides our joint customers with expanded reach of their Event Management Systems, or EMS, by combining integrated fault management and service delivery assurance into a single integrated console view with a seamless troubleshooting workflow.

**EMC® Ionix Control Center** (formerly SMARTS) NetScout is an EMC Velocity2 partner and provides integration between the nGenius Service Assurance Solution and the EMC Ionix Service Assurance Manager, EMC Ionix IP Availability Manager and EMC Ionix Discovery Manager. Integration between the nGenius solution and EMC Ionix solution provides our joint customers with complementary visibility into the packet-flow data within the service delivery environment and a bi-directional workflow between the nGenius Solution and EMC Ionix platform.

**Riverbed** The combined NetScout-Riverbed solution provides a market-leading product set for application acceleration and network and application performance analysis. The partnership helps enterprises optimize performance by allowing them to accelerate their applications over WANs without any loss of visibility into application performance.

### **Product Enhancements and New Products**

NetScout continuously enhances its solutions to meet the increasing demands and ever changing technology landscape of IP networks and service and applications. Typically these types of changes result in marginal

## **Table of Contents**

increases in the functionality of the products, which do not meet the criteria for capitalization. In recent years we delivered major product upgrades across our product lines, more tightly integrating deep packet forensics into our top-down performance troubleshooting workflows, improving the flexibility of our industry-leading advanced early warning capabilities, and adding support for new sources of performance metrics. During fiscal year 2010, we released several new products and enhancements that will help our customers meet the challenges of managing service delivery and application and network performance issues across large, globally distributed enterprise, service provider, and government networks. Key introductions include:

**Cisco MSE Integration** the integration of our Sniffer Global product with the Cisco Mobility Solution with the Cisco® 3300 Series Mobility Services Engine, or MSE.

**nGenius InfiniStream 2900 series appliance** provides a smaller form factor and lower capacity deep packet capture appliance that dramatically lowers the cost and enables deployment further out in the network.

**nGenius Virtual Agent** enables deployment of our monitoring technologies into virtualized server environments enabling organizations to regain lost visibility resulting from server virtualization projects. Our first integration is with the VMWare platform.

**nGenius Integrated Agent** enables the deployment of our monitoring technologies into network equipment and computer platforms extending visibility to the network edge and branch offices. Our first integration is with the Cisco Integrated Services Router platforms.

**nGenius Subscriber Intelligence** specifically addresses the needs of mobile operators to manage user experience in IP-based environments enabling contextual visibility from service creation to users consumption.

## **Strategy**

Enhancing shareholder value through sustained growth and increased profitability based on our continued market leadership is our primary objective. We continue to see a strong level of interest by the market for our products and technology as both enterprise and service provider customers struggle to keep up with the increasing complexity and volume of service traffic over IP networks. Both of these segments are looking for unified approaches that can scale to manage and assure the delivery of critical services over a highly distributed IP networks. We intend to capitalize on this growing market demand and momentum by driving a number of top-level industry issues and increasing our relevance, technology leadership and overall mindshare. We intend to pursue growth by increasing our ongoing business with our established customers, expanding our worldwide coverage and presence to add new customers, growing and establishing new relationships with technology alliance partners and extracting greater leverage of strategic resellers and go to market partners. Key elements of our strategy include:

**Drive technology innovation to extend our market leadership** We are increasing our investment in research and development to expand and enhance our unified service delivery management capabilities that capitalize on our extensive experience with global enterprise and service provider organizations with very large, high-capacity IP-based networks. We intend to take advantage of our unique position in both the enterprise and service provider markets to cross-leverage our technology development for both markets to enable greater capabilities for our current and new customers. We will enhance and extend our product line to meet the increasing challenges of managing a diverse range of services over an increasingly global network environment.

**Continued portfolio enhancements** We plan to continue to enhance our products and solutions to address the management challenges associated with virtualization, cloud computing, service-oriented architectures, VoIP, video, and telepresence technologies. In addition, we will continue to drive our solutions to help IT organizations address the challenges of borderless networks, datacenter consolidation, branch office consolidation and optimization, increasing mobility and the move to a more process-oriented operating environment.





## Table of Contents

**Enabling pervasive visibility** We intend to continue to expand our intelligent data source family to enable our customers to achieve more visibility in more places across their end-to-end network environment. We are expanding our nGenius InfiniStream appliance family to enable greater levels of storage and processing capacity and to expand our software-based nGenius Virtual Agent and nGenius Integrated Agent technology to enable wider deployment of our technology within virtual computing environments, network devices and computing platforms. We intend to greatly enhance our ability to scale and to generate real-time metadata to meet the need for addressing a rapidly growing level of data traffic and an increasingly complex application environment. This includes extending and strengthening our market and technology lead by developing new and innovative ways to address the increasing volume of data traffic and enable support for 40 Gigabit and 100 Gigabit technologies. We will also support the impending large increase of IPv6 deployments globally.

**Expand our customer base in both enterprise and service provider markets** As of March 31, 2010, NetScout's customer set included 94 of the Fortune 100 companies and approximately forty percent of the Fortune Global 2000. We are deployed in more than 120 service provider networks across 39 countries. It is our intention to substantially grow our presence in both the enterprise and service provider markets. In the enterprise market, we are growing the installed base footprint to include a broader number of top-tier enterprise customers as well as extending to reach the mid-market enterprise customers. We intend to increase the use of our products across the IT organization to include new operational groups as we continue to extend the capabilities and value of our products and solutions. In the Service Provider market, we are expanding our presence through new service provider customer acquisitions as well as expanding our footprint further out into the Radio Access Network, or RAN, deeper into the provider core and into new datacenter expansions as cloud-based service offerings become increasingly strategic to service providers. In addition, we intend to stretch the use of our products across the service provider operational organizations to enable greater leverage from a common view into network, services and subscriber data.

**Increase market relevance and awareness** To generate increased demand for our products we will continue to aggressively promote and position our technology, products and solutions to both the enterprise and service provider market and drive our vision and strategy of unified service delivery management. In addition, we will continue to drive industry initiatives around managing service delivery.

**Scale and grow our direct sales force** We are expanding our direct sales force in fiscal year 2011. In fiscal year 2010 we began the segmentation of our sales force to specifically and effectively target the enterprise and service provider markets. Each of these segments has different technology issues, challenges and sales cycles. Consequently, NetScout has begun the process of creating highly optimized and aligned organizations to better meet the needs of these two diverse market segments.

**Extend our technology partner alliance ecosystem** We plan to continue to enhance our technology value, product capabilities and customer relevance through the continued integration of our products into technology partner products. This includes both interoperability integration efforts, as well as embedding our technology into alliance partner products to gain a more pervasive footprint across both enterprise and service provider networks. In addition, we will continue to develop further our integration into both enterprise and service provider management platforms with an increased emphasis on network equipment manufacturers and enterprise management and service provider Operation Support System, or OSS, integration.

**Enhance and extend our services and support operations** We plan to extend and continue to enhance our services and support capabilities to support our growing customer base in both the enterprise and service provider markets. We continue to enhance our training with personalized and blended education programs to help our customers deploy and use our products more effectively. We have strengthened our classroom training and recently added web-based on-demand training programs. We also continue to evolve and enhance our extensive certification programs designed to recognize network professionals who have demonstrated an in-depth understanding of nGenius and Sniffer products and technologies.

## **Table of Contents**

### **Sales and Marketing**

We sell our products, support and services through a direct sales force and an indirect reseller and distribution channel. Our sales force uses a high-touch sales model that consists of face-to-face meetings with customers to understand and identify their unique business challenges and requirements. Our sales teams then translate those requirements into tailored business solutions that allow the customer to maximize the performance of its infrastructure and service delivery environment. Due to the complexity of the systems and the capital expenditure involved, our sales cycle typically takes between three to 12 months. We build strategic relationships with our customers by continually enhancing our solution, based on their expressed needs, to help them address their evolving service delivery management challenges. In addition to providing a comprehensive solution to meet these needs, we continually provide software enhancements to our customers as part of their maintenance contracts with us. These enhancements are designed to provide additional and ongoing value to our existing customers to promote loyalty and the expansion of their deployment of our products. Existing customer growth is also driven by the expansion and changes in their networks as they add new infrastructure elements, new users, new locations, new applications and experience new and increasing service traffic volumes.

Our sales force is organized into four main geographic teams covering sales around the globe. Revenue from sales outside the United States represented 27%, 25% and 27% of our total revenue in the fiscal years ended March 31, 2010, 2009 and 2008, respectively. Sales to customers outside the United States are primarily export sales through indirect channel partners, who are generally responsible for distributing our products and providing technical support and service to customers within their territories. Sales arrangements are primarily transacted in United States dollars. Our reported international revenue does not include any revenue from sales to customers outside the United States that are shipped to our United States-based indirect channel partners. These domestic resellers fulfill customer orders based upon joint selling efforts in conjunction with our direct sales force and may subsequently ship our products to international locations; however, we report these shipments as United States revenue since we ship the products to a domestic location. We expect revenue from sales to customers outside the United States to continue to account for a growing, significant portion of our total revenue in the future. For more information on the geographic distribution of our revenue, see Note 17 to the attached consolidated financial statements.

As of March 31, 2010, our international field sales organization consisted of employees located in the United Kingdom, Germany, France, Spain, Italy, Norway, China, Hong Kong, Japan, Korea, Malaysia, Singapore, Taiwan, Mexico, Canada, Brazil, South Africa, Australia and India.

Our marketing organization drives our market strategy, product positioning and messaging and produces and manages a variety of programs such as advertising, trade shows, industry events, public and analyst relations, direct mail, seminars, sales promotions, and web marketing to promote the sale and acceptance of our solutions and to build the NetScout, nGenius and Sniffer brand names in the marketplace. Key elements of our marketing strategy focus on thought leadership, market education, go to market strategies, reputation management, demand generation, and the acceleration of our strategic selling relationships with local and global resellers, systems integrators, and our technology alliance partners.

### **Seasonality**

We have experienced, and expect to continue to experience, quarterly variations in our order bookings as a result of a number of factors, including the length of the sales cycle, complexity of customer environments, new product introductions and their market acceptance and seasonal factors impacted by customer projects and typical IT buying cycles. Due to these factors, we historically have experienced stronger bookings during our fiscal third and fourth quarters. Net revenue can also be affected by unforeseen delays in product shipments due to issues such as on hand inventory constraints, unexpected delays in customer IT modernization projects and other delays in investments in IT management technologies and products.

## **Table of Contents**

### **Support Services**

Customer satisfaction is a key driver of NetScout's success. NetScout's MasterCare support programs offer customers various levels of high quality support services to assist in the deployment and use of our solutions. We have support personnel strategically deployed across the globe to deliver 24/7 toll-free telephone support to our premium MasterCare customers. Some of the support services, such as on-site support activities, are provided by qualified third party support partners. In addition many of our certified resellers provide first-level support to NetScout end-users. This is especially prevalent in international locations where time zones and language, among other factors, make it more efficient for end-users to have the reseller provide initial support functions. MasterCare support also includes updates to our software and firmware at no additional charge, if and when such updates are developed and made generally available to our commercial customer base. If ordered, MasterCare support commences upon expiration of the standard warranty for software. For software, which also includes firmware, the standard warranty commences upon shipment and expires 90 days thereafter. With regard to hardware, the standard warranty commences upon shipment and expires 12 months thereafter. We believe our warranties are consistent with commonly accepted industry standards.

### **Research and Development**

Our continued success depends significantly on our ability to anticipate and create solutions that will meet emerging customer requirements. We have invested significant financial resources and personnel into the development of our products and technology. Our continued investment in research and development is crucial to our business and our continued success in the market. We have assembled a team of highly skilled engineers with expertise in various technologies associated with our business and the technologies being deployed by our customers. These include, networks, protocols, applications, application delivery, WAN technologies, storage and systems management. As we have expanded our market to also include the wireless service provider segment, we have added a significant number of resources with expertise in service provider networks and technologies including GSM, UMTS, CDMA2000 and LTE technologies. We plan to continue to expand our product offerings and capabilities in the near future, and therefore, plan to continue to invest and dedicate significant resources to our research and development activities. In addition, as we continue to expand our position in the service provider market, we will need to continue to expand our offerings and purpose-built capabilities for these customers. We will continue to make substantial investments in growing our service provider technology expertise to maintain and grow our market and technology lead for this rapidly growing market segment opportunity.

We predominantly develop our products internally, with some third party contracting. We have also acquired developed technology through business acquisitions. To promote industry standards and manifest technology leadership, we participate in and support the activities and recommendations of industry standards bodies, such as the Internet Engineering Task Force, or IETF, the 3<sup>rd</sup> Generation Partnership Project, or 3GPP, and we also engage in close and regular dialogue with our key customers and alliance partners. These activities provide early insight into the direction of network and applications performance requirements for current and emerging technologies.

### **Manufacturing**

Our manufacturing operations consist primarily of final product assembly, configuration and testing. We purchase components and subassemblies from suppliers and construct our hardware products in accordance with NetScout standard specifications. We inspect, test and use process control to ensure the quality and reliability of our products. In February 1998, we obtained ISO 9001 quality systems registration, a certification showing that our corporate procedures and manufacturing facilities comply with standards for quality assurance and process control. In July 2003, we obtained ISO 9001:2000 quality systems registration, a certification showing that our corporate procedures comply with standards for continuous improvement and customer satisfaction.

## **Table of Contents**

Although we generally use standard parts and components for our products, which are available from various suppliers, each of the computer network interface cards used in our devices is currently available only from separate single source suppliers. We have generally been able to obtain adequate supplies of components in a timely manner from current suppliers. While currently we purchase from specific suppliers, we believe that, in most cases, alternate suppliers can be identified if current suppliers are unable to fulfill our needs. Our reliance on single source suppliers is further described in Item 1A Risk Factors.

We manufacture our products based upon near-term demand resulting from detailed sales forecasts. Due to the fact that these forecasts have a high degree of variability because of such factors as time of year, overall economic conditions and employee incentives, we maintain inventory levels in advance of receipt of firm orders to try and ensure that we have sufficient stock to satisfy all incoming orders.

## **Customers**

We sell our products to enterprise, public sector and service providers and other organizations with large- and medium-sized high-speed computer networks. Our enterprise customers cover a wide variety of industries, such as financial services, technology, manufacturing, healthcare, utilities, education and retail. In the telecommunications service provider segment we address mobile operators, wireline operators and cable operators. A significant number of our service provider customers are mobile operators.

## **Backlog**

We configure our products to customer specifications and generally deliver the final products to the customer within a relatively short time after receipt of the purchase order. These orders also often include service engagements and technical support coverage. Customers may reschedule or cancel orders prior to shipment with little or no penalty.

We concluded our fiscal year 2010 with an immaterial amount of combined product backlog, consisting of unshipped orders, and deferred product revenue. Our combined product backlog at March 31, 2009 was \$10.0 million.

## **Channels**

In recent years we implemented reseller specific programs to improve our reach to customers and presence in new markets through channel partners. We sell through a broad range of channel partners including value added resellers, or VARs, value added distributors, or VADs, resellers, and system integrators, or SIs, for both the enterprise and service provider markets. These channel partners help us market and sell our products to a broad array of organizations globally and allow us to better allocate and leverage our field sales force resources. In addition, and in conjunction with, our increasing relationship with Cisco Systems, we have been developing channel programs that enable us to cross-leverage our common channel partners to enable us to leverage the extended reach and value of the global Cisco reseller channel.

Historically and currently, we have used indirect distribution channels principally as intermediaries on contractual terms for customers with whom we have no contract. Our sales force meets with end user customers to present NetScout products and solutions, conduct demonstrations, provide evaluation equipment, recommend detailed product solutions, develop product deployment designs and timelines, and assist in establishing financial and other justification for the proposed solution. During this selling process a channel partner, who has contracts with both the end customer and NetScout, may be brought in to facilitate the transaction and to provide fulfillment services. In the case of international channel partners, those services usually also include currency translation and first line maintenance support. In the U.S., fulfillment services are usually limited to invoicing and cash collection. Under this approach, we have limited dependence upon channel partners for the major elements of the selling process. In many cases, there are multiple channel partners with the required contractual relationships, so dependence on any single channel partner is minimized.

## **Table of Contents**

Total revenue from indirect channels represented 61%, 59% and 65% of our total revenue for the fiscal years ended March 31, 2010, 2009 and 2008, respectively.

### **Competition**

The service assurance and performance management market is highly competitive and is a somewhat fragmented market that has overlapping technologies and competitors and is continually evolving. Consequently, there are a number of companies that deliver some pieces of what our solutions offer and also include larger IT management companies that are competing for the same IT budget for managing performance and service delivery.

We believe we compete primarily on the basis of offering a complete and comprehensive service delivery management solution that broadly enables IT organizations to address the challenges of managing and assuring the delivery of critical IT services and applications to predict, identify and resolve the root causes of poor performance of large-scale, distributed computing environments. We believe other principal competitive factors in our market include scalability, ability to address a large number of applications, locations and users, product performance, the ability to easily deploy into existing network environments and the ability to administer and manage the products. We believe that our solutions provide superior data and perform better than competitive products as measured by a broad range of metrics including the ability to recognize and track a large number of applications, scalability to support increasing levels of data and network traffic and the ability to look at both data and control plane traffic across an entire end-to-end network. Our ability to sustain such a competitive advantage depends on our ability to deliver continued technology innovation and adapt to meet the evolving needs of our customers.

We believe we are currently the only vendor providing a comprehensive and unified end-to-end service delivery management solution that is capable of addressing the needs of both enterprise and service provider customers and can scale to meet the enormous challenges of today's dynamic service delivery environments. However, there have been some acquisitions by large IT management vendors to strengthen their portfolio in the service assurance market and they will continue to invest in this area. We believe that we compete favorably in the service delivery management and service assurance markets and are the only vendor with a comprehensive service assurance and service delivery management solution that scales to meet the needs of today's dynamic IP-based network operating environments. We have a strong and dynamic purpose-built architecture, compared to many vendors' attempts to combine separate and un-integrated technology elements, we believe we have a significant advantage in scalability, comprehensiveness of data gathered, performance, ease-of-use, unified workflows and the ability to scale our solution to address large global deployments that encompass a large number of applications, services, locations and users.

In the enterprise market, our larger competitors include Computer Associates and OPNET Technologies, Inc. along with a number of smaller private companies and new market entrants. In addition, we both compete with and partner with the large enterprise management vendors, such as International Business Machines, or IBM, Hewlett Packard, or HP, and EMC Corporation, or EMC, who currently offer limited performance management solutions but could provide enhanced solutions in the future. In the service provider market our primary large competitors include Tektronix and JDS Uniphase Corporation, or JDSU, who provide operational management systems based primarily on monitoring legacy signaling data, along with a number of smaller private companies and new market entrants. Competitive factors in our industry are further described in Item 1A Risk Factors.

### **Intellectual Property Rights**

We rely on patent, copyright, trademark, and trade secret laws and contract rights to establish and maintain our rights in our technology and products. While our intellectual property rights are an important element in our success, our business as a whole does not depend on any one particular patent, trademark, copyright, trade secret, license, or other intellectual property right.

## **Table of Contents**

NetScout uses contracts, statutory laws, domestic and foreign intellectual property registration processes, and international intellectual property treaties to police and protect its intellectual property portfolio and rights from infringement. From a contractual perspective, NetScout uses license agreements and non-disclosure agreements to limit the use of our intellectual property and protect NetScout trade secrets from unauthorized use and disclosure. In addition to license agreements, NetScout relies on U.S. and international copyright law to protect against unauthorized copying of software programs, in the U.S. and abroad. NetScout has obtained U.S. and foreign trademark registrations to preserve and protect certain trademarks and trade names. NetScout has also filed and obtained U.S. patents to protect certain unique NetScout inventions from being unlawfully exploited by other parties. However, there is no assurance that pending or future patent applications will be granted, that we will be able to obtain patents covering all of our products, or that we will be able to license, if needed, patents from other companies on favorable terms or at all. Our proprietary rights are subject to other risks and uncertainties described under Item 1A Risk Factors.

## **Employees**

As of March 31, 2010, we had 791 employees, 574 of whom were employed in the United States. Of the total, 280 were in sales, 17 were in marketing, 112 were in support services, 244 were in research and development, 29 were in manufacturing, and 109 were in general and administrative functions. None of our employees is represented by a collective bargaining agreement.

## ***Item 1A. Risk Factors.***

In addition to the other information in this report, the following discussion should be considered carefully in evaluating NetScout and our business. This Annual Report on Form 10-K contains forward-looking statements under Section 21E of the Exchange Act and other federal securities laws. These statements relate to future events or our future financial performance and are identified by terminology such as may, will, could, should, expects, plans, intends, seeks, anticipates, believes, estimates, potential or continue, or the negative of such comparable terminology. These statements are only predictions. You should not place undue reliance on these forward-looking statements. Actual events or results may differ materially. Factors that may cause such differences include, but are not limited to, the factors discussed below and in our other filings with the Securities and Exchange Commission, or SEC. These factors may cause our actual results to differ materially from any forward-looking statement.

Our operating results and financial condition have varied in the past and may in the future vary significantly depending on a number of factors. Except for the historical information in this report, the matters contained in this report include forward-looking statements that involve risk and uncertainties. The following factors are among many that could cause actual results to differ materially from those contained in or implied by forward-looking statements made in this report. These statements involve the risks and uncertainties identified below as well as additional risks and uncertainties that are not yet identified or that we currently think are immaterial may also impact our business operations. Such factors are among many that may have a material adverse impact upon our business, results of operations and financial condition.

**Our quarterly operating results may fluctuate.** Our quarterly revenue and operating results are difficult to predict and may fluctuate significantly from quarter to quarter. Most of our expenses, such as employee compensation, benefits and rent, are relatively fixed in the short term. Moreover, our expense levels are based, in part, on our expectations regarding future revenue levels. As a result, if revenue for a particular quarter is below our expectations, we may not be able to reduce operating expenses proportionately for that quarter, and, therefore, this revenue shortfall would have a disproportionately negative impact on our operating results for that quarter.

## Table of Contents

Our quarterly revenue may fluctuate as a result of a variety of factors, many of which are outside of our control, including the following:

technology spending by current and potential customers;

uneven demand for application and network performance management solutions;

the timing, size and receipt of orders from customers, especially in light of our lengthy sales cycle;

the timing and market acceptance of new products or product enhancements by us or our competitors;

changes in the distribution channels through which our products are sold;

the timing of hiring sales personnel and the speed at which such personnel become productive;

our ability to anticipate or adapt effectively to developing markets and rapidly changing technologies;

changes in the number and size of our competitors;

the timing and impact of security-related threats and outbreaks (e.g., worms and viruses);

customer difficulty in implementing our products;

changes in foreign currency exchange rates;

attrition of key employees;

changes in the prices of our competitors' products; and

economic slowdowns and the occurrence of unforeseeable events, such as terrorist attacks, which contribute to such slowdowns.

**Uncertain conditions in the global economy and constraints in the global credit market may adversely affect our revenue and results of operations.** Disruptions in the current global economy and constraints in the global credit market may cause some of our customers to reduce, delay, or cancel spending on capital and technology projects, resulting in reduced spending with us. While some industry sectors such as government and telecommunications may be less susceptible to the effects of an economic slowdown, our enterprise customers may be adversely affected, especially in financial services and consumer industries. Continued volatility in and disruption of financial markets could limit customers' ability to obtain adequate financing to maintain operations and result in a decrease in sales volume that could have a negative impact on our results of operations. Further, competitors may respond to economic conditions by lowering their prices, which could put pressure on our pricing. We could also experience lower than anticipated order levels, cancellations of orders in backlog, defaults on outstanding

accounts receivable and extended payment or delivery terms.

**Constraints in the global credit market may affect our ability to obtain credit on favorable terms or at all and to refinance any debt facilities.** If conditions in the global credit markets are not favorable, we may be limited in our ability to obtain credit or obtain credit on favorable terms and could increase our borrowing costs.

**We may not successfully complete acquisitions or integrate acquisitions we do make, which could impair our ability to compete and could harm our operating results.** We may need to acquire complementary businesses, products or technologies to remain competitive or expand our business. We actively investigate and evaluate potential acquisitions of complementary businesses, products and technologies in the ordinary course of business. We may compete for acquisition opportunities with entities having significantly greater resources than us. As a result, we may not succeed in acquiring some or all businesses, products or technologies that we seek to acquire. Our inability to effectively consummate acquisitions on favorable terms could significantly impact our ability to compete effectively in our targeted markets and could negatively affect our results of operations.



**Table of Contents**

Acquisitions that we do complete could adversely impact our business. The potential adverse consequences from acquisitions include:

the potentially dilutive issuance of common stock or other equity instruments;

the incurrence of debt and amortization expenses related to goodwill and acquired intangible assets;

the potentially costly and disruptive impact of assuming unfavorable pre-existing contractual relationships of acquired companies that we would not have otherwise entered into and potentially exiting or modifying such relationships;

the potential litigation or other claims in connection with, or inheritance of claims or litigation risk as a result of, an acquisition including claims from terminated employees, customers, third parties or enforcement actions by various regulators;

the incurrence of significant costs and expenses; and

the potentially negative impact of poor performance of an acquisition on our earnings per share.

Acquisition transactions also involve numerous business risks. These risks from acquisitions include:

difficulties in assimilating the acquired operations, technologies, personnel and products;

difficulties in managing geographically dispersed operations;

difficulties in assimilating diverse financial reporting and management information systems;

difficulties in maintaining uniform standards, controls, procedures and policies;

the diversion of management's attention from other business concerns;

use of cash to pay for acquisitions may limit other potential uses of our cash, including stock repurchases and retirement of outstanding indebtedness;

substantial accounting charges for restructuring and related expenses, write-off of in-process research and development, impairment of goodwill, amortization or impairment of intangible assets and share-based compensation expense;

the potential disruption of our business;

the potential loss of key employees, customers, distributors or suppliers;

the inability to generate sufficient revenue to offset acquisition or investment costs; and

the potential for delays in customer purchases due to uncertainty and the inability to maintain relationships with customers of the acquired businesses.

**We have a significant amount of debt. If we fail to maintain sufficient cash as our debt becomes due or are unable to renew our revolving credit facility prior to its expiration, this may adversely affect our business, financial condition, and operating results.** At March 31, 2010, we had outstanding debt of \$79.4 million and a \$10 million revolving credit facility, both of which expire in December 2012. We expect that existing cash, cash equivalents, marketable securities, cash provided from operations and our revolving credit facility will be sufficient to meet ongoing cash requirements. However, failure to generate sufficient cash as our debt becomes due or to renew our revolving credit facility prior to its expiration could adversely affect our business, financial condition, operating results and cash flows.

**A significant portion of our marketable securities is invested in auction rate securities. Continued failures in these auctions could affect our liquidity.** A significant percentage of our marketable securities portfolio is invested in auction rate securities. These investments range from AAA to A rated and are collateralized by student loans with underlying support by the federal government through the Federal Family

---

**Table of Contents**

Education Loan Program, or FFELP, and by monoline insurance companies. Beginning in February 2008 and continuing through the date of this report, the majority of auction rate securities in the marketplace, including all of the auction rate securities that we hold in our portfolio, experienced failed auctions. Such failures resulted in the interest rates on these investments resetting to predetermined rates in accordance with the underlying loan agreements. In the event we need to liquidate our investments in these types of securities, we will not be able to do so until a future auction on these investments is successful, the issuer redeems the outstanding securities, a buyer is found outside the auction process which may require us to take a significant discount from the face value of the securities, the securities mature, or there is a default requiring immediate repayment from the issuer. In the future, should our auction rate securities be subject to additional auction failures and we determine that the decline in value of auction rate securities are other than temporary, we would recognize a loss in our consolidated statement of operations, which could be material. Because these securities are currently illiquid due to the credit environment, we are currently unable to access this cash in the short term. If this illiquidity in the auction rate security market continues we may not be able to use these funds, if needed, to make debt payments, and should we need to access these assets for operations, this result could have a negative effect on our business, financial condition and operating results of the company.

**If we fail to introduce new products and enhance our existing products to keep up with rapid technological change, demand for our products may decline.** The market for application and network performance management and service assurance solutions is characterized by rapid changes in technology, evolving industry standards, changes in customer requirements and frequent product introductions and enhancements. Our success is dependent upon our ability to meet our customers' needs, which are driven by changes in computer networking technologies, new application technologies and the emergence of new industry standards. In addition, new technologies may shorten the life cycle for our products or could render our existing or planned products obsolete. If we are unable to develop and introduce new network and application performance management and service assurance products or enhancements to existing products in a timely and successful manner, this inability could have a material and adverse impact on our business, operating results and financial condition.

We have introduced and intend to continue to introduce new products. If the introduction of these products is significantly delayed or if we are unsuccessful in bringing these products to market, our business, operating results and financial condition could be materially and adversely impacted.

**If our products contain errors, they may be costly to correct, revenue may be delayed, we could be sued and our reputation could be harmed.** Despite testing by our customers and us, errors may be found in our products after commencement of commercial shipments. If errors are discovered, we may not be able to correct them in a timely manner or at all. In addition, we may need to make significant expenditures of capital resources in order to eliminate errors and failures. Errors and failures in our products could result in loss of or delay in market acceptance of our products and could damage our reputation. If one or more of our products fail, a customer may assert warranty and other claims for substantial damages against us. The occurrence or discovery of these types of errors or failures could have a material and adverse impact on our business, operating results and financial condition.

**We face significant competition from other technology companies.** The market for application and network performance management and service assurance solutions is highly competitive. The market is fragmented with a number of vendors offering pieces of what our total solution delivers. We believe customers make service management system purchasing decisions based primarily upon the following factors:

product performance, functionality and price;

name and reputation of vendor;

distribution strength; and

alliances with industry partners.

## **Table of Contents**

We compete with a growing number of smaller providers of application and network performance management solutions and providers of portable network traffic analyzers and probes. In addition, leading network equipment and application technology vendors offer their own limited management solutions, including products which they license from other competitors. Some of our current and potential competitors have longer operating histories, greater name recognition and substantially greater financial, management, marketing, service, support, technical, distribution and other resources than we do. Further, in recent years some of our competitors have been acquired by larger companies that are seeking to enter or expand in the markets in which we operate. Therefore, given their larger size and greater resources our competitors may be able to respond more effectively than we can to new or changing opportunities, technologies, standards and customer requirements.

As a result of these and other factors, we may not be able to compete effectively with our current or future competitors, which could have a material and adverse impact on our business, operating results and financial condition.

**The success of our business depends, in part, on the continued growth in the market for and the commercial acceptance of application and network performance management and service assurance solutions.** We derive all of our revenue from the sale of products and services that are designed to allow our customers to assure the delivery of services through the management of the performance of applications across IP networks. Therefore, we must be able to predict the appropriate features and prices for future products to address the market, the optimal distribution strategy and the future changes to the competitive environment. In order for us to be successful, our potential customers must recognize the value of more sophisticated application and network management solutions, decide to invest in the management of their networked applications and, in particular, adopt our management solutions. Any failure of this market to continue to be viable would materially and adversely impact our business, operating results and financial condition. Additionally, businesses may choose to outsource the operations and management of their networks to managed service providers. Our business may depend on our ability to continue to develop relationships with these service providers and successfully market our products to them.

**The current economic and geopolitical environment may impact some specific industries into which we sell.** Many of our customers are concentrated in a small number of industries, including financial services, public sector, healthcare, and the service provider market segment. Certain industries may be more acutely affected by economic, geopolitical and other factors than other sectors. To the extent that one or more of the sectors in which our customer base operates is adversely impacted, whether as a result of general conditions affecting all sectors or as a result of conditions affecting only those particular sectors, our business, financial condition and results of operations could be materially and adversely impacted.

**Our success depends, in part, on our ability to manage and leverage our distribution channels.** Sales to our indirect distribution channels, which include resellers, original equipment manufacturers, distributors, systems integrators and service providers, accounted for 61%, 59%, and 65% of our total revenue for the fiscal years ended March 31, 2010, 2009 and 2008, respectively. To increase our sales we need to continue to enhance our indirect sales efforts, to continue to manage and expand these existing distribution channels and to develop new indirect distribution channels. Our channel partners have no obligation to purchase any products from us. In addition, they could internally develop products that compete with our solutions or partner with our competitors or bundle or resell competitors' solutions, possibly at lower prices. The potential inability to develop new relationships or to expand and manage our existing relationships with partners, the potential inability or unwillingness of our partners to market and sell our products effectively or the loss of existing partnerships could have a material and adverse impact on our business, operating results and financial condition.

**Our success depends, in part, on our ability to expand and manage our international operations.** Sales to customers outside the United States accounted for 27%, 25%, and 27% of our total revenue for the fiscal years ended March 31, 2010, 2009 and 2008, respectively. We currently expect international revenue to continue to account for a significant percentage of total revenue in the future. We believe that we must continue to expand

## Table of Contents

our international sales activities in order to be successful. Our international sales growth will be limited if we are unable to:

expand international indirect distribution channels;

hire additional overseas sales personnel;

adapt products for local markets and comply with foreign regulations; and

manage geographically dispersed operations.

The major geographic areas outside of the United States in which we manage our business are Europe (including the United Kingdom, Germany, France, Spain, Italy and Norway), Asia (including China, Hong Kong, Japan, Korea, Malaysia, Singapore and Taiwan) and the Rest of World (including South Africa, Australia, Canada, India, Brazil and Mexico). Our international operations, including our operations in the United Kingdom, mainland Europe, India, Asia-Pacific and other regions are generally subject to a number of risks, including:

failure of local laws to provide the same degree of protection that the laws in the United States provide against infringement of our intellectual property;

protectionist laws and business practices that favor local competitors;

dependence on local indirect channel partners;

conflicting and changing governmental laws and regulations;

longer sales cycles;

greater difficulty in collecting accounts receivable; and

foreign currency exchange rate fluctuations and political and economic instability.

**Our future growth depends on our ability to maintain and periodically expand our sales force.** We must maintain and periodically increase the size of our sales force in order to increase our direct sales and support our indirect sales channels. Because our products are very technical, sales people require a comparatively long period of time to become productive, typically three to twelve months. This lag in productivity, as well as the challenge of attracting qualified candidates, may make it difficult to meet our sales force growth targets. Further, we may not generate sufficient sales to offset the increased expense resulting from growing our sales force. If we are unable to maintain and periodically expand our sales capability, our business, operating results and financial condition could be materially and adversely impacted.

**Our reliance on sole source suppliers could adversely impact our business.** Specific components that are necessary for the hardware assembly of our instruments are obtained from separate sole source suppliers or a limited group of suppliers. These components include our network interface cards. Our reliance on sole or limited suppliers involves several risks, including a potential inability to obtain an adequate supply of required components and the inability to exercise control over pricing, quality and timely delivery of components. We do not generally maintain long-term agreements with any of our suppliers or have on hand large volumes of inventory. Our inability to obtain adequate deliveries

or the occurrence of any other circumstance that would require us to seek alternative sources of these components would impact our ability to ship our products on a timely basis. This could damage relationships with our current and prospective customers, cause shortfalls in expected revenue, and could materially and adversely impact our business, operating results and financial condition.

**Our success depends on our ability to protect our intellectual property rights.** Our business is heavily dependent on our intellectual property. We rely upon a combination of patent, copyright, trademark and trade secret laws and registrations and non-disclosure and other contractual and license arrangements to protect our intellectual property rights. The reverse engineering, unauthorized copying, or other misappropriation of our

---

## **Table of Contents**

intellectual property could enable third parties to benefit from our technology without compensating us. Legal proceedings to enforce our intellectual property rights could be burdensome and expensive and could involve a high degree of uncertainty. In addition, legal proceedings may divert management's attention from growing our business. There can be no assurance that the steps we have taken to protect our intellectual property rights will be adequate to deter misappropriation of proprietary information, or that we will be able to detect unauthorized use by third parties and take appropriate steps to enforce our intellectual property rights. Further, we also license software from third parties for use as part of our products, and if any of these licenses were to terminate, we might experience delays in product shipment until we develop or license alternative software.

**Others may claim that we infringe on their intellectual property rights.** From time to time we may be subject to claims by others that our products infringe on their intellectual property rights, patents, copyrights or trademarks. These claims, whether or not valid, could require us to spend significant sums in litigation, pay damages or royalties, delay product shipments, reengineer our products, rename our products and rebuild name recognition or acquire licenses to such third-party intellectual property. We may not be able to secure any required licenses on commercially reasonable terms or secure them at all. We expect that these claims could become more frequent as more companies enter the market for network and application infrastructure performance management solutions. Any of these claims or resulting events could have a material and adverse impact on our business, operating results and financial condition.

**We may fail to secure necessary additional financing.** We may require significant capital resources to expand our business and remain competitive in the rapidly changing network performance management industry. We may need to invest in our operations as well as acquire complementary businesses, products or technologies. Our future success may depend in part on our ability to obtain additional financing to support our continued growth and operations. If our existing sources of liquidity are insufficient to satisfy our operating requirements, we may need to seek to raise capital by:

issuing additional common stock or other equity instruments;

acquiring additional bank debt;

issuing debt securities; or

obtaining lease financings;

However, we may not be able to obtain additional capital when we want or need it, or capital may not be available on satisfactory terms. Furthermore, any additional capital may have terms and conditions that adversely affect our business, such as new financial or operating covenants, or that may result in additional dilution to our stockholders.

**We must hire and retain skilled personnel.** Our success depends in large part upon our ability to attract, train, motivate and retain highly skilled employees, particularly sales and marketing personnel, software engineers, and technical support personnel. If we are unable to attract and retain the highly skilled technical personnel that are integral to our sales, marketing, product development and technical support teams, the rate at which we can generate sales and develop new products or product enhancements may be limited. This inability could have a material and adverse impact on our business, operating results and financial condition.

**Loss of key personnel could adversely impact our business.** Our future success depends to a significant degree on the skills, experience and efforts of Anil Singhal, our President, Chief Executive Officer, and co-founder, and Michael Szabados, our Chief Operating Officer, and our other executive officers and senior managers to work effectively as a team. The loss of one or more of our key personnel could have a material and adverse impact on our business, operating results and financial condition.

**Our estimates and judgments related to critical accounting policies could be inaccurate.** We consider accounting policies related to revenue recognition, commissions expense, valuation of inventories, valuation of

## **Table of Contents**

goodwill and acquired intangible assets, capitalized software development costs, derivative financial instruments, purchased software and internal use software, share-based compensation and income taxes to be critical in fully understanding and evaluating our financial results. Management makes certain significant accounting judgments and estimates related to these policies. Our business, operating results and financial condition could be materially and adversely impacted in future periods if our accounting judgments and estimates related to these critical accounting policies prove to be inaccurate.

**Failure to manage growth properly and to implement enhanced automated systems could adversely impact our business.** The growth in size and complexity of our business and our customer base has been and will continue to be a challenge to our management and operations. To manage further growth effectively, we must integrate new personnel and manage expanded operations. If we are unable to manage our growth effectively, our costs, the quality of our products, the effectiveness of our sales organization, retention of key personnel, our business, and our operating results and financial condition could be materially and adversely impacted. Any disruptions or ineffectiveness relating to our systems implementations and enhancements could adversely affect our ability to process customer orders, ship products, provide services and support to our customers, bill and track our customers, fulfill contractual obligations, and otherwise run our business.

**The effectiveness of our disclosure and internal controls may be limited.** Our disclosure controls and procedures and internal control over financial reporting may not prevent all material errors and intentional misrepresentations. Any system of internal control can only provide reasonable assurance that all control objectives are met. Some of the potential risks involved could include, but are not limited to, management judgments, simple errors or mistakes, willful misconduct regarding controls or misinterpretation. Under Section 404 of the Sarbanes-Oxley Act we are required to evaluate and determine the effectiveness of our internal control over financial reporting. Compliance with this legislation requires management's attention and resources and will likely continue to cause us to incur significant expense. Management's assessment of our internal control over financial reporting may identify weaknesses that need to be addressed in our internal control system. If we are unable to conclude that our internal control over financial reporting is effective, investors could lose confidence in our reported financial information which could have an adverse effect on the market price of our stock or impact our borrowing ability. In addition, changes in operating conditions and changes in compliance with policies and procedures currently in place may result in inadequate internal control over financial reporting in the future.

**The price of our common stock may decrease due to market volatility.** The market price of our common stock has been volatile and has fluctuated since the initial public offering of our common stock on August 12, 1999. The market price of our common stock may continue to fluctuate in response to a number of factors, some of which are beyond our control. Though activity in our stock has increased over the past two years, trading activity of our stock has historically been relatively thin, in part as a result of officers and directors and institutional shareholders holding a significant percentage of our stock. In addition, the market prices of securities of technology companies have been volatile and have experienced fluctuations that often have been unrelated or disproportionate to the operating performance of these companies. Also, broad market fluctuations could adversely impact the market price of our common stock, which in turn could cause impairment of goodwill that could materially and adversely impact our financial condition and results of operations.

It is not uncommon when the market price of a stock has been volatile for holders of that stock to institute securities class action litigation against the company that issues that stock. If any of our stockholders brought such a lawsuit against us, even if the lawsuit is without merit, we could incur substantial costs defending the lawsuit beyond any insurance coverage which we may have for such risks. Such a lawsuit could also divert the time and attention of our management.

**If we fail to develop our brand cost-effectively, our business may suffer.** We believe that developing and maintaining awareness of our brand in a cost-effective manner is important to achieving widespread acceptance of our existing and future products and services and is an important element in attracting new customers.



---

**Table of Contents**

Furthermore, we believe that the importance of brand recognition will increase as competition in our market develops. Successful promotion of our brand will depend largely on the effectiveness of our marketing efforts and on our ability to provide reliable and useful products and services at competitive prices. Brand promotion activities may not yield increased revenue, and even if they do, any increased revenue may not offset the expenses we incurred in building our brand. If we fail to promote and maintain our brand successfully, or incur substantial expenses in an unsuccessful attempt to promote and maintain our brand, we may fail to attract enough new customers or retain our existing customers to the extent necessary to realize a sufficient return on our brand-building efforts, and this could have a material and adverse impact on our financial condition and results of operations.

**Increased customer demands on our technical support services may adversely affect our relationships with our customers and our financial results.** We offer technical support services with many of our products. We may be unable to respond quickly enough to accommodate short-term increases in customer demand for support services. We also may be unable to modify the format of our support services to compete with changes in support services provided by competitors. Further customer demand for these services, without corresponding revenues, could have a material and adverse impact on our financial condition and results of operations.

**Our effective tax rate may increase or fluctuate, which could increase our income tax expense and reduce our net income.** Our effective tax rate could be adversely affected by several factors, many of which are outside of our control, including:

Changes in the relative proportions of revenues and income before taxes in the various jurisdictions in which we operate that have differing statutory tax rates;

Changing tax laws, regulations, and interpretations in multiple jurisdictions in which we operate as well as the requirements of certain tax rulings;

Changes in accounting and tax treatment of share-based compensation;

The valuation of generated and acquired deferred tax assets and the related valuation allowance on these assets;

The tax effects of purchase accounting for acquisitions and restructuring charges that may cause fluctuations between reporting periods; and

Tax assessments, or any related tax interest or penalties that could significantly affect our income tax expense for the period in which the settlements take place;

An adverse change in our effective tax rate could have a material and adverse effect on our financial condition and results of operations.

**We or our suppliers may be impacted by new regulations related to climate change.** We or our suppliers may become subject to new laws enacted with regards to climate change. In the event that new laws are enacted or current laws are modified in countries in which we or our suppliers operate, our flow of product may be impacted which could have a material and adverse effect on our financial condition and results of operations.

**Uncertainties of regulation of the Internet could have a material and adverse impact on our financial condition and results of operations.** Currently, few laws or regulations apply directly to access to or commerce on the Internet. We could be materially adversely affected by regulation of the Internet and Internet commerce in any country where we operate. Such regulations could include matters such as VoIP, among other things. The adoption of regulation of the Internet and Internet commerce could decrease demand for our products and, at the same time, increase the cost of selling our products, which could have a material and adverse effect on our financial condition and results of operations. In addition, the enactment of new federal, state, or foreign data privacy laws and regulations could cause customers not to be able to take advantage of all the features or capabilities of our products which in turn could reduce demand for certain of our products.



**Table of Contents**

***Item 1B. Unresolved Staff Comments***

We have no unresolved comments from the SEC.

***Item 2. Properties***

We currently lease approximately 175,000 square feet of space in an office building in Westford, Massachusetts, for our headquarters. The current lease will expire in September 2013, and we have an option to extend the lease for two additional five-year terms. We lease office space in seventeen other cities throughout the world for our sales and support personnel, as well as 72,742 square feet of space in San Jose, California. We lease 34,021 square feet of office space for our engineering and support personnel in India. We believe that our existing facilities are adequate to meet our foreseeable requirements or that suitable additional or substitute space will be available on commercially reasonable terms.

***Item 3. Legal Proceedings***

On November 14, 2008, certain former shareholders of Fidelia Technology, Inc. filed an amended complaint in the Superior Court of California, San Francisco County, against Network General Corporation and certain its officers and directors relating to the consideration received by the shareholders in the merger between Fidelia and Network General in January 2006. We acquired Network General in November 2007. Following full legal briefing and a hearing held on February 18, 2009, the court dismissed the amended complaint against certain of the former officers and directors of Network General, and permitted certain claims to proceed against Network General and its former president. As of May 6, 2010, subsequent to our year end, without admission or finding of liability by any party and to avoid further expense and inconvenience of this litigation, the plaintiffs and the remaining defendants agreed to a confidential Settlement Agreement and Mutual Release, resolving all claims the parties had or may have had against one another, with dismissal of the lawsuit to follow. The settlement of the claims are immaterial to our ongoing operations and financial condition because all settlement payments will be made directly by our insurance carrier.

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

We completed our initial public offering on August 17, 1999. Since that time, our common stock has traded on the Nasdaq Global Market and its predecessor, the Nasdaq National Market, under the symbol NTCT. The following table sets forth, for the periods indicated, the high and low closing sales prices for our common stock. Such information reflects inter-dealer price, without retail mark-up, markdown or commission and may not represent actual transactions.

| <b>Quarter Ended</b>     | <b>High</b> | <b>Low</b> |
|--------------------------|-------------|------------|
| <b>Fiscal Year 2009:</b> |             |            |
| June 30, 2008            | \$ 12.99    | \$ 8.30    |
| September 30, 2008       | \$ 15.85    | \$ 10.00   |
| December 31, 2008        | \$ 10.79    | \$ 6.19    |
| March 31, 2009           | \$ 14.80    | \$ 6.58    |
| <b>Fiscal Year 2010:</b> |             |            |
| June 30, 2009            | \$ 10.66    | \$ 7.42    |
| September 30, 2009       | \$ 13.73    | \$ 9.05    |
| December 31, 2009        | \$ 15.00    | \$ 12.26   |
| March 31, 2010           | \$ 15.57    | \$ 14.02   |

**Stockholders**

As of May 25, 2010 we had 107 stockholders of record. We believe that the number of beneficial holders of our common stock exceeds 6,800.

## **Table of Contents**

### **Stock Performance Graph**

This performance graph shall not be deemed filed for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities under that Section, and shall not be deemed to be incorporated by reference into any filing of NetScout Systems, Inc. under the Exchange Act or the Securities Act of 1933, as amended.

The Stock Performance Graph set forth below compares the yearly change in the cumulative total stockholder return on our common stock during the five year period from March 31, 2005 through March 31, 2010, with the cumulative total return of the Nasdaq Composite Index and the Nasdaq Computer & Data Processing Index. The comparison assumes \$100 was invested on March 31, 2005 in our common stock or in the Nasdaq Composite Index and the Nasdaq Computer & Data Processing Index and assumes reinvestment of dividends, if any.

The stock price performance shown on the graph below is not necessarily indicative of future price performance. Information used in the graph was obtained from Research Data Group, Inc., a source believed to be reliable, but NetScout is not responsible for any errors or omissions in such information.

### **Dividend Policy**

In fiscal years 2010 and 2009, we did not declare any cash dividends and do not anticipate declaring cash dividends in the foreseeable future. In addition, the terms of our credit facility limit our ability to pay cash dividends on our capital stock. It is our intention to retain all future earnings for reinvestment to fund our expansion and growth. Any future cash dividend declaration will be at the discretion of our Board of Directors and will depend upon, among other things, our future earnings, general financial conditions, capital requirements, existing bank covenants and general business conditions.

**Table of Contents**

**Issuer Purchases of Equity Securities**

During the fourth quarter of fiscal year 2010, we did not repurchase any shares of our outstanding common stock pursuant to the open market stock repurchase program further described in Note 12 to the attached consolidated financial statements.

**Table of Contents****Item 6. Selected Financial Data****SELECTED CONSOLIDATED FINANCIAL DATA**

The selected consolidated financial data set forth below should be read in conjunction with our audited consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included under Item 7 of this Annual Report on Form 10-K. The consolidated statement of operations data for the fiscal years ended March 31, 2010, 2009 and 2008 and the consolidated balance sheet data as of March 31, 2010 and 2009 are derived from audited consolidated financial statements included under Item 8 of this Annual Report on Form 10-K. The consolidated statement of operations data for the fiscal years ended March 31, 2007 and 2006 and the consolidated balance sheet data as of March 31, 2008, 2007 and 2006 have been derived from audited consolidated financial statements of NetScout that do not appear in this Annual Report on Form 10-K. The historical results are not necessarily indicative of the operating results to be expected in the future.

|  | 2010                                  | 2009             | Year ended March 31,<br>2008(1) 2007 |                 | 2006            |
|--|---------------------------------------|------------------|--------------------------------------|-----------------|-----------------|
|  | (In thousands, except per share data) |                  |                                      |                 |                 |
| <b>Statement of Operations Data:</b>   |                                       |                  |                                      |                 |                 |
| Revenue:   |                                       |                  |                                      |                 |                 |
| Product  | \$ 142,113                            | \$ 154,161       | \$ 106,182                           | \$ 63,524       | \$ 63,775       |
| Service  | 118,229                               | 113,443          | 62,774                               | 38,948          | 34,101          |
| <b>Total revenue</b>   | <b>260,342</b>                        | <b>267,604</b>   | <b>168,956</b>                       | <b>102,472</b>  | <b>97,876</b>   |
| Cost of revenue:   |                                       |                  |                                      |                 |                 |
| Product  | 35,564                                | 43,315           | 33,965                               | 17,184          | 18,639          |
| Service  | 20,500                                | 20,824           | 13,721                               | 6,444           | 5,894           |
| <b>Total cost of revenue</b>   | <b>56,064</b>                         | <b>64,139</b>    | <b>47,686</b>                        | <b>23,628</b>   | <b>24,533</b>   |
| <b>Gross margin</b>  | <b>204,278</b>                        | <b>203,465</b>   | <b>121,270</b>                       | <b>78,844</b>   | <b>73,343</b>   |
| Operating expenses:  |                                       |                  |                                      |                 |                 |
| Research and development   | 36,650                                | 40,189           | 30,000                               | 18,320          | 18,284          |
| Sales and marketing  | 99,059                                | 98,818           | 69,652                               | 42,470          | 39,501          |
| General and administrative   | 20,609                                | 26,118           | 26,149                               | 10,531          | 8,873           |
| Amortization of acquired intangible assets   | 2,057                                 | 1,962            | 811                                  | 155             | 149             |
| <b>Total operating expenses</b>  | <b>158,375</b>                        | <b>167,087</b>   | <b>126,612</b>                       | <b>71,476</b>   | <b>66,807</b>   |
| <b>Income (loss) from operations</b>   | <b>45,903</b>                         | <b>36,378</b>    | <b>(5,342)</b>                       | <b>7,368</b>    | <b>6,536</b>    |
| Interest and other income (expense), net   | (2,832)                               | (5,337)          | (1,207)                              | 3,898           | 2,627           |
| <b>Income (loss) before income tax expenses (benefit) and cumulative effect of accounting change</b> | <b>43,071</b>                         | <b>31,041</b>    | <b>(6,549)</b>                       | <b>11,266</b>   | <b>9,163</b>    |
| Income tax expense (benefit)   | 15,154                                | 10,993           | (4,461)                              | 3,598           | 3,366           |
| <b>Cumulative effect of accounting change, net of taxes of \$42</b>                                  |                                       |                  |                                      | <b>69</b>       |                 |
| <b>Net income (loss)</b>   | <b>\$ 27,917</b>                      | <b>\$ 20,048</b> | <b>(\$ 2,088)</b>                    | <b>\$ 7,737</b> | <b>\$ 5,797</b> |
| <b>Basic net income (loss) per share</b>   | <b>\$ 0.69</b>                        | <b>\$ 0.51</b>   | <b>(\$ 0.06)</b>                     | <b>\$ 0.24</b>  | <b>\$ 0.19</b>  |
| <b>Diluted net income (loss) per share</b>   | <b>\$ 0.67</b>                        | <b>\$ 0.49</b>   | <b>(\$ 0.06)</b>                     | <b>\$ 0.23</b>  | <b>\$ 0.18</b>  |
| <b>Weighted average common shares outstanding used in computing:</b>                                 |                                       |                  |                                      |                 |                 |
| <b>Net income (loss) per share - basic</b>   | <b>40,691</b>                         | <b>39,351</b>    | <b>34,913</b>                        | <b>31,713</b>   | <b>31,041</b>   |

Edgar Filing: NETSCOUT SYSTEMS INC - Form 10-K

|                                     |        |        |        |        |        |
|-------------------------------------|--------|--------|--------|--------|--------|
| Net income (loss) per share diluted | 41,915 | 40,925 | 34,913 | 33,050 | 31,885 |
|-------------------------------------|--------|--------|--------|--------|--------|

- (1) On November 1, 2007, NetScout completed its acquisition of Network General Central Corporation, or Network General, for aggregate consideration of approximately \$212 million.



**Table of Contents**

|   | 2010           | 2009       | March 31,<br>2008(1) | 2007       | 2006      |
|---|----------------|------------|----------------------|------------|-----------|
|   | (In thousands) |            |                      |            |           |
| <b>Balance Sheet Data:</b>  |                |            |                      |            |           |
| Cash, cash equivalents and short- and long-term marketable securities | \$ 170,551     | \$ 135,912 | \$ 100,931           | \$ 100,104 | \$ 87,465 |
| Working capital   | 91,174         | 51,720     | 13,754               | 79,493     | 72,998    |
| Total assets  | 482,601        | 436,734    | 420,937              | 180,419    | 165,755   |
| Debt  | 79,356         | 92,500     | 98,750               |            |           |
| Total stockholders' equity  | 266,843        | 225,731    | 197,333              | 138,407    | 126,591   |

(1) On November 1, 2007, NetScout completed its acquisition of Network General for aggregate consideration of approximately \$212 million, including \$53 million in cash.

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

The following information should be read in conjunction with the audited consolidated financial information and the notes thereto included in this Annual Report on Form 10-K. In addition to historical information, the following discussion and other parts of this Annual Report contain forward-looking statements that involve risks and uncertainties. You should not place undue reliance on these forward-looking statements. Actual events or results may differ materially due to competitive factors and other factors discussed in Item 1A. *Risk Factors* and elsewhere in this Annual Report. These factors may cause our actual results to differ materially from any forward-looking statement.

**Overview**

NetScout Systems was founded in 1984 and is headquartered in Westford, Massachusetts. We design, develop, manufacture, market, sell and support market leading unified service delivery management, service assurance and application and network performance management solutions focused on assuring service delivery for the world's largest, most demanding and complex internet protocol, or IP, based service delivery environments. We manufacture and market these products in integrated hardware and software solutions that are used by commercial enterprises, large governmental agencies and telecommunication service providers worldwide. We have a single operating segment and substantially all of our identifiable assets are located in the United States.

Our operating results are influenced by a number of factors, including, but not limited to, the mix and quantity of products and services sold, pricing, costs of materials used in our products, growth in employee related costs, including commissions, and the expansion of our operations. Factors that affect our ability to maximize our operating results include, but are not limited to, our ability to introduce and enhance existing products, the marketplace acceptance of those new or enhanced products, continued expansion into international markets, development of strategic partnerships, competition, successful integration efforts and current economic conditions.

**Results Overview**

Despite a difficult economy, we continued to execute on our core strategies and were able to generate net income and net income per share growth of 39% and 37%, respectively, in fiscal year 2010 through gross margin improvements and reduced operating costs. Fiscal year 2010 also included strong bookings, especially in our service provider vertical market, and strong cash flow.

Our revenue results in the second half of this past year were driven by a 12 percent year-over-year increase in bookings. This bookings increase, as stated earlier, was due to growth in sales to our customers in the service provider vertical market. We expect that momentum of bookings growth to continue into fiscal year 2011 led

## **Table of Contents**

primarily by continued performance in the wireless service provider sector and a return to strength in our core enterprise vertical markets led by financial services and government.

In addition to record bookings, deferred revenue increased \$22.3 million during the year ended March 31, 2010 as we saw our customers continuing to make large commitments through renewals of maintenance service contracts.

Although revenue decreased 3% from fiscal year 2009, we achieved significant gross margin improvements. Gross margin for fiscal year 2010 was 78%, up 2 points from fiscal year 2009. We did this in part through price actions and cost reduction. In addition, there was a shift towards higher margin products.

We also met our goal of expanding operating margins and improved operating efficiencies. As a result, our fiscal year 2010 operating margin was 18%, up from 14% in fiscal year 2009.

We also achieved a record high cash, cash equivalents and marketable securities balance of over \$170 million at March 31, 2010. This represents an increase of \$34.6 million over the previous fiscal year end and \$19.3 million over the previous quarter end.

All of these results are supported by our unwavering commitment to develop market leading products that will expand our market reach while solving the challenges facing IT managers in such areas as virtualization and cloud computing. During our fiscal year 2010 we launched some significant new products aimed at increasing our value proposition in the enterprise, including the government and financial services sectors. We also remain focused on building market share in the very fast growing wireless service provider market. During fiscal year 2010, we released Subscriber Intelligence, which is an important new product targeted at this sector.

### ***Use of Non-GAAP Financial Measures***

From time to time in press releases regarding quarterly earnings, presentations and other communications, we may provide financial information determined by methods other than in accordance with generally accepted accounting principles, or GAAP. Recent non-GAAP financial measures have included non-GAAP revenue, income from operations, net income and net income per diluted share, each of which were adjusted from amounts determined based on GAAP to exclude the effect of purchase accounting adjustments to reduce to fair value acquired deferred revenue resulting from our acquisition of Network General in November 2007, and to add back share-based compensation expenses, merger integration expenses and the amortization of acquired intangible assets, net of related income tax effects.

Management regularly uses supplemental non-GAAP financial measures internally to understand, manage and evaluate its business and to make operating decisions. These non-GAAP measures are among the primary factors that management uses in planning and forecasting future periods. Management believes these non-GAAP financial measures enhance the reader's overall understanding of NetScout's current financial performance and its prospects for the future by providing a higher degree of transparency for certain financial measures and providing a level of disclosure that helps investors understand how the Company plans and measures its business. We believe that providing these non-GAAP measures affords investors a view of our operating results that may be more easily compared to our peer companies and also enables investors to consider our operating results on both a GAAP and non-GAAP basis during the period where GAAP results were affected by our acquisition of Network General.

These non-GAAP measures are not in accordance with GAAP, should not be considered an alternative for measures prepared in accordance with GAAP, and may have limitations in that they do not reflect all our results of operations as determined in accordance with GAAP. These non-GAAP measures should only be used to evaluate our results of operations in conjunction with the corresponding GAAP measures. The presentation of non-GAAP information is not meant to be considered superior to, in isolation from or as a substitute for results prepared in accordance with GAAP.

**Table of Contents**

The following table reconciles revenue, net income and net income per share on a GAAP and non-GAAP basis for the years ended March 31, 2010, 2009 and 2008 (in thousands):

|   | Year ended March 31, |            |            |
|---|----------------------|------------|------------|
|   | 2010                 | 2009       | 2008       |
| GAAP revenue  | \$ 260,342           | \$ 267,604 | \$ 168,956 |
| Product deferred revenue fair value adjustment        | 31                   | 1,860      | 410        |
| Service deferred revenue fair value adjustment        | 1,286                | 9,922      | 12,230     |
| Non-GAAP revenue                                      | \$ 261,659           | \$ 279,386 | \$ 181,596 |
| GAAP net income                                       | \$ 27,917            | \$ 20,048  | \$ (2,088) |
| Deferred revenue fair value adjustment                | 1,317                | 11,782     | 12,640     |
| Share-based compensation expense                      | 5,456                | 5,122      | 2,069      |
| Amortization of acquired intangible assets            | 6,037                | 5,959      | 2,888      |
| Inventory fair value adjustment                       |                      |            | 1,287      |
| Integration expense                                   |                      | 1,858      | 12,708     |
| Income tax adjustments                                | (4,868)              | (9,394)    | (12,005)   |
| Non-GAAP net income                                   | \$ 35,859            | \$ 35,375  | \$ 17,499  |
| GAAP diluted net income per share                     | \$ 0.67              | \$ 0.49    | \$ (0.06)  |
| Share impact of non-GAAP adjustments identified above | 0.19                 | 0.37       | 0.54       |
| Non-GAAP diluted net income per share                 | \$ 0.86              | \$ 0.86    | \$ 0.48    |

**Critical Accounting Policies**

We consider accounting policies related to cash, cash equivalents and marketable securities, revenue recognition, commission expense, valuation of inventories, assumptions related to purchase accounting, valuation of goodwill and acquired intangible assets, capitalization of software development costs, derivative financial instruments, share based compensation and income taxes to be critical in fully understanding and evaluating our financial results. The application of these policies involves significant judgments and estimates by us. For more information on our critical accounting policies, see Note 2 to the attached consolidated financial statements.

**Cash and Cash Equivalents and Marketable Securities**

We account for our investments in accordance with the Financial Accounting Standards Board, or FASB's, authoritative guidance. Under the provisions, we have classified our investments as available-for-sale which are carried at fair value based on quoted market prices and associated unrealized gains or losses are recorded as a separate component of stockholders' equity until realized. We consider all highly liquid investments purchased with a maturity of three months or less to be cash equivalents and those with maturities greater than three months are considered to be marketable securities. Cash and cash equivalents typically consist of money market instruments, commercial paper with a maturity of three months or less and cash maintained with various financial institutions. Marketable securities generally consist of U.S. Treasury bills, commercial paper with an original maturity of greater than three months, U.S. government bonds, agency bonds, corporate bonds, auction rate securities and municipal bonds. Cash equivalents and short-term marketable securities are stated at cost plus accrued interest, which approximates fair value.

Long-term marketable securities consist of auction rate securities, corporate bonds and certificate of deposits. The auction rate securities we hold are all collateralized by student loans with underlying support by the Federal Education Loan Program, or FFELP. Auction rate securities typically were stated at par value prior to February 2008 due to liquidity provided through the auction process. While we continue to earn interest on auction rate securities the failure of these auctions has created illiquidity. As a result, par value no longer



## **Table of Contents**

approximates the estimated fair value of auction rate securities. A discounted cash flow model was used to determine the estimated fair value of our investment in auction rate securities as of March 31, 2010 and 2009. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, timing and amount of cash flows, a liquidity risk premium and expected holding periods of the investments. Based on this assessment of fair value, as of March 31, 2010 we have recorded a cumulative decline in the fair value of auction rate securities of \$3.9 million (\$2.4 million net of tax) which was deemed temporary. Assumptions used to value these securities and in determining the temporary nature of this impairment require significant judgment by management. Changes in the assumptions could result in materially different estimates of fair values and the failure of these securities to return to par value or a decision by the Company to sell these securities at a loss could have a material adverse impact on earnings.

### ***Revenue Recognition***

Product revenue consists of sales of our hardware products and licensing of our software products. Product revenue is recognized upon shipment, provided that evidence of an arrangement exists, title and risk of loss have passed to the customer, fees are fixed or determinable and collection of the related receivable is probable. Because we have determined that the software components of our products are more than incidental to the functionality and value of these products, we recognize our revenue in accordance with authoritative guidance on software revenue recognition.

Service revenue consists primarily of fees from customer support agreements, consulting and training. We generally provide software and hardware support as part of product sales. Revenue related to the initial bundled software and hardware support is recognized ratably over the support period. In addition, customers can elect to purchase extended support agreements for periods after the initial software warranty expiration, typically for 12-month periods. Revenue from customer support agreements is recognized ratably over the support period. Revenue from consulting and training services is recognized as the work is performed.

Multi-element arrangements are concurrent customer purchases of a combination of our product and service offerings that may be delivered at various points in time. For multi-element arrangements, each element of the purchase is analyzed and a portion of the total purchase price is allocated to the undelivered elements, primarily support agreements and training, using vendor-specific objective evidence of fair value of the undelivered elements. Under the residual method, the remaining portion of the total purchase price is allocated to the delivered elements, generally hardware and licensed software products, regardless of any separate prices stated within the contract for each element. Vendor-specific objective evidence of fair value of the undelivered elements is based on the price customers pay when the element is sold separately. We review the separate sales of the undelivered elements on a semi-annual basis and update, when appropriate, our vendor-specific objective evidence of fair value for such elements to ensure that it reflects our recent pricing experience.

As discussed in the Recent Accounting Standards section of this Management Discussion and Analysis, our accounting for revenue arrangements will change next fiscal year with the adoption of new authoritative guidance.

### ***Commission Expense***

We recognize commission expense related to the renewal of maintenance contracts at the time an order is booked. As a result, commission expense can be recognized in full even though the related revenue may not be fully recognized. Commission expense on product revenue and corresponding new maintenance contracts is recognized in the same period as the related product revenue, typically upon shipment.

### ***Uncollected Deferred Product Revenue***

Because of our revenue recognition policies, there are circumstances for which we are unable to recognize product revenue relating to sales transactions that have been shipped and billed. While the receivable represents

---

**Table of Contents**

an enforceable obligation, for balance sheet presentation purposes we have not recognized the deferred revenue or the related account receivable and no amounts appear in our consolidated balance sheets for such transactions. The aggregate amount of unrecognized accounts receivable and deferred revenue was \$2.0 million and \$1.2 million at March 31, 2010 and 2009, respectively.

***Valuation of Inventories***

Inventories are stated at the lower of actual cost or their net realizable value. Cost is determined by using the first-in, first-out, or FIFO method. Inventories consist primarily of raw materials and finished goods. Inventory carrying values are reduced to our estimate of net realizable value. We regularly monitor our inventories for potential obsolete and excess inventory. Our net realizable value adjustment is based upon our estimates of forecasts of unit sales, expected timing and impact of new product introductions, historical product demand, current economic trends, expected market acceptance of our products and expected customer buying patterns. We adjust the carrying value of inventory to reflect its net realizable value when lower than original cost. As of March 31, 2010 and 2009, net realizable value adjustments included within inventory on the balance sheet totaled \$1.1 million and \$986 thousand, respectively. Significant judgments and estimates are made when establishing the net realizable value adjustment. If these accounting judgments and estimates prove to be materially inaccurate, our financial results could be materially and adversely impacted in future periods.

***Assumptions Related to Purchase Accounting and the Valuation of Goodwill and Acquired Intangible Assets***

Purchase accounting requires estimates to determine the fair values of assets and liabilities acquired, including judgments to determine any acquired intangible assets such as customer relationships and developed product technology, as well as assessments of the fair value of existing assets such as property and equipment. Liabilities acquired can include reserves for litigation and other contingencies and require judgment in ascertaining a reasonable value. Independent appraisals may be used to assist in the determination of the fair value of certain assets and liabilities, but even those determinations would be based on significant estimates provided by us, such as forecasted revenues or profits on contract-related intangibles. Numerous factors are typically considered in the purchase accounting assessments, which are conducted by NetScout professionals from legal, finance, human resources, information systems, research and development, sales and executive management. Significant changes in assumptions and estimates subsequent to completing the allocation of purchase price to the assets and liabilities acquired, as well as differences in actual results versus estimates, could result in material impacts to earnings.

The carrying value of goodwill was \$128.2 million as of March 31, 2010 and 2009. Goodwill is reviewed for impairment at the enterprise-level at least annually or more frequently when events and circumstances occur indicating that the recorded goodwill may be impaired. If the book value of our enterprise exceeds its fair value, the implied fair value of goodwill is compared with the carrying value of goodwill. If the carrying value of goodwill exceeds the implied fair value, an impairment loss is recognized in income equal to that excess.

We consider the market capitalization of our outstanding common stock versus our stockholders' equity as one indicator that may potentially trigger an impairment of goodwill analysis. Significant judgments and estimates are made when assessing impairment. If these accounting judgments and estimates prove to be materially inaccurate, goodwill may be determined to be impaired and our financial results could be materially and adversely impacted in future periods. Likewise, if a future event or circumstance indicates that an impairment assessment is required and goodwill is determined to be impaired, our financial results could be materially and adversely impacted in future periods. As of March 31, 2010, based upon our review, we determined that there has been no goodwill impairment.

The carrying value of acquired intangible assets was \$53.6 million and \$59.6 million as of March 31, 2010 and 2009, respectively. The carrying value of acquired intangible assets is recorded at their estimated fair values at the date of acquisition. Our acquired intangible assets include acquired software; customer relationships and an

---

**Table of Contents**

indefinite lived tradename resulting from the acquisition of Network General on November 1, 2007 (see Note 7 to our consolidated financial statements). We amortize acquired intangible assets over their estimated useful lives on a straight-line basis, except for the acquired tradename which has an indefinite life and thus, is not amortized. The carrying value of the indefinite lived Sniffer tradename is evaluated for potential impairment on an annual basis. At March 31, 2010, we determined that there had been no impairment of acquired intangible assets or indefinite lived assets. Significant judgment and estimates are made when estimating fair value and useful lives for acquired intangible assets. If these accounting judgments and estimates prove to be materially inaccurate, the value of these assets and our financial results could be materially and adversely impacted. We periodically review long-lived assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives of these assets are no longer appropriate.

***Capitalization of Software Development Costs***

Costs incurred in the research and development of our products are expensed as incurred, except for certain software development costs. Costs associated with the development of computer software are expensed prior to establishment of technological feasibility and capitalized thereafter until the related software products are available for general release to customers. Judgment is required in determining the point at which technological feasibility has been met. Amortization of capitalized software development costs begin once projects are ready for sale to the general public and are charged to cost of revenue on a straight-line basis over two years.

Capitalized software development costs are periodically assessed for recoverability in the event of changes to the anticipated future revenue for the software products or changes in product technologies. Unamortized capitalized software development costs that are determined to be in excess of the net realizable value of the software products would be expensed in the period in which such a determination is made.

***Derivative Financial Instruments***

The FASB's authoritative guidance establishes accounting and reporting standards for derivative instruments and hedging activities. All hedging activities must be documented at the inception of the hedge and must meet the definition of highly effective in offsetting changes to future cash flows in order for the derivative to qualify for hedge accounting. Under the guidance, if an instrument qualifies for hedge accounting, the changes in the fair value each period for open contracts, measured as of the end of the period, are recorded to other comprehensive income. Otherwise, changes in the fair value are recorded in earnings each period. Management must perform initial and ongoing tests in order to qualify for hedge accounting. In accordance with the guidance, we account for our instruments under hedge accounting. The effectiveness and a measurement of ineffectiveness of qualifying hedge contracts is assessed by NetScout quarterly. We record the fair value of our derivatives in other current assets and other current liabilities. The effective portion of gains or losses resulting from changes in the fair value of qualifying hedges are recorded in other comprehensive income (loss) until the forecasted transaction occurs, with any ineffective portion classified directly to our consolidated statement of operations based on the expense categories of the items being hedged. When forecasted transactions occur, unrealized gains or losses associated with the effective portion of the hedge are reclassified to the respective expense categories in our consolidated statement of operations. Gains or losses related to hedging activity are included as operating activities in our consolidated statement of cash flows.

***Share-based Compensation***

We recognize compensation expense for all share-based payments granted after April 1, 2006 and those shares granted in prior periods but not yet vested as of April 1, 2006. Under the fair value recognition provisions, we recognize share-based compensation net of an estimated forfeiture rate and only recognize compensation cost for those shares expected to vest on a straight-line basis over the requisite service period of the award.

## **Table of Contents**

Determining the appropriate fair value model and calculating the fair value of share-based payment awards requires the input of highly subjective assumptions, including the expected life of the share-based payment awards and stock price volatility. Management estimated the volatility based on historical volatility of our stock. The assumptions used in calculating the fair value of share-based payment awards represent management's best estimates, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if circumstances change and we use different assumptions, our share-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the share-based compensation expense could be significantly different from what we have recorded in the current period.

Based on historical experience, we assumed an annualized forfeiture rate of 0% for awards granted to our directors during fiscal years 2010, 2009, and 2008, and an annualized forfeiture rate of 10% for awards granted to our senior executives and remaining employees during fiscal years 2010, 2009 and 2008. We will record additional expense if the actual forfeitures are lower than estimated and will record a recovery of prior expense if the actual forfeitures are higher than estimated.

### ***Income Taxes***

Significant judgments and estimates are made when calculating our annual provision for income taxes. In addition, we may record certain tax reserves to address potential exposures involving our tax positions. Our estimate of the value of our tax reserves contains assumptions based on past experiences and judgments about the interpretation of statutes, rules and regulations by taxing jurisdictions. If these judgments and estimates prove to be materially inaccurate, our tax rate could fluctuate significantly and our financial results could be materially and adversely impacted in the future.

We recognize deferred income tax assets and liabilities based on the differences between the financial statement carrying amounts and the tax basis of these assets and liabilities as well as on acquired or incurred net operating loss carryforward amounts. We make an assessment of the likelihood that our deferred income tax assets will be recovered from future taxable income, and, to the extent that recovery is not believed to be more likely than not, a valuation allowance is established. All available evidence, both positive and negative, is considered in the determination of recording a valuation allowance. We consider past performance, future taxable income and ongoing tax planning strategies when assessing the need for a valuation allowance.

As of March 31, 2010, deferred income tax assets were \$32.8 million, consisting primarily of \$23.5 million of federal and state net operating loss carryforwards, \$1.8 million of federal and state tax credits and \$7.5 million other temporary book and tax accounting differences. Significant accounting judgments and estimates are made when determining whether it is more likely than not that our deferred income tax assets will be realized and, accordingly, do not require a valuation allowance. If these judgments and estimates prove to be materially inaccurate, a valuation allowance may be required and our financial results could be materially and adversely impacted in the future. If we determine that we will not be able to realize some or all of the deferred income taxes in the future, an adjustment to the deferred income tax assets will be credited to income tax expense in the period such determination is made.

A valuation allowance has been established for certain federal foreign tax credits related to the Network General acquisition, which we believe do not meet the "more likely than not" criteria. If it is later determined that we are able to utilize all or a portion of the deferred tax assets for which a valuation allowance has been established, then we will recognize these deferred tax assets through a benefit to our income tax provision and the reduction of the valuation allowance. An adjustment to these deferred tax assets will be charged to income tax expense in the period such determination is made.



**Table of Contents**

We account for uncertain tax positions in accordance with generally accepted accounting principles. These standards clarify the accounting for uncertainty in income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. A two-step approach is utilized for evaluating tax positions. Recognition (Step 1) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more likely than not to be sustained upon examination. Measurement (Step 2) is only addressed if Step 1 has been satisfied. Under Step 2, the tax benefit is measured at the largest amount of benefit, determined on a cumulative probability basis, that is more likely than not to be realized upon settlement. As used in the accounting standards, the term more likely than not means that the likelihood of an occurrence is greater than 50%.

**Table of Contents****Results of Operations****Fiscal Years Ended March 31, 2010 and 2009****Revenue**

Product revenue consists of sales of our hardware products and licensing of our software products. Service revenue consists of customer support agreements, consulting and training. No one direct customer or indirect channel partner accounted for more than 10% of our total revenue during fiscal years ended March 31, 2010 and 2009.

|          | Fiscal Year Ended March 31, |                        | 2009       |                        | Change      |      |
|----------|-----------------------------|------------------------|------------|------------------------|-------------|------|
|          | 2010                        | (Dollars in Thousands) | 2009       | (Dollars in Thousands) | \$          | %    |
|          |                             | % of Revenue           |            | % of Revenue           |             |      |
| Revenue: |                             |                        |            |                        |             |      |
| Product  | \$ 142,113                  | 55%                    | \$ 154,161 | 58%                    | \$ (12,048) | (8%) |
| Service  | 118,229                     | 45                     | 113,443    | 42                     | 4,786       | 4%   |
|          | \$ 260,342                  | 100%                   | \$ 267,604 | 100%                   | \$ (7,262)  | (3%) |

*Product.* The 8%, or \$12.0 million, decrease in product revenue was primarily the result of decreased volume due to the impact of the global economic downturn on our customers' capital spending during the year ended March 31, 2010, which included a \$5.7 million decline in product revenues for our financial vertical and a \$16.3 million decline in our other enterprise businesses. This decline was partially offset by growth in our service provider vertical of \$9.5 million. While product bookings increased 11% over fiscal year 2009 we entered 2009 with significant backlog which allowed for higher revenue in fiscal year 2009 on lower bookings. Compared to fiscal year 2009, we realized an increase of approximately 30% in the average selling price per unit due to a shift in product mix towards our Infinistream product line and away from lower priced probes. We also generated \$7.6 million of product revenue from our new lower capacity Infinistream product launched during the year. Product revenue recognized during the year ended March 31, 2009 reflects a \$1.9 million purchase accounting adjustment that was made to reduce acquired deferred product revenue to fair value as a result of the Network General acquisition. The impact of purchase accounting adjustments was not material for fiscal year 2010. Product revenue as a percent of total revenue decreased three points when compared to the year ended March 31, 2009.

*Service.* The 4%, or \$4.8 million, increase in service revenue was due to the renewal of maintenance contracts associated with the acquired Network General business at full value, while deferred revenue acquired in November 2007 and subsequently recognized into revenue had been reduced to fair value as required under purchase accounting. This adjustment to service revenue was \$8.6 million lower in fiscal year 2010 than it was in fiscal year 2009. This was offset by a \$4.3 million decrease in maintenance revenue due to a portion of our customers not renewing their customer support agreements as well as the Company ending its support for some of its older product models. While our renewal rate has not changed significantly from prior periods, growth in product revenue and associated new maintenance typically offsets lost renewals. With an 8% decline in product revenue in fiscal year 2010 compared to fiscal year 2009, this offset did not occur at the same rate as in prior periods.

**Table of Contents**

Total product and service revenue from direct and indirect channels are as follows:

|                      | Fiscal Year Ended March 31, |                   |                        |              | Change            |             |
|----------------------|-----------------------------|-------------------|------------------------|--------------|-------------------|-------------|
|                      | 2010                        | 2009              | (Dollars in Thousands) |              | \$                | %           |
|                      |                             |                   | % of Revenue           | % of Revenue |                   |             |
| Indirect             | \$ 159,379                  | \$ 158,195        | 61%                    | 59%          | \$ 1,184          | 1%          |
| Direct               | 100,963                     | 109,409           | 39                     | 41           | (8,446)           | (8%)        |
| <b>Total revenue</b> | <b>\$ 260,342</b>           | <b>\$ 267,604</b> | <b>100%</b>            | <b>100%</b>  | <b>\$ (7,262)</b> | <b>(3%)</b> |

The 1%, or \$1.2 million, increase in indirect channel revenue is the result of a 4% growth in our international revenue. Sales to customers outside the United States are primarily export sales through indirect channel partners, who are generally responsible for distributing our products and providing technical support and service to customers within their territories. Sales arrangements are primarily transacted in United States dollars. Our reported international revenue does not include any revenue from sales to customers outside the United States that are shipped to our United States-based indirect channel partners. These domestic resellers fulfill customer orders based upon joint selling efforts in conjunction with our direct sales force and may subsequently ship our products to international locations; however, we report these shipments as United States revenue since we ship the products to a domestic location. The 8%, or \$8.4 million, decrease in direct channel revenue and change in sales mix between direct and indirect is primarily the result of lower revenue in the United States due to the decline in volume with our larger direct financial services and enterprise customers.

Total revenue by geography is as follows:

|                        | Fiscal Year Ended March 31, |                   |                        |              | Change            |             |
|------------------------|-----------------------------|-------------------|------------------------|--------------|-------------------|-------------|
|                        | 2010                        | 2009              | (Dollars in Thousands) |              | \$                | %           |
|                        |                             |                   | % of Revenue           | % of Revenue |                   |             |
| United States          | \$ 189,517                  | \$ 199,737        | 73%                    | 75%          | \$ (10,220)       | (5%)        |
| International:         |                             |                   |                        |              |                   |             |
| Europe                 | 35,072                      | 37,618            | 14                     | 14           | (2,546)           | (7%)        |
| Asia                   | 13,694                      | 12,973            | 5                      | 5            | 721               | 6%          |
| Rest of World          | 22,059                      | 17,276            | 8                      | 6            | 4,783             | 28%         |
| Subtotal International | 70,825                      | 67,867            | 27                     | 25           | 2,958             | 4%          |
| <b>Total revenue</b>   | <b>\$ 260,342</b>           | <b>\$ 267,604</b> | <b>100%</b>            | <b>100%</b>  | <b>\$ (7,262)</b> | <b>(3%)</b> |

United States revenues declined 5%, or \$10.2 million, due to the impact of the global economic downturn on capital spending for our enterprise and financial services customers, however, we saw the beginnings of a return to health in the financial services vertical and strong growth in the service provider vertical. However, core enterprise spending and resulting revenue continued to lag as we saw these customers remaining cautious on significant IT spending. The 7%, or \$2.5 million, decrease in revenue in Europe was a result of decreased revenue from the northern European region. The 28%, or \$4.8 million, increase in revenue from the Rest of the World, which includes Africa, Australia, Canada, Brazil, India, Mexico and the United Arab Emirates, was primarily due to further market penetration in this region from our service provider and enterprise verticals. We expect revenue from sales to customers outside the United States to continue to account for a significant portion of our total revenue in the future. In accordance with United States export control regulations we do not sell or do business with countries subject to economic sanctions and export controls.



**Table of Contents****Cost of Revenue and Gross Profit**

Cost of product revenue consists primarily of material components, personnel expenses, media duplication, manuals, packaging materials, overhead and amortization of capitalized software and developed product technology. Cost of service revenue consists primarily of personnel, material, overhead and support costs.

|                        | Fiscal Year Ended March 31, |                        |            |              | Change     |       |
|------------------------|-----------------------------|------------------------|------------|--------------|------------|-------|
|                        | 2010                        | (Dollars in Thousands) | 2009       | % of Revenue | \$         | %     |
| Cost of revenue:       |                             |                        |            |              |            |       |
| Product                | \$ 35,564                   | 14%                    | \$ 43,315  | 16%          | \$ (7,751) | (18%) |
| Service                | 20,500                      | 8                      | 20,824     | 8            | (324)      | (2%)  |
| Total cost of revenue  | \$ 56,064                   | 22%                    | \$ 64,139  | 24%          | \$ (8,075) | (13%) |
| Gross profit:          |                             |                        |            |              |            |       |
| Product \$             | \$ 106,549                  | 41%                    | \$ 110,846 | 41%          | \$ (4,297) | (4%)  |
| Product gross profit % | 75%                         |                        | 72%        |              | 3%         |       |
| Service \$             | 97,729                      | 38%                    | 92,619     | 35%          | 5,110      | 6%    |
| Service gross profit % | 83%                         |                        | 82%        |              | 1%         |       |
| Total gross profit \$  | \$ 204,278                  |                        | \$ 203,465 |              | \$ 813     | %     |
| Total gross profit %   | 78%                         |                        | 76%        |              | 2%         |       |

*Product.* The 18%, or \$7.8 million, decrease in cost of product revenue was due to the 8%, or \$12.0 million decline in product revenue for the years ended March 31, 2010 when compared to March 31, 2009 as well as improved gross profit percentage. The product gross profit percentage increased by three points from 72% to 75% for the year ended March 31, 2010. This increase was primarily due to favorable product mix, with a shift towards higher margin products, such as 10G Infinistream and software. In addition, there was a decrease in the indirect manufacturing costs largely due to lower incentive compensation as well as lower product component costs. Average headcount in cost of product was 27 for both years ended March 31, 2010 and 2009.

*Service.* The 2%, or \$324 thousand, decrease in cost of service revenue was primarily due to a \$232 thousand reduction in integration costs associated with the acquisition of Network General, a \$294 thousand decrease in travel in our support and consulting groups and a \$198 thousand decrease in employee compensation. These costs were partially offset by higher allocations due to increased headcount. The 6%, or \$5.1 million, increase in service gross profit corresponds with the 4%, or \$4.8 million, increase in service revenue, as well as additional operating leverage from the reduced direct expenses. Average headcount in cost of service was 105 and 99 for the years ended March 31, 2010 and 2009, respectively.

*Gross profit.* Despite the decrease in revenue of 3%, or \$7.3 million, our gross profit increased \$813 thousand due to a two point increase in gross profit percentage from 76% to 78%. This increase in gross profit percentage is primarily attributable to favorable product mix towards higher margin hardware platforms and a larger percentage of higher margin service revenue.

**Table of Contents****Operating Expenses**

|  | Fiscal Year Ended March 31, |            |                   |            | Change            |             |
|--|-----------------------------|------------|-------------------|------------|-------------------|-------------|
|  | 2010                        | 2009       |                   |            |                   |             |
|  | (Dollars in Thousands)      |            |                   |            |                   |             |
|  |                             | % of       |                   | % of       | \$                | %           |
|  |                             | Revenue    |                   | Revenue    |                   |             |
| Research and development                   | \$ 36,650                   | 14%        | \$ 40,189         | 15%        | \$ (3,539)        | (9%)        |
| Sales and marketing                        | 99,059                      | 38%        | 98,818            | 37%        | 241               | %           |
| General and administrative                 | 20,609                      | 8%         | 26,118            | 10%        | (5,509)           | (21%)       |
| Amortization of acquired intangible assets | 2,057                       | 1%         | 1,962             | %          | 95                | 5%          |
| <b>Total</b>                               | <b>\$ 158,375</b>           | <b>61%</b> | <b>\$ 167,087</b> | <b>62%</b> | <b>\$ (8,712)</b> | <b>(5%)</b> |

*Research and development.* Research and development expenses consist primarily of personnel expenses, fees for outside consultants, overhead and related expenses associated with the development of new products and the enhancement of existing products.

The 9%, or \$3.5 million, decrease in research and development expenses is primarily due to a \$2.7 million decrease in incentive compensation and other employee related expenses, a \$408 thousand decrease due to the capitalization of salaries associated with late stage software development, a \$328 thousand reduction in integration costs associated with the acquisition of Network General and a \$226 thousand decrease in travel expenses. Average headcount in research and development was 238 and 244 for the fiscal years ended March 31, 2010 and 2009, respectively.

*Sales and marketing.* Sales and marketing expenses consist primarily of personnel expenses, including commissions, overhead and other expenses associated with selling activities and marketing programs such as trade shows, seminars, advertising, and new product launch activities.

The \$241 thousand increase in total sales and marketing expenses was primarily due to \$1.3 million in increased sales commissions as well as a \$965 thousand increase in other employee related expenses. Despite the decline in revenue, commissions increased due to incremental special incentive programs and commission expense on increased service bookings, including maintenance renewals for which some revenue will be recognized in future periods. These were partially offset by a \$501 thousand decrease in travel expenses, a \$422 thousand decrease in expenses related to the NetScout user conference, a \$366 thousand decrease in allocated overhead costs such as lower internal IT spending, a \$378 thousand decrease in integration expenses as a result of the Network General acquisition, a \$242 thousand decrease in rent and other office expenses as well as a \$176 thousand reduction in sales meeting expenses. Average headcount in sales and marketing was 297 and 303 for the fiscal years ended March 31, 2010 and 2009, respectively.

*General and administrative.* General and administrative expenses consist primarily of personnel expenses for executive, financial, legal and human resource employees, overhead and other corporate expenditures.

The 21%, or \$5.5 million, decrease in general and administrative expenses was due to a \$2.6 million decrease in professional fees, a \$1.7 million decrease in incentive compensation, a decrease of \$782 thousand relating to Network General integration and acquisition related expenses and a \$612 thousand decrease in bad debt expense. The decrease in professional fees was primarily due to the settlement of litigation in the prior year, as well as savings from entity consolidation and other cost reduction initiatives. Average headcount in general and administrative was 109 for both fiscal years ended March 31, 2010 and 2009.

*Amortization of acquired intangible assets.* Amortization of acquired intangible assets consists primarily of amortization of customer relationships related to the acquisition of Network General.

The \$95 thousand increase in amortization of acquired intangible assets was due to the write off of a net beneficial lease due to the closure of an office acquired in the acquisition of Network General in November 2007.

**Table of Contents****Interest and Other Income (Expense), Net**

Interest and other income (expense), net includes interest earned on our cash, cash equivalents, marketable securities and restricted investments and interest expense.

|  | Fiscal Year Ended March 31, |              | Fiscal Year Ended March 31, |              | Change   |       |
|--|-----------------------------|--------------|-----------------------------|--------------|----------|-------|
|  | 2010                        | 2009         | 2010                        | 2009         | \$       | %     |
|  | (Dollars in Thousands)      |              | (Dollars in Thousands)      |              |          |       |
|  | % of Revenue                | % of Revenue | % of Revenue                | % of Revenue |          |       |
| Interest and other income (expense), net | \$ (2,832)                  | (1%)         | \$ (5,337)                  | (2%)         | \$ 2,505 | (47%) |

The 47%, or \$2.5 million, change in interest and other income (expense), net was primarily due to a \$2.8 million decrease in interest expense due to a reduction in the interest rate as well as a reduction of approximately \$13 million on the outstanding principal of our debt due to scheduled debt repayments. During the years ended March 31, 2010 and 2009, the average interest rates on our outstanding debt were 3.45% and 5.94%, respectively. Additionally, the change was affected by a \$1.1 million decrease in foreign currency transaction expense due to a reduction in the settlement of transactions, such as the collection of accounts receivable or the payment of liabilities related to our international locations, which were denominated in currencies other than the U.S. dollar. These decreases to interest and other income (expense) were partially offset by a \$1.4 million decrease in interest income due to a decrease in market interest rates received on investments as well as a \$61 thousand loss on the disposal of assets.

**Income Tax Expense**

The annual effective tax rate for fiscal year 2010 is 35.2%, compared to an annual effective tax rate of 35.4% for fiscal year 2009. Generally, the annual effective tax rates differ from statutory rates primarily due to the impact of tax exempt interest income, differences in tax rates in foreign jurisdictions and federal and state tax credits. The difference in our effective tax rate compared to the prior year is primarily due to a decrease in tax exempt interest income, an increase in qualified production activities deduction and the impact of the expiration of the federal research and development credit as of December 31, 2009.

|                          | Fiscal Year Ended March 31, |              | Fiscal Year Ended March 31, |              | Change   |     |
|--------------------------|-----------------------------|--------------|-----------------------------|--------------|----------|-----|
|                          | 2010                        | 2009         | 2010                        | 2009         | \$       | %   |
|                          | (Dollars in Thousands)      |              | (Dollars in Thousands)      |              |          |     |
|                          | % of Revenue                | % of Revenue | % of Revenue                | % of Revenue |          |     |
| Income tax expense       | \$ 15,154                   | 6%           | \$ 10,993                   | 4%           | \$ 4,161 | 38% |
| <b>Net Income (Loss)</b> |                             |              |                             |              |          |     |

Net income (loss) for the fiscal years ended March 31, 2010 and 2009 was as follows:

|                   | Fiscal Year Ended March 31, |              | Fiscal Year Ended March 31, |              | Change   |     |
|-------------------|-----------------------------|--------------|-----------------------------|--------------|----------|-----|
|                   | 2010                        | 2009         | 2010                        | 2009         | \$       | %   |
|                   | (Dollars in Thousands)      |              | (Dollars in Thousands)      |              |          |     |
|                   | % of Revenue                | % of Revenue | % of Revenue                | % of Revenue |          |     |
| Net income (loss) | \$ 27,917                   | 11%          | \$ 20,048                   | 7%           | \$ 7,869 | 39% |

The \$7.9 million increase in net income during the fiscal year ended March 31, 2010 was largely attributable to the \$8.7 million decrease in operating expenses mainly due to decreased employee related expenses and incentive compensation, a \$2.5 million decrease in interest and other income (expense) and an \$813 thousand increase in total product and service gross profit.

**Table of Contents****Fiscal Years Ended March 31, 2009 and 2008****Revenue**

Product revenue consists of sales of our hardware products and licensing of our software products. Service revenue consists of customer support agreements, consulting and training. No one direct customer or indirect channel partner accounted for more than 10% of our total revenue during fiscal years ended March 31, 2009 and 2008.

|               | Fiscal Year Ended March 31, |            |                        |              | Change    |     |
|---------------|-----------------------------|------------|------------------------|--------------|-----------|-----|
|               | 2009                        | 2008       | (Dollars in Thousands) |              | \$        | %   |
|               |                             |            | % of Revenue           | % of Revenue |           |     |
| Revenue:      |                             |            |                        |              |           |     |
| Product       | \$ 154,161                  | \$ 106,182 | 58%                    | 63%          | \$ 47,979 | 45% |
| Service       | 113,443                     | 62,774     | 42                     | 37           | 50,669    | 81% |
| Total revenue | \$ 267,604                  | \$ 168,956 | 100%                   | 100%         | \$ 98,648 | 58% |

*Product.* The 45%, or \$48.0 million, increase in product revenue was primarily due to the Network General acquisition. Product revenue as a percent of total revenue decreased five points when compared to fiscal year 2008. The acquisition of Network General has shifted the revenue mix as Network General had a larger service component to its business.

*Service.* The 81%, or \$50.7 million, increase in service revenue was primarily due to the expansion of our customer base due to the acquisition of Network General and an increase in the number of customer support agreements attributable to new product sales generated during the last 12 months, combined with continued renewals of customer support agreements from our expanding installed product base.

Total product and service revenue from direct and indirect channels are as follows:

|               | Fiscal Year Ended March 31, |            |                        |              | Change    |     |
|---------------|-----------------------------|------------|------------------------|--------------|-----------|-----|
|               | 2009                        | 2008       | (Dollars in Thousands) |              | \$        | %   |
|               |                             |            | % of Revenue           | % of Revenue |           |     |
| Indirect      | \$ 158,195                  | \$ 109,740 | 59%                    | 65%          | \$ 48,455 | 44% |
| Direct        | 109,409                     | 59,216     | 41                     | 35           | 50,193    | 85% |
| Total revenue | \$ 267,604                  | \$ 168,956 | 100%                   | 100%         | \$ 98,648 | 58% |

The 44%, or \$48.5 million, increase in indirect channel revenue is primarily the result of additional revenue generated as a result of the Network General acquisition as well as increased sales to the federal sector, which we sell to entirely through channel partners, and increased international sales which are almost exclusively sold through channel partners. Sales to customers outside the United States are primarily export sales through indirect channel partners, who are generally responsible for distributing our products and providing technical support and service to customers within their territories. Sales arrangements are primarily transacted in United States dollars. Our reported international revenue does not include any revenue from sales to customers outside the United States that are shipped to our United States-based indirect channel partners. These domestic resellers fulfill customer orders based upon joint selling efforts in conjunction with our direct sales force and may subsequently ship our products to international locations; however, we report these shipments as United States revenue since we ship the products to a domestic location. The 85%, or \$50.2 million, increase in direct channel revenue is primarily the result of additional revenue generated as a result of the Network General acquisition and a significant increase in fiscal 2009 in revenue from the United States where direct selling is more prevalent.





**Table of Contents**

Total revenue by geography is as follows:

|                        | Fiscal Year Ended March 31, |                        | 2008       |                        | Change    |      |
|------------------------|-----------------------------|------------------------|------------|------------------------|-----------|------|
|                        | 2009                        | (Dollars in Thousands) | 2008       | (Dollars in Thousands) | \$        | %    |
|                        |                             | % of Revenue           |            | % of Revenue           |           |      |
| United States          | \$ 199,737                  | 75%                    | \$ 123,321 | 73%                    | \$ 76,416 | 62%  |
| International:         |                             |                        |            |                        |           |      |
| Europe                 | 37,618                      | 14                     | 27,188     | 16                     | 10,430    | 38%  |
| Asia                   | 12,973                      | 5                      | 11,093     | 7                      | 1,880     | 17%  |
| Rest of World          | 17,276                      | 6                      | 7,354      | 4                      | 9,922     | 135% |
| Subtotal International | 67,867                      | 25                     | 45,635     | 27                     | 22,232    | 49%  |
| Total revenue          | \$ 267,604                  | 100%                   | \$ 168,956 | 100%                   | \$ 98,648 | 58%  |

Revenue from sales to customers outside the United States increased 49%, or \$22.2 million, primarily as a result of the acquisition of Network General and increased sales to international telecommunications customers. This increase is due to a broad increase in international business but most notable in the Rest of World where we had a 135% increase in revenue. We expect revenue from sales to customers outside the United States to continue to account for a significant portion of our total revenue in the future. Revenue from sales to customers in the United States increased by 62%, or \$76.4 million, primarily as the result of the Network General acquisition. The fiscal year ended March 31, 2008 only included five months of increased revenue since the Network General acquisition occurred on November 1, 2007.

**Cost of Revenue and Gross Profit**

Cost of product revenue consists primarily of material components, manufacturing personnel expenses, media duplication, manuals, packaging materials, licensed technology fees, overhead and amortization of capitalized software and developed product technology. The year ended March 31, 2008 also includes the cost of revenue impact associated with a purchase accounting adjustment to increase inventory to fair value at November 1, 2007. Cost of service revenue consists primarily of personnel, material, overhead and support costs.

|                        | Fiscal Year Ended March 31, |                        | 2008       |                        | Change    |     |
|------------------------|-----------------------------|------------------------|------------|------------------------|-----------|-----|
|                        | 2009                        | (Dollars in Thousands) | 2008       | (Dollars in Thousands) | \$        | %   |
|                        |                             | % of Revenue           |            | % of Revenue           |           |     |
| Cost of revenue:       |                             |                        |            |                        |           |     |
| Product                | \$ 43,315                   | 16%                    | \$ 33,965  | 20%                    | \$ 9,350  | 28% |
| Service                | 20,824                      | 8                      | 13,721     | 8                      | 7,103     | 52% |
| Total cost of revenue  | \$ 64,139                   | 24%                    | \$ 47,686  | 28%                    | \$ 16,453 | 35% |
| Gross profit:          |                             |                        |            |                        |           |     |
| Product \$             | \$ 110,846                  | 41%                    | \$ 72,217  | 43%                    | \$ 38,629 | 53% |
| Product gross profit % | 72%                         |                        | 68%        |                        | 4%        |     |
| Service \$             | 92,619                      | 35%                    | 49,053     | 29%                    | 43,566    | 89% |
| Service gross profit % | 82%                         |                        | 78%        |                        | 4%        |     |
| Total gross profit \$  | \$ 203,465                  |                        | \$ 121,270 |                        | \$ 82,195 | 68% |
| Total gross profit %   | 76%                         |                        | 72%        |                        | 4%        |     |



**Table of Contents**

*Product.* The 28%, or \$9.4 million, increase in cost of product revenue was primarily due to the 45% increase in product revenue during the year ended March 31, 2009. A majority of the increase in revenue was associated with the acquisition of Network General. The product gross margin percentage increased by four points from 68% to 72% for the years ended March 31, 2008 and 2009, respectively, due to product mix and realized cost synergies mainly from reduced material costs resulting from the Network General acquisition. Average headcount in cost of product was 27 and 26 for the years ended March 31, 2009 and 2008, respectively

*Service.* The 52%, or \$7.1 million, increase in cost of service revenue was primarily due to the \$4.5 million increase in personnel costs associated with our customer support and training groups as a result of the Network General acquisition and \$1.6 million of increased allocated overhead costs such as higher internal IT spending. The 89%, or \$43.6 million, increase in service gross profit corresponds with the 81%, or \$50.7 million, increase in service revenue, offset by the 52%, or \$7.1 million, increase in cost of service revenue. The service gross margin percentage increased by four points from 78% to 82% for the year ended March 31, 2008 and 2009, respectively, due to a decline in purchase accounting valuation adjustments year over year as well as cost synergies resulting from the Network General acquisition. The acquisition of the Network General business has also shifted the revenue mix with service revenue accounting for a greater percentage of total revenue. Average headcount in cost of service was 99 and 63 for the years ended March 31, 2009 and 2008, respectively.

*Gross profit.* Our gross profit increased 68%, or \$82.2 million. This increase was consistent with our revenue growth of 58%, or \$98.6 million. The net effect of the combined increases in revenue and cost of revenue was a four point increase in gross profit percentage from 72% to 76% for the years ended March 31, 2008 and 2009, respectively. This increase in gross margin percentage is primarily attributable to favorable product mix, a shift in revenue mix towards our higher margin service business and realized cost synergies in fiscal year 2009 as a result of the Network General integration.

**Operating Expenses**

|  | Fiscal Year Ended March 31, |              |                   |              | Change           |            |
|--|-----------------------------|--------------|-------------------|--------------|------------------|------------|
|  | 2009                        | 2008         |                   |              | \$               | %          |
|  | (Dollars in Thousands)      |              |                   |              |                  |            |
|  |                             | % of Revenue |                   | % of Revenue |                  |            |
| Research and development                   | \$ 40,189                   | 15%          | \$ 30,000         | 18%          | \$ 10,189        | 34%        |
| Sales and marketing                        | 98,818                      | 37%          | 69,652            | 41%          | 29,166           | 42%        |
| General and administrative                 | 26,118                      | 10%          | 26,149            | 16%          | (31)             | 0%         |
| Amortization of acquired intangible assets | 1,962                       | %            | 811               | %            | 1,151            | 142%       |
| <b>Total</b>                               | <b>\$ 167,087</b>           | <b>62%</b>   | <b>\$ 126,612</b> | <b>75%</b>   | <b>\$ 40,475</b> | <b>32%</b> |

*Research and development.* Research and development expenses consist primarily of personnel expenses, fees for outside consultants, overhead and related expenses associated with the development of new products and the enhancement of existing products.

The 34%, or \$10.2 million, increase in research and development expenses is primarily due to an \$8.1 million increase in employee related expenses, \$803 thousand increased overhead costs such as higher internal IT spending and \$1.1 million in increased depreciation as a result of the Network General acquisition. These expenses increased primarily due to the fact that the fiscal year ended March 31, 2008 included only five months of increased expenses since the Network General acquisition occurred on November 1, 2007. Average headcount in research and development was 244 and 173 for the fiscal years ended March 31, 2009 and 2008, respectively.

*Sales and marketing.* Sales and marketing expenses consist primarily of personnel expenses, including commissions, overhead and other expenses associated with selling activities and marketing programs such as trade shows, seminars, advertising, and new product launch activities.

**Table of Contents**

The 42%, or \$29.2 million, increase in total sales and marketing expenses was primarily due to a \$22.4 million increase in employee related expenses and sales incentive compensation tied directly to the 58% increase in revenue as a result of the acquisition of Network General, \$2.3 million in increased travel expenses, \$577 thousand in increased overhead costs such as higher internal IT spending, \$1.6 million in increased sales office and rent expense from the additional sales offices and \$489 thousand increase in sales meeting expenses. These expenses increased primarily due to the fact that the year ended March 31, 2008 included only five months of increased expenses since the Network General acquisition occurred on November 1, 2007. Average headcount in sales and marketing was 303 and 218 for the fiscal years ended March 31, 2009 and 2008, respectively.

*General and administrative.* General and administrative expenses consist primarily of personnel expenses for executive, financial, legal and human resource employees, overhead and other corporate expenditures.

The \$31 thousand decrease in general and administrative expenses was primarily due to a \$6.0 million increase in employee related expenses, a \$1.1 million increase in depreciation as a result of the Network General acquisition as well as the implementation of an Enterprise Resource Planning, or ERP, system on August 1, 2007, a \$612 thousand increase in additional software licenses required for the additional headcount as a result of the Network General acquisition, a \$570 thousand increase in accounting related fees and expenses and a \$489 thousand increase in bad debt expenses offset by a \$310 thousand decrease in consulting expenses and an \$8.2 million decrease in Network General integration expenses. These expense increases noted above were primarily due to the fact that the year ended March 31, 2008 only included five months of increased expenses since the Network General acquisition occurred on November 1, 2007. Average headcount in general and administrative was 109 and 77 for the fiscal years ended March 31, 2009 and 2008, respectively.

*Amortization of acquired intangible assets.* Amortization of acquired intangible assets consists primarily of amortization of customer relationships related to the acquisition of Network General.

The \$1.2 million increase in amortization of acquired intangible assets was due to amortization of the customer relationships and net beneficial leases acquired in the acquisition of Network General in November 2007, offset by a \$6 thousand decrease in Quantiva, Inc., or Quantiva, non-compete agreement amortization expense which became fully amortized during the first quarter of fiscal year 2008.

**Interest and Other Income (Expense), Net**

Interest and other income (expense), net includes interest earned on our cash, cash equivalents, marketable securities and restricted investments and interest expense.

|  | Fiscal Year Ended March 31, |         | 2008       |      | Change     |        |
|--|-----------------------------|---------|------------|------|------------|--------|
|  | 2009                        |         | 2008       |      |            |        |
|  | (Dollars in Thousands)      |         |            |      |            |        |
|  |                             | % of    | % of       | \$   | %          |        |
|  |                             | Revenue | Revenue    |      |            |        |
| Interest and other income (expense), net | \$ (5,337)                  | (2%)    | \$ (1,207) | (1%) | \$ (4,130) | (342%) |

The \$4.1 million decrease in interest and other income (expense), net was primarily due to the \$2.3 million increase in interest expense associated with debt that we entered into as a result of the acquisition of Network General, and a \$1.8 million decrease in interest income due to the decrease in market interest rates received on investments in marketable securities.

**Income Tax Expense (Benefit)**

The annual effective tax rate for fiscal year 2009 is 35.4%, compared to an annual benefit of (68.1%) for fiscal year 2008. Generally, the annual effective tax rates differ from statutory rates primarily due to the impact of tax exempt interest income, differences in tax rates in foreign jurisdictions and federal and state tax credits.

**Table of Contents**

The difference in our effective tax rate compared to the prior year is primarily the result of our change to a net income position from a loss position in the prior year, a decrease in tax exempt interest income and the impact of federal and state tax credits during fiscal year 2009.

|                              | Fiscal Year Ended March 31, |              | Change     |      |           |      |
|------------------------------|-----------------------------|--------------|------------|------|-----------|------|
|                              | 2009                        | 2008         | \$         | %    |           |      |
|                              | (Dollars in Thousands)      |              |            |      |           |      |
|                              | % of Revenue                | % of Revenue |            |      |           |      |
| Income tax expense (benefit) | \$ 10,993                   | 4%           | \$ (4,461) | (3%) | \$ 15,454 | 346% |
| <b>Net Income (Loss)</b>     |                             |              |            |      |           |      |

Net income (loss) for the fiscal years ended March 31, 2009 and 2008 was as follows:

|                   | Fiscal Year Ended March 31, |              | Change     |      |           |        |
|-------------------|-----------------------------|--------------|------------|------|-----------|--------|
|                   | 2009                        | 2008         | \$         | %    |           |        |
|                   | (Dollars in Thousands)      |              |            |      |           |        |
|                   | % of Revenue                | % of Revenue |            |      |           |        |
| Net income (loss) | \$ 20,048                   | 7%           | \$ (2,088) | (1%) | \$ 22,136 | 1,062% |

The \$22.1 million increase in net income during the fiscal year ended March 31, 2009 was mainly attributable to the increase in total product and service gross profit of \$82.2 million, offset by a \$40.5 million increase in operating expenses mainly due to increased employee related expenses and incentive compensation as well as a \$4.1 million increase in net interest expense.

**Contractual Obligations**

As of March 31, 2010, we had the following contractual obligations:

**Payment due by period (Dollars in thousands)**

| Contractual Obligations                 | Total             | Less than        |                  |                 | More than 5 years |
|---|-------------------|------------------|------------------|-----------------|-------------------|
|   |                   | 1 year           | 1-3 years        | 3-5 years       |                   |
| Short and long-term debt obligations(1) | \$ 84,037         | \$ 13,311        | \$ 70,726        | \$              | \$                |
| Unconditional purchase obligations      | 6,320             | 6,320            |                  |                 |                   |
| Operating lease obligations(2)          | 16,154            | 5,961            | 8,815            | 1,378           |                   |
| Retirement obligations                  | 2,671             | 252              | 1,777            | 398             | 244               |
| <b>Total contractual obligations</b>    | <b>\$ 109,182</b> | <b>\$ 25,844</b> | <b>\$ 81,318</b> | <b>\$ 1,776</b> | <b>\$ 244</b>     |

As of March 31, 2010, the total amount of net unrecognized tax benefits for uncertain tax positions and the accrual for the related interest was \$349 thousand. We are unable to make a reliable estimate when cash settlement, if any, will occur with a tax authority as the timing of examinations and ultimate resolution of those examinations is uncertain.

- (1) Includes accrued interest at an interest rate of 2.688% for our outstanding term loan at March 31, 2010.
- (2) We lease facilities and certain equipment under operating lease agreements extending through September 2013 for a total of \$16.2 million.



## **Table of Contents**

### **Off-Balance Sheet Arrangements**

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements. As such, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

### **Warranty and Indemnification**

We warrant that our software and hardware products will substantially conform to the documentation accompanying such products on their original date of shipment. For software, which also includes firmware, the standard warranty commences upon shipment and expires 90 days thereafter. With regard to hardware, the standard warranty commences upon shipment and expires 12 months thereafter. Additionally, this warranty is subject to various exclusions which include, but are not limited to, non-conformance resulting from modifications made to the software or hardware by a party other than NetScout; customer's failure to follow our installation, operation or maintenance instructions; and events outside of our reasonable control. We also warrant that all support services will be performed in a good and workmanlike manner. We believe that our product and support service warranties are consistent with commonly accepted industry standards. No warranty cost information is presented and no warranty costs are accrued since service revenue associated with warranty is deferred at the time of sale and recognized ratably over the warranty period.

Contracts that we enter into in the ordinary course of business may contain standard indemnification provisions. Pursuant to these agreements, we may agree to defend third party claims brought against a partner or direct customer claiming infringement of such third party's (i) U.S. patent and/or European Union, or EU, or other selected countries' patents, (ii) Berne convention member country copyright, and/or (iii) U.S., EU, and/or other selected countries' trademark or intellectual property rights. Moreover, this indemnity may require us to pay any damages awarded against the partner or direct customer in such type of lawsuit as well as reimburse the partner or direct customer for reasonable attorney's fees incurred by them from the lawsuit.

On limited occasions, we may agree to provide other forms of indemnification to partners or direct customers, such as indemnification that would obligate us to defend and pay any damages awarded to a third party against a partner or direct customer based on a lawsuit alleging that such third party has suffered personal injury or tangible property damage legally determined to have been caused by negligently designed or manufactured products.

In connection with its formation, Network General agreed to indemnify certain stockholders against third-party claims arising out of the stock subscription agreement or services rendered to Network General by those stockholders. We have recorded no liability associated with these indemnifications as we are not aware of any pending or threatened actions or claims against the indemnified parties that are probable losses and consider the likelihood of any successful claims or actions to be remote.

We have agreed to indemnify our directors and officers and our subsidiaries' directors and officers if they are made a party or are threatened to be made a party to any proceeding (other than an action by or in the right of NetScout) by reason of the fact that the indemnified are an agent of NetScout or by reason of anything done or not done by them in any such capacity. This indemnity includes the directors and officers of Network General prior to its acquisition by NetScout on November 1, 2007. The indemnity is for any and all expenses and liabilities of any type (including but not limited to, judgments, fines and amounts paid in settlement) reasonably incurred by the directors or officers in connection with the investigation, defense, settlement or appeal of such proceeding, provided they acted in good faith.



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

Cash, cash equivalents, and marketable securities consist of the following:

|  | 2010                   | As of March 31,<br>2009 | 2008       |
|--|------------------------|-------------------------|------------|
|  | (Dollars in Thousands) |                         |            |
| Cash and cash equivalents                        | \$ 63,322              | \$ 82,222               | \$ 56,702  |
| Short-term marketable securities                 | 69,875                 | 24,162                  | 10,465     |
| Long-term marketable securities                  | 37,354                 | 29,528                  | 33,764     |
| Cash, cash equivalents and marketable securities | \$ 170,551             | \$ 135,912              | \$ 100,931 |

At March 31, 2010, we had a revolving credit facility with a syndicate of lenders led by KeyBank National Association, or KeyBank, which allows us to borrow up to \$10 million for working capital purposes and to obtain letters of credit subject to a sublimit. Amounts outstanding under the facility bear interest at a floating interest rate dependent upon, at our election, LIBOR or KeyBank's prime rate, in each case plus a margin, and are collateralized by substantially all of our assets. Under the agreement, we are required to comply with certain financial covenants which require that we maintain minimum certain amounts of liquidity, the most restrictive of which is a minimum fixed charge coverage ratio of no less than 1.25 to 1.00 and a maximum leverage ratio of less than 3.00 to 1.00. As of March 31, 2010, we were in compliance with such covenants. As of March 31, 2010, no amounts were outstanding under the revolving credit facility.

Cash, cash equivalents, and marketable securities increased by \$34.6 million from March 31, 2009 to March 31, 2010. While cash and cash equivalents decreased by \$18.9 million, short and long-term marketable securities increased in total by \$53.5 million.

Our long-term marketable securities include investments in auction rate securities valued at \$28.5 million at March 31, 2010. Auction rate securities are publicly issued securities with long-term maturities for which interest rates reset through a Dutch auction in short-term intervals, in the case of our securities every 35 days. This mechanism was structured to allow existing investors to roll over their holdings and continue to own their respective securities or liquidate their holdings by selling at par value through the auction process. The Company invested in these securities as part of its cash management program. Historically, this auction process provided liquidity and supported a short-term classification of these securities on the consolidated balance sheet. Beginning in February 2008 and continuing through March 31, 2010, auctions have failed resulting in a lack of short-term liquidity for these securities, which has caused us to classify our auction rate securities within long term marketable securities on the consolidated balance sheet. As of March 31, 2010, our auction rate securities consisted of six positions issued by municipal agencies with a total par value of \$32.4 million and a current estimated market value totaling \$28.5 million. The auction rate securities held by NetScout at March 31, 2010 have maturity dates ranging from December 2032 through December 2039. As of March 31, 2010, these investments have investment grade ratings ranging from AAA to A. These investments are collateralized by student loans with underlying support by the federal government through the Federal Family Education Loan Program and by monoline insurance companies. We have the ability and intent to hold these securities until a recovery in the auction process or other liquidity event occurs. The fair value of these securities has been estimated by management based on the assumptions disclosed in Note 4 to our consolidated financial statements. We will continue to analyze our auction rate securities each reporting period for impairment, and we may be required to record an impairment charge in the consolidated statement of operations if the decline in fair value is determined to be other-than-temporary. The estimated fair value of our auction rate securities could change significantly based on market and economic conditions, including changes in market rates, the estimated timing until a liquidity event, the discount factor associated with illiquidity and the credit ratings of our securities. There is no assurance as to when liquidity will return to this investment class, and therefore, we continue to monitor and evaluate these securities. Subsequent to year end we were notified that a total of \$4.3 million of these holdings were being redeemed at par value, providing liquidity for a portion of these securities. Based on our

**Table of Contents**

expected operating cash flows, and our other sources of cash, we do not expect the lack of liquidity in these investments to affect our ability to execute our current business plan.

Cash and cash equivalents were impacted by the following:

|   | 2010                   | Year Ending March 31,<br>2009 | 2008      |
|---|------------------------|-------------------------------|-----------|
|   | (Dollars in thousands) |                               |           |
| Net cash provided by operating activities           | \$ 47,224              | \$ 44,396                     | \$ 36,336 |
| Net cash (used in) provided by investing activities | (61,075)               | (17,843)                      | 466       |
| Net cash (used in) provided by financing activities | (5,049)                | (1,315)                       | 458       |

*Net cash provided by operating activities.*

Net cash provided by operating activities amounted to \$47.2 million during the fiscal year ended March 31, 2010. The primary sources of operating cash flow in the fiscal year ended March 31, 2010 included net income of \$27.9 million, adjusted to exclude the effects of non-cash items of \$25.6 million, including depreciation and amortization, share-based compensation expense, deferred income taxes, inventory write-downs and loss on disposal of fixed assets, a \$22.3 million increase in deferred revenue resulting from increased billings and a \$5.7 million increase in prepaid income taxes, offset by a \$25.7 million increase in accounts receivable resulting from increased billings, a \$4.0 million decrease in accrued compensation and other expense primarily due to a decrease in non-sales incentive compensation based on Company underperformance in the year ended March 31, 2010. The overall increase in cash provided by operating activities is attributable to net income improvement over the prior year.

Net cash provided by operating activities amounted to \$44.4 million during the fiscal year ended March 31, 2009. The primary sources of operating cash flow in the fiscal year ended March 31, 2009 included net income of \$20.0 million, adjusted to exclude the effects of non-cash items of \$23.8 million, including depreciation and amortization, share-based compensation expense, deferred income taxes and inventory write-downs, an \$8.6 million decrease in prepaid expenses and other current assets mainly due to discontinuance of outsourcing the Network General inventory and a \$4.9 million decrease in inventories, offset by a \$7.8 million increase in accounts receivable resulting from increased revenue and billing and the timing of cash collections and shipments. The overall increase in cash provided by operating activities is attributable to net income improvement over the prior year.

Net cash provided by operating activities amounted to \$36.3 million during the fiscal year ended March 31, 2008. The primary sources of operating cash flow in the fiscal year ended March 31, 2008 included a \$34.5 million increase in deferred revenue including incremental maintenance contract renewals from Network General customers, a \$7.2 million decrease in accounts receivables, net of the effects of the acquisition of the Network General business, as a result of additional sales and the timing of such sales within the fiscal year ended March 31, 2008, offset by a \$3.1 million increase in inventory due to purchases to support anticipated order flow.

*Net cash (used in) provided by investing activities.*

For the fiscal years ended March 31, 2010, 2009 and 2008, cash (used in) provided by investing activities reflects the purchase of marketable securities of \$92.9 million, \$30.3 million and \$32.5 million, respectively, offset by the proceeds from maturities and sales of marketable securities due to cash management activities of \$39.1 million, \$17.4 million and \$69.3 million, respectively. The fiscal year ended March 31, 2010 includes \$408 thousand in capitalized software development costs. The fiscal year ended March 31, 2008 includes cash used in the acquisition of Network General of \$30.9 million, net of cash acquired in such transaction. Cash used in investing activities also includes capital expenditures. Capital expenditures for internal use software of \$515 thousand for the fiscal year ended March 31, 2008 represents costs of procurement and development of a new

---

## **Table of Contents**

ERP system that was implemented in August 2007. Capital expenditures for fixed assets of \$6.8 million, \$5.0 million and \$4.9 million for the fiscal years ended March 31, 2010, 2009 and 2008, respectively, represent an investment in our infrastructure as we prepared for future growth. We anticipate that our investment in our infrastructure will grow in future quarters.

*Net cash (used in) provided by financing activities.*

Net cash used in financing activities was \$5.0 million during the fiscal year ended March 31, 2010. The primary outflow was due to the repayment of \$13.1 million of our long-term debt with KeyBank which included a \$3.1 million excess cash flow payment, offset by \$3.0 million for the net issuance of common stock under stock plans and a tax benefit from stock options exercised of \$5.1 million.

Net cash used in financing activities was \$1.3 million during the fiscal year ended March 31, 2009. The primary outflow was due to the repayment of \$6.3 million of our long-term debt with KeyBank, offset by proceeds from the exercise of stock options in the amount of \$4.6 million and a tax benefit from stock options exercised of \$362 thousand.

Net cash provided by financing activities was \$458 thousand during the fiscal year ended March 31, 2008. The primary source was proceeds received from the incurrence of long-term debt with KeyBank in connection with the re-financing of our senior secured floating rate notes, due in 2012, totaling \$99.0 million net of deferred financing costs, offset by the repayments of long-term debt totaling \$101.3 million which represents repayment of senior secured floating rate notes and the first principal payment on our long-term debt with KeyBank. Cash provided by financing activities for the fiscal year ended March 31, 2008 also included the exercise of stock options in the amount of \$2.7 million.

### ***Liquidity***

We believe that our cash balances, short-term marketable securities classified as available-for-sale and future cash flows generated by operations will be sufficient to meet our anticipated cash needs for working capital, capital expenditures and scheduled principal and interest payments on our debt for at least the next 12 months. If demand for our product were to decrease substantially, our ability to generate cash flow sufficient for our short-term working capital and expenditure needs could be materially impacted.

Additionally, a portion of our cash may be used to acquire or invest in complementary businesses or products or to obtain the right to use complementary technologies. From time to time, in the ordinary course of business, we evaluate potential acquisitions of such businesses, products or technologies such as our acquisition of Network General. If our existing sources of liquidity are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or debt securities. The sale of additional equity or debt securities could result in additional dilution to our stockholders.

At March 31, 2010, we had foreign currency forward contracts with notional amounts totaling \$9.4 million. The valuation of outstanding foreign currency forward contracts at March 31, 2010 resulted in a liability balance of \$359 thousand, reflecting unfavorable contract rates in comparison to current market rates at this date, and an asset balance of \$94 thousand, reflecting favorable contract rates in comparison to current market rates. The counterparty to these forward contracts is a large multinational commercial bank, and we believe the risk of nonperformance is not material. However, we cannot be assured that the financial institution will not be impacted by changes in the economic environment.

### **Recent Accounting Standards**

Fair Value Disclosures. In January 2010, the FASB issued amended standards requiring additional fair value disclosures. The amended standards require disclosures of transfers in and out of Levels I and II of the fair value

---

**Table of Contents**

hierarchy, as well as requiring gross basis disclosures for purchases, sales, issuances and settlements within the Level III reconciliation which will replace the net presentation format. Additionally, the update clarifies the requirement to determine the level of disaggregation for fair value measurement disclosures and to disclose valuation techniques and inputs used for both recurring and nonrecurring fair value measurements in either Level II or Level III. We adopted the new guidance in the fourth quarter of our fiscal year 2010, except for the gross presentation of the Level III rollforward information which is effective for fiscal years beginning after December 15, 2010 (fiscal year 2012 for NetScout). Because these new standards are related primarily to disclosures, their adoption has not had and is not expected to have a significant impact on our financial position or results of operations.

**Revenue Arrangements with Multiple Deliverables.** In September 2009, authoritative guidance on software enabled products was issued. Under this guidance, tangible products that contain software components that work together with the hardware to provide the essential functionality of the tangible product will be removed from the scope of the software revenue recognition guidance. These products will be accounted for under guidance for multiple deliverable arrangements that do not include software. Products that contain software only will continue to be accounted for under the software revenue recognition guidance. Under the new guidance, we will allocate any discount in an arrangement proportionally across all hardware-related deliverables using our best estimate of selling price, rather than under the residual method as described in our current revenue accounting policy footnote. This guidance is effective for fiscal years beginning on or after June 15, 2010 (fiscal year 2012 for NetScout), and early adoption is permitted. We are early adopting the new guidance on April 1, 2010 and do not expect its impact to be significant.

**Variable Interest Entities.** In June 2009, the FASB issued an amendment to the accounting and disclosure requirements for the consolidation of qualifying special-purpose entities. This amendment contains new criteria for determining the primary beneficiary, and increases the frequency of required reassessments to determine whether a company is the primary beneficiary of a variable interest entity. This amendment also contains a new requirement that any term, transaction, or arrangement that does not have a substantive effect on an entity's status as a variable interest entity, a company's power over a variable interest entity, or a company's obligation to absorb losses or its right to receive benefits of an entity must be disregarded in applying the amendment. The elimination of the qualifying special-purpose entity concept and its consolidation exceptions means more entities will be subject to consolidation assessments and reassessments. The amendment is effective as of the beginning of an enterprise's first fiscal year beginning after November 15, 2009 (fiscal year 2011 for NetScout), and for interim periods within that first period, with earlier adoption prohibited. The guidance is not expected to have an impact on our financial position or results of operations, since we do not have any variable interest entities and do not expect to have these entities at adoption.

**Transfers of Financial Assets.** In June 2009, the FASB issued an amendment to the accounting and disclosure requirements for transfers of financial assets. This amendment eliminates the concept of a qualifying special-purpose entity, creates more stringent conditions for reporting a transfer of a portion of a financial asset as a sale, clarifies other sale-accounting criteria, and changes the initial measurement of a transferor's interest in transferred financial assets. This amendment will be effective for transfers of financial assets in fiscal years beginning after November 15, 2009 (fiscal year 2011 for NetScout), and in interim periods within those fiscal years with earlier adoption prohibited. The guidance is not expected to have an impact on our financial position or results of operations, since we do not have any special-purpose entities and do not expect to have these entities at adoption.

***Item 7A. Quantitative and Qualitative Disclosures About Market Risk***

***Market Risk.*** Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our primary market risk exposures are in the areas of illiquidity of auction rate securities, interest rate risk and foreign currency exchange rate risk. We currently do not hedge interest rate exposure, but do not believe that a fluctuation in interest rates would have a material impact on the

---

**Table of Contents**

value of our cash equivalents and marketable securities. Our long-term marketable securities, which consist primarily of auction rate securities, are stated at fair value based on risk adjusted discounted cash flow calculations. Prior to February 2008, these securities typically were stated at par value. While we continue to earn interest on auction rate securities at the maximum contractual rate, these securities are not currently trading and therefore do not currently have a readily determinable market value. Accordingly, par value no longer approximates the estimated fair value of auction rate securities. As a result of their illiquidity, we have recorded a temporary impairment at March 31, 2010 against the carrying value of our auction rate securities.

*Credit Risk.* Our cash equivalents and marketable securities consist primarily of money market instruments, U.S. Treasury bills, certificates of deposit, commercial paper, corporate bonds, municipal obligations and student loan backed auction rate securities.

Additional information regarding auction rate securities is detailed in Note 3 to the Consolidated Financial Statements held by NetScout at March 31, 2010.

At March 31, 2010 and periodically throughout the year, we have maintained cash balances in various operating accounts in excess of federally insured limits. We limit the amount of credit exposure with any one financial institution by evaluating the creditworthiness of the financial institutions with which we invest.

*Interest Rate Risk.* We are exposed to market risks related to fluctuations in interest rates related to our term loan with KeyBank. As of March 31, 2010, we owed \$79.4 million on this loan with a weighted average interest rate of 2.69% effective December 31, 2009 until the next reset date. A sensitivity analysis was performed on the outstanding portion of our debt obligation as of March 31, 2010 and 2009. Should the current weighted average interest rate increase or decrease by 10%, the resulting annual increase or decrease to interest expense would be approximately \$203 thousand and \$388 thousand as of March 31, 2010 and 2009, respectively.

*Foreign Currency Exchange Risk.* As a result of our foreign operations, we face exposure to movements in foreign currency exchange rates, primarily the Euro, British Pound, Canadian Dollar and Indian Rupee. The current exposures arise primarily from expenses denominated in foreign currencies. NetScout currently engages in foreign currency hedging activities in order to limit these exposures.

As of March 31, 2010, we had foreign currency forward contracts with notional amounts totaling \$9.4 million. The valuation of outstanding foreign currency forward contracts at March 31, 2010 resulted in a liability balance of \$359 thousand, reflecting unfavorable contract rates in comparison to current market rates at this date and an asset balance of \$94 thousand reflecting favorable rates in comparison to current market rates. At March 31, 2009 we did not have any foreign currency forward contracts.

We do not use derivative financial instruments for speculative trading purposes. The counterparty to these forward contracts is a multinational commercial bank. We believe the risk of counterparty nonperformance is not material. However, we cannot be assured that the financial institution will not be further impacted by the negative economic environment.

***Item 8. Financial Statements and Supplementary Data***

NetScout's Consolidated Financial Statements and Schedule and Report of Independent Registered Public Accounting Firm appear beginning on page F-1 attached to this report.

***Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure***

There have been no changes in or disagreements with accountants on accounting or financial disclosure matters.

## **Table of Contents**

### ***Item 9A. Controls and Procedures***

#### *Evaluation of Disclosure Controls and Procedures*

As of March 31, 2010, NetScout, under the supervision and with the participation of our management, including the Company's principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(b) promulgated under the Exchange Act. Based upon that evaluation, our principal executive officer and principal financial officer concluded that, as of March 31, 2010, our disclosure controls and procedures were effective in ensuring that material information relating to NetScout, including its consolidated subsidiaries, required to be disclosed by NetScout in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities Exchange Commission's rules and forms, including ensuring that such material information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

#### *Changes in Internal Control over Financial Reporting*

During the year ended March 31, 2010, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Exchange Act Rule 13a-15(f). Our internal control over financial reporting was designed to provide reasonable assurance regarding reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. 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. Our management assessed the effectiveness of our internal control over financial reporting as of March 31, 2010. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission, or COSO, in Internal Control - Integrated Framework. Based on our assessment, we concluded that our internal control over financial reporting was effective as of March 31, 2010.

The effectiveness of the Company's internal control over financial reporting as of March 31, 2010 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein at F-2 of this Annual Report on Form 10-K.

### ***Item 9B. Other Information***

Not applicable.

**Table of Contents**

**PART III**

***Item 10. Directors and Executive Officers of the Registrant***

The information required by this Item 10 is included under the captions Directors and Executive Officers, Election of Directors, Section 16(a) Beneficial Ownership Reporting Compliance, Code of Ethics, The Board of Directors and its Committees and Corporate Governance in our definitive Proxy Statement with respect to our 2010 Annual Meeting of Stockholders to be filed with the SEC no later than 120 days after the end of the fiscal year and is incorporated herein by reference.

***Item 11. Executive Compensation***

The information required by this Item 11 is included under the caption Compensation and Other Information Concerning Executive Officers in our definitive Proxy Statement with respect to our 2010 Annual Meeting of Stockholders to be filed with the SEC not later than 120 days after the end of the fiscal year and is incorporated herein by reference.

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

The information required by this Item 12 is included under the captions Security Ownership of Certain Beneficial Owners and Management and Equity Compensation Plan Information in our definitive Proxy Statement with respect to our 2010 Annual Meeting of Stockholders to be filed with the SEC not later than 120 days after the end of the fiscal year and is incorporated herein by reference.

***Item 13. Certain Relationships and Related Transactions***

The information required by this Item 13 is included, as applicable, under the captions Director Independence, Employment and Other Agreements and Transactions with Related Persons in our definitive Proxy Statement with respect to our 2010 Annual Meeting of Stockholders to be filed with the SEC not later than 120 days after the end of the fiscal year and is incorporated herein by reference.

***Item 14. Principal Accountant Fees and Services***

The information required by this Item 14 is included under the captions Auditors Fees and Services and Policy on Audit Committee Pre-approval of Audit and Non-audit Services in our definitive Proxy Statement with respect to our 2010 Annual Meeting of Stockholders to be filed with the SEC not later than 120 days after the end of the fiscal year and is incorporated herein by reference.

**Table of Contents**

**PART IV**

***Item 15. Exhibits and Financial Statement Schedule***

|        |   |     |
|--------|---|-----|
| (a) 1. | Consolidated Financial Statements.  |     |
|        | Report of Independent Registered Public Accounting Firm   | F-2 |
|        | Consolidated Balance Sheets as of March 31, 2010 and 2009   | F-3 |
|        | Consolidated Statements of Operations for the Years Ended March 31, 2010, 2009 and 2008   | F-4 |
|        | Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss) for the Years Ended March 31, 2010, 2009 and 2008   | F-5 |
|        | Consolidated Statements of Cash Flows for the Years Ended March 31, 2010, 2009 and 2008   | F-6 |
|        | Notes to Consolidated Financial Statements  | F-7 |
| 2.     | Financial Statement Schedule.   |     |
|        | Valuation and Qualifying Accounts   | S-1 |
|        | No other financial statement schedules have been included because they are either not applicable or the information is in the financial statements.                                       |     |
| 3.     | List of Exhibits.   |     |
|        | We hereby file as part of, or incorporate by reference into, this Annual Report on Form 10-K the exhibits listed on the index to exhibits immediately following the financial statements. |     |
| (b)    | We hereby file as part of this Annual Report on Form 10-K the exhibits listed in Item 15(a)(3) above.   |     |
| (c)    | We hereby file as part of this Annual Report on Form 10-K the financial statement schedule listed in Item 15(a)(2) above.   |     |



**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.

NETSCOUT SYSTEMS, INC.

By: */s/* ANIL K. SINGHAL  
**Anil K. Singhal**  
**President, Chief Executive Officer,**  
**and Chairman**

Date: May 28, 2010

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.

| <b>Signature</b>  | <b>Title(s)</b>   | <b>Date</b>  |
|---|---|--------------|
| <i>/s/</i> ANIL K. SINGHAL<br><b>Anil K. Singhal</b>              | President, Chief Executive Officer, and<br>Chairman (Principal Executive Officer)                         | May 28, 2010 |
| <i>/s/</i> DAVID P. SOMMERS<br><b>David P. Sommers</b>            | Senior Vice President, General Operations and<br>Chief Financial Officer (Principal Financial<br>Officer) | May 28, 2010 |
| <i>/s/</i> JEFFREY R. WAKELY<br><b>Jeffrey R. Wakely</b>          | Vice President, Finance and Chief Accounting<br>Officer (Principal Accounting Officer)                    | May 28, 2010 |
| <i>/s/</i> VICTOR A. DEMARINES<br><b>Victor A. DeMarines</b>      | Director  | May 28, 2010 |
| <i>/s/</i> JOHN R. EGAN<br><b>John R. Egan</b>                    | Director  | May 28, 2010 |
| <i>/s/</i> JOSEPH G. HADZIMA, JR.<br><b>Joseph G. Hadzima, Jr</b> | Director  | May 28, 2010 |
| <i>/s/</i> STUART MCGUIGAN<br><b>Stuart McGuigan</b>              | Director  | May 28, 2010 |
| <i>/s/</i> VINCENT J. MULLARKEY<br><b>Vincent J. Mullarkey</b>    | Director  | May 28, 2010 |
| <i>/s/</i> STEPHEN PEARSE<br><b>Stephen Pearse</b>                | Director  | May 28, 2010 |

**Stephen Pearse**

**Table of Contents**

**NetScout Systems, Inc.**

**Index to Consolidated Financial Statements**

|  |     |
|--|-----|
| <u>Report of Independent Registered Public Accounting Firm</u>   | F-2 |
| <u>Consolidated Balance Sheets as of March 31, 2010 and 2009</u>   | F-3 |
| <u>Consolidated Statements of Operations for the Years Ended March 31, 2010, 2009 and 2008</u>   | F-4 |
| <u>Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss) for the Years Ended March 31, 2010, 2009 and 2008</u> | F-5 |
| <u>Consolidated Statements of Cash Flows for the Years Ended March 31, 2010, 2009 and 2008</u>   | F-6 |
| <u>Notes to Consolidated Financial Statements</u>  | F-7 |

F-1

---

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of NetScout Systems, Inc.:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15 (a)(1) present fairly, in all material respects, the financial position of NetScout Systems, Inc. and its subsidiaries at March 31, 2010 and 2009, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2010 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 index appearing under Item 15 (a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2010, 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 these financial statements and the financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide 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.

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.

/s/ PRICEWATERHOUSECOOPERS LLP

Boston, Massachusetts

May 28, 2010

**Table of Contents****NetScout Systems, Inc.****Consolidated Balance Sheets****(In thousands, except share and per share data)**

|   | March 31,<br>2010 | March 31,<br>2009 |
|---|-------------------|-------------------|
| <b>Assets</b>   |                   |                   |
| Current assets:   |                   |                   |
| Cash and cash equivalents   | \$ 63,322         | \$ 82,222         |
| Marketable securities   | 69,875            | 24,162            |
| Accounts receivable, net of allowance for doubtful accounts of \$427 and \$572 at March 31, 2010 and 2009, respectively   | 65,556            | 39,827            |
| Inventories   | 9,181             | 6,850             |
| Prepaid income taxes  | 2,730             | 8,389             |
| Deferred income taxes   | 2,698             | 2,796             |
| Prepaid expenses and other current assets   | 5,422             | 4,939             |
| <b>Total current assets</b>   | <b>218,784</b>    | <b>169,185</b>    |
| Fixed assets, net   | 12,773            | 13,848            |
| Goodwill  | 128,177           | 128,177           |
| Acquired intangible assets, net   | 53,573            | 59,610            |
| Deferred income taxes   | 30,062            | 34,941            |
| Long-term marketable securities   | 37,354            | 29,528            |
| Other assets  | 1,878             | 1,445             |
| <b>Total assets</b>   | <b>\$ 482,601</b> | <b>\$ 436,734</b> |
| <b>Liabilities and Stockholders Equity</b>  |                   |                   |
| Current liabilities:  |                   |                   |
| Accounts payable  | \$ 7,307          | \$ 6,385          |
| Accrued compensation  | 19,806            | 23,156            |
| Accrued other   | 5,051             | 5,407             |
| Income taxes payable  |                   | 1,702             |
| Current portion of long-term debt   | 11,250            | 10,000            |
| Deferred revenue  | 84,196            | 70,815            |
| <b>Total current liabilities</b>  | <b>127,610</b>    | <b>117,465</b>    |
| Other long-term liabilities   | 551               | 771               |
| Accrued long-term retirement benefits   | 1,645             | 1,330             |
| Long-term deferred revenue  | 17,846            | 8,937             |
| Long-term debt, net of current portion  | 68,106            | 82,500            |
| <b>Total liabilities</b>  | <b>215,758</b>    | <b>211,003</b>    |
| Commitments and contingencies (Note 16)   |                   |                   |
| Stockholders equity:  |                   |                   |
| Preferred stock, \$0.001 par value: 5,000,000 shares authorized; no shares issued or outstanding at March 31, 2010 and 2009   |                   |                   |
| Common stock, \$0.001 par value: 150,000,000 shares authorized; 46,490,166 and 44,811,729 shares issued and 41,769,680 and 40,279,712 shares outstanding at March 31, 2010 and 2009, respectively | 46                | 45                |
| Additional paid-in capital  | 209,146           | 192,844           |
| Accumulated other comprehensive loss  | (1,817)           | (1,461)           |

## Edgar Filing: NETSCOUT SYSTEMS INC - Form 10-K

|   |            |            |
|---|------------|------------|
| Treasury stock at cost, 4,720,584 and 4,532,017 shares at March 31, 2010 and 2009, respectively | (31,691)   | (28,939)   |
| Retained earnings   | 91,159     | 63,242     |
| Total stockholders' equity  | 266,843    | 225,731    |
| Total liabilities and stockholders' equity  | \$ 482,601 | \$ 436,734 |

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

F-3

**Table of Contents**

## NetScout Systems, Inc.

## Consolidated Statements of Operations

(In thousands, except per share data)

|  | Year ended March 31, |                  |                   |
|--|----------------------|------------------|-------------------|
|  | 2010                 | 2009             | 2008              |
| <b>Revenue:</b>  |                      |                  |                   |
| Product  | \$ 142,113           | \$ 154,161       | \$ 106,182        |
| Service  | 118,229              | 113,443          | 62,774            |
| <b>Total revenue</b>   | <b>260,342</b>       | <b>267,604</b>   | <b>168,956</b>    |
| <b>Cost of revenue:</b>  |                      |                  |                   |
| Product  | 35,564               | 43,315           | 33,965            |
| Service  | 20,500               | 20,824           | 13,721            |
| <b>Total cost of revenue</b>   | <b>56,064</b>        | <b>64,139</b>    | <b>47,686</b>     |
| <b>Gross profit</b>  | <b>204,278</b>       | <b>203,465</b>   | <b>121,270</b>    |
| <b>Operating expenses:</b>   |                      |                  |                   |
| Research and development   | 36,650               | 40,189           | 30,000            |
| Sales and marketing  | 99,059               | 98,818           | 69,652            |
| General and administrative   | 20,609               | 26,118           | 26,149            |
| Amortization of acquired intangible assets                           | 2,057                | 1,962            | 811               |
| <b>Total operating expenses</b>                                      | <b>158,375</b>       | <b>167,087</b>   | <b>126,612</b>    |
| <b>Income (loss) from operations</b>                                 | <b>45,903</b>        | <b>36,378</b>    | <b>(5,342)</b>    |
| <b>Interest and other income (expense):</b>                          |                      |                  |                   |
| Interest income  | 644                  | 2,031            | 3,813             |
| Interest expense   | (3,464)              | (6,287)          | (4,019)           |
| Other expense, net   | (12)                 | (1,081)          | (1,001)           |
| <b>Total interest and other income (expense), net</b>                | <b>(2,832)</b>       | <b>(5,337)</b>   | <b>(1,207)</b>    |
| <b>Income (loss) before income tax expense (benefit)</b>             | <b>43,071</b>        | <b>31,041</b>    | <b>(6,549)</b>    |
| <b>Income tax expense (benefit)</b>                                  | <b>15,154</b>        | <b>10,993</b>    | <b>(4,461)</b>    |
| <b>Net income (loss)</b>   | <b>\$ 27,917</b>     | <b>\$ 20,048</b> | <b>\$ (2,088)</b> |
| <b>Basic net income (loss) per share</b>                             | <b>\$ 0.69</b>       | <b>\$ 0.51</b>   | <b>\$ (0.06)</b>  |
| <b>Diluted net income (loss) per share</b>                           | <b>\$ 0.67</b>       | <b>\$ 0.49</b>   | <b>\$ (0.06)</b>  |
| <b>Weighted average common shares outstanding used in computing:</b> |                      |                  |                   |
| Net income (loss) per share basic                                    | 40,691               | 39,351           | 34,913            |
| Net income (loss) per share diluted                                  | 41,915               | 40,925           | 34,913            |

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





**Table of Contents**

## NetScout Systems, Inc.

**Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss)**

(In thousands, except share data)

|  | Common<br>stock Voting |           | Accumulated<br>Other<br>Comprehensive<br>Income |         | Treasury stock |              | Retained<br>Earnings | Total<br>Stockholders'<br>Equity | Comprehensive<br>Income<br>(Loss) |
|--|------------------------|-----------|---|---------|----------------|--------------|----------------------|----------------------------------|-----------------------------------|
|  | Shares                 | Par Value | Additional<br>Paid In<br>Capital                | (Loss)  | Shares         | Stated Value |                      |                                  |                                   |
| Balance, March 31, 2007  | 36,581,852             | \$ 36     | \$ 122,074                                      | \$ (46) | 4,532,017      | \$ (28,939)  | \$ 45,282            | \$ 138,407                       |                                   |
| Net Loss   |                        |           |   |         |                |              | (2,088)              | (2,088)                          | \$ (2,088)                        |
| Net unrealized investment losses   |                        |           |   | (145)   |                |              |                      | (145)                            | (145)                             |
| Current translation adjustment   |                        |           |   | 437     |                |              |                      | 437                              | 437                               |
| Comprehensive loss   |                        |           |   |         |                |              |                      |                                  | \$ (1,796)                        |
| Issuance of common stock pursuant to exercise of options                         | 532,211                | 1         | 2,735   |         |                |              |                      | 2,736                            |                                   |
| Issuance of common stock pursuant to vesting of restricted stock units           | 256,739                |           |   |         |                |              |                      |                                  |                                   |
| Issuance of common stock pursuant to acquisition of Network General              | 6,000,000              | 6         | 55,911  |         |                |              |                      | 55,917                           |                                   |
| Stock-based compensation expense for stock options granted to employees          |                        |           | 175   |         |                |              |                      | 175                              |                                   |
| Stock-based compensation expense for restricted stock units granted to employees |                        |           | 1,868   |         |                |              |                      | 1,868                            |                                   |
| Stock-based compensation expense for awards granted to non-employees             |                        |           | 26  |         |                |              |                      | 26                               |                                   |
| Balance, March 31, 2008  | 43,370,802             | 43        | 182,789   | 246     | 4,532,017      | (28,939)     | 43,194               | 197,333                          |                                   |
| Net Income   |                        |           |   |         |                |              | 20,048               | 20,048                           | \$ 20,048                         |
| Net unrealized investment losses   |                        |           |   | (1,707) |                |              |                      | (1,707)                          | (1,707)                           |
| Comprehensive income   |                        |           |   |         |                |              |                      |                                  | \$ 18,341                         |
| Issuance of common stock pursuant to exercise of options                         | 819,580                | 2         | 4,571   |         |                |              |                      | 4,573                            |                                   |
| Issuance of common stock pursuant to vesting of restricted stock units           | 621,347                |           |   |         |                |              |                      |                                  |                                   |
| Stock-based compensation expense for stock options granted to employees          |                        |           | 141   |         |                |              |                      | 141                              |                                   |
| Stock-based compensation expense for restricted stock units granted to employees |                        |           | 4,981   |         |                |              |                      | 4,981                            |                                   |
| Tax benefits of disqualifying dispositions of incentive stock options            |                        |           | 362   |         |                |              |                      | 362                              |                                   |
| Balance, March 31, 2009  | 44,811,729             | 45        | 192,844   | (1,461) | 4,532,017      | (28,939)     | 63,242               | 225,731                          |                                   |
| Net Income   |                        |           |   |         |                |              | 27,917               | 27,917                           | \$ 27,917                         |
| Net unrealized investment losses   |                        |           |   | (196)   |                |              |                      | (196)                            | (196)                             |
| Net unrealized losses on derivative financial instruments                        |                        |           |   | (160)   |                |              |                      | (160)                            | (160)                             |
| Comprehensive income   |                        |           |   |         |                |              |                      |                                  | \$ 27,561                         |

Edgar Filing: NETSCOUT SYSTEMS INC - Form 10-K

|   |            |       |            |            |           |             |           |            |
|---|------------|-------|------------|------------|-----------|-------------|-----------|------------|
| Issuance of common stock pursuant to exercise of options  | 1,026,771  | 1     | 5,790      |            |           |             |           | 5,791      |
| Issuance of common stock pursuant to vesting of restricted stock units and repurchase of common stock for net settlements | 651,666    |       |            | 188,567    | (2,752)   |             |           | (2,752)    |
| Stock-based compensation expense for stock options granted to employees   |            |       | 10         |            |           |             |           | 10         |
| Stock-based compensation expense for restricted stock units granted to employees  |            |       | 5,446      |            |           |             |           | 5,446      |
| Tax benefits of disqualifying dispositions of incentive stock options   |            |       | 5,056      |            |           |             |           | 5,056      |
| Balance, March 31, 2010   | 46,490,166 | \$ 46 | \$ 209,146 | \$ (1,817) | 4,720,584 | \$ (31,691) | \$ 91,159 | \$ 266,843 |

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

F-5

**Table of Contents**

## NetScout Systems, Inc.

## Consolidated Statements of Cash Flows

(In thousands)

|  | Year Ended March 31, |           |            |
|--|----------------------|-----------|------------|
|  | 2010                 | 2009      | 2008       |
| <b>Cash flows from operating activities:</b>   |                      |           |            |
| Net income (loss)  | \$ 27,917            | \$ 20,048 | \$ (2,088) |
| Adjustments to reconcile net income (loss) to cash provided by operating activities: |                      |           |            |
| Depreciation and amortization  | 14,357               | 13,805    | 8,726      |
| Loss on disposal of fixed assets   | 258                  | 8         | 13         |
| Inventory write-down   | 309                  | 300       | 316        |
| Share-based compensation expense associated with equity awards                       | 5,456                | 5,122     | 2,069      |
| Deferred income taxes  | 5,189                | 8,225     | (1,812)    |
| Changes in assets and liabilities, net of the effects of acquisitions                |                      |           |            |
| Accounts receivable  | (25,729)             | (7,779)   | 7,161      |
| Inventories  | (2,171)              | 4,933     | (3,079)    |
| Prepaid income taxes   | 5,659                | (3,353)   | (4,379)    |
| Prepaid expenses and other current assets  | (380)                | 8,640     | (2,494)    |
| Other assets   | (25)                 | 798       | 1,114      |
| Accounts payable   | (238)                | (2,822)   | (2,040)    |
| Accrued compensation and other expenses  | (3,966)              | (2,897)   | (2,545)    |
| Income taxes payable   | (1,702)              | 637       | 873        |
| Deferred revenue   | 22,290               | (1,269)   | 34,501     |
| Net cash provided by operating activities  | 47,224               | 44,396    | 36,336     |
| <b>Cash flows from investing activities:</b>   |                      |           |            |
| Purchase of marketable securities  | (92,919)             | (30,326)  | (32,495)   |
| Proceeds from maturities and sales of marketable securities                          | 39,064               | 17,449    | 69,277     |
| Purchase of fixed assets   | (6,812)              | (4,966)   | (4,858)    |
| Acquisition of Network General, net of cash acquired                                 |                      |           | (30,943)   |
| Capitalized expenditures for internal use software                                   |                      |           | (515)      |
| Capitalized software development costs   | (408)                |           |            |
| Net cash (used in) provided by investing activities                                  | (61,075)             | (17,843)  | 466        |
| <b>Cash flows from financing activities:</b>   |                      |           |            |
| Issuance of common stock under stock plans, net                                      | 3,039                | 4,573     | 2,736      |
| Proceeds from issuance of long-term debt, net of issuance costs                      |                      |           | 98,972     |
| Repayment of long-term debt  | (13,144)             | (6,250)   | (101,250)  |
| Excess tax benefit from stock options exercised                                      | 5,056                | 362       |            |
| Net cash (used in) provided by financing activities                                  | (5,049)              | (1,315)   | 458        |
| Effect of exchange rate changes on cash and cash equivalents                         |                      | 282       | 517        |
| Net (decrease) increase in cash and cash equivalents                                 | (18,900)             | 25,520    | 37,777     |
| Cash and cash equivalents, beginning of year   | 82,222               | 56,702    | 18,925     |
| Cash and cash equivalents, end of year   | \$ 63,322            | \$ 82,222 | \$ 56,702  |

## Edgar Filing: NETSCOUT SYSTEMS INC - Form 10-K

### Supplemental disclosure of cash flow information:

|                            |          |          |          |
|----------------------------|----------|----------|----------|
| Cash paid for interest     | \$ 3,063 | \$ 5,878 | \$ 3,503 |
| Cash paid for income taxes | \$ 2,897 | \$ 4,859 | \$ 2,652 |

### Supplemental disclosure of non-cash investing and financing activities:

|   |    |    |            |
|---|----|----|------------|
| Common stock issued in connection with the acquisition of Network General | \$ | \$ | \$ 56,100  |
| Issuance of debt in connection with the acquisition of Network General    | \$ | \$ | \$ 100,000 |

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

F-6

**Table of Contents**

**NetScout Systems, Inc.**

**Notes to Consolidated Financial Statements**

**1. Nature of Business**

NetScout Systems, Inc., or NetScout or the Company, designs, develops, manufactures, markets, sells and supports market leading unified service delivery management, service assurance and application and network performance management solutions focused on assuring service delivery for the world's largest, most demanding and complex internet protocol, or IP, based service delivery environments. NetScout manufactures and markets these products in integrated hardware and software solutions that are used by commercial enterprises, large governmental agencies and telecommunication service providers worldwide. NetScout has a single operating segment and substantially all of its identifiable assets are located in the United States.

**2. Summary of Significant Accounting Policies**

**Basis of Presentation**

The consolidated financial statements include the accounts of NetScout and its wholly-owned subsidiaries. All inter-company transactions and balances have been eliminated in consolidation.

**Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles, or GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates in these financial statements include revenue recognition, valuation of inventories, assumptions related to purchase accounting, valuation of goodwill and acquired intangible assets, capitalization of software development costs, derivative financial instruments, purchased software and internal use software, share-based compensation and income taxes. These items are continuously monitored and analyzed by management for changes in facts and circumstances and material changes in these estimates could occur in the future.

**Cash and Cash Equivalents and Marketable Securities**

Under current authoritative guidance, NetScout has classified its investments as available-for-sale which are carried at fair value based on quoted market prices and associated unrealized gains or losses are recorded as a separate component of stockholders' equity until realized. NetScout considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents and those with maturities greater than three months are considered to be marketable securities. Cash equivalents and short-term marketable securities are stated at cost plus accrued interest, which approximates fair value.

Refer to Note 3 for further information regarding cash, cash equivalents and marketable securities held by NetScout at March 31, 2010.

At March 31, 2010 and periodically throughout the year, NetScout has maintained cash balances in various operating accounts in excess of federally insured limits. NetScout limits the amount of credit exposure by investing only with credit worthy institutions.

**Restricted Investment**

NetScout has a restricted investment account related to a deferred compensation plan of \$988 thousand and \$1.2 million as of March 31, 2010 and 2009, respectively, which is included in prepaid and other current assets. At March 31, 2010, there were unrealized gains of \$51 thousand recorded as accumulated other comprehensive

---

**Table of Contents**

**NetScout Systems, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

income (loss) related to this investment. At March 31, 2009, there were unrealized gains of \$42 thousand recorded as accumulated other comprehensive income (loss) related to this investment. The restriction on the investment account has no impact on the fair value as the restriction would not pass to another party in the event of the sale of the investments.

**Revenue Recognition**

Product revenue consists of sales of NetScout's hardware products and licensing of its software products. Product revenue is recognized upon shipment, provided that evidence of an arrangement exists, title and risk of loss have passed to the customer, fees are fixed or determinable and collection of the related receivable is probable. Because NetScout has determined that the software components of its products are more than incidental to the functionality and value of these products, the Company recognizes revenue in accordance with authoritative guidance for software revenue recognition.

Service revenue consists primarily of fees from customer support agreements, consulting and training. NetScout generally provides software and hardware support as part of product sales. Revenue related to the initial bundled software and hardware support is recognized ratably over the support period. In addition, customers can elect to purchase extended support agreements for periods after the initial software warranty expiration, typically for 12-month periods. Revenue from customer support agreements is recognized ratably over the support period. Revenue from consulting and training services is recognized as the work is performed.

The Company enters into multiple element arrangements in the normal course of business with its customers. Each element in such arrangements is analyzed and a portion of the total fee under the arrangement is allocated to the undelivered elements, primarily support agreements and training, using vendor specific objective evidence of fair value of the element, and the remaining portion of the total fee is allocated to the delivered elements (i.e., generally, hardware products and licensed software products), regardless of any separate prices stated within the contract for each element, under the residual method. Vendor specific objective evidence of fair value is based on the price customers pay when the element is sold separately. The separate sales of the undelivered elements is reviewed on a semi-annual basis and, when appropriate, vendor-specific objective evidence of fair value for such elements is updated to ensure that it reflects recent pricing experience.

As discussed in the Recent Accounting Standards section of this footnote, our accounting for revenue arrangements will change next fiscal year with the adoption of new authoritative guidance.

**Commission Expense**

We recognize commission expense related to the renewal of maintenance contracts at the time an order is booked. As a result, commission expense can be recognized in full even though the related revenue may not be fully recognized. Commission expense on product revenue and corresponding new maintenance contracts is recognized in the same period as related product revenue, typically upon shipment.

**Uncollected Deferred Product Revenue**

Because of NetScout's revenue recognition policies, there are circumstances for which the Company does not recognize revenue relating to sales transactions that have been billed, but the related account receivable has not been collected. While the receivable represents an enforceable obligation, for balance sheet presentation purposes, NetScout has not recognized the deferred revenue or the related account receivable and no amounts

---

**Table of Contents**

**NetScout Systems, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

appear in the consolidated balance sheets for such transactions. The aggregate amount of unrecognized accounts receivable and deferred revenue was \$2.0 million and \$1.2 million at March 31, 2010 and 2009, respectively.

**Concentration of Credit Risk and Significant Customers**

Financial instruments, which include cash, cash equivalents, short-term marketable securities, accounts receivable and accounts payable, are stated at cost, plus accrued interest where applicable, which approximates fair value. Long-term marketable securities include auction rate securities which are currently illiquid, corporate bonds and certificates of deposit. Auction rate securities are stated at fair value based on discounted cash flow calculations. At March 31, 2010, the Company had one customer which accounted for more than 10% of the accounts receivable balance. At March 31, 2009, no one customer or channel partner accounted for more than 10% of the accounts receivable balance. No one direct customer or indirect channel partner accounted for more than 10% of total revenue during the fiscal years ended March 31, 2010, 2009 and 2008. Historically, the Company has not experienced any significant non-performance by its customers nor does the Company anticipate non-performance by its customers in the future; accordingly, the Company does not require collateral.

**Inventories**

Inventories are stated at the lower of actual cost or net realizable value. Cost is determined by using the first-in, first-out, or FIFO, method.

**Fixed Assets**

Fixed assets are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized on a straight-line basis over the shorter of the lease term or anticipated useful life of the improvement. Gains and losses upon asset disposal are recognized in the year of disposition. Expenditures for replacements and building improvements are capitalized, while expenditures for maintenance and repairs are charged against earnings as incurred.

**Assumptions Related to Purchase Accounting and the Valuation of Goodwill and Acquired Intangible Assets**

NetScout accounts for acquisitions using the purchase method of accounting. This method requires estimates to determine the fair values of assets and liabilities acquired, including judgments to determine any acquired intangible assets such as customer relationships and developed product technology, as well as assessments of the fair value of existing assets such as property and equipment. Liabilities acquired can include reserves for litigation and other contingencies and require judgment in ascertaining a reasonable value. Independent appraisals may be used to assist in the determination of the fair value of certain assets and liabilities, but even those determinations would be based on significant estimates provided by us, such as forecasted revenues or profits on contract-related intangibles. Many factors are typically considered in the purchase accounting assessments, which are conducted by Company professionals from legal, finance, human resources, information systems, research and development, sales and executive management. Significant changes in assumptions and estimates subsequent to completing the allocation of purchase price to the assets and liabilities acquired, as well as differences in actual results versus estimates, could result in material impacts to earnings.

NetScout amortizes acquired intangible assets over their estimated useful lives on a straight-line basis, except for an acquired tradename which has an indefinite life and thus, is not amortized. NetScout considered the

---

**Table of Contents**

**NetScout Systems, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

economic consumption method for amortizing acquired intangible assets and determined that the straight-line method was preferable given the amount of subjectivity involved in projecting the timing of cash flows related to the acquired intangibles. The Company periodically reviews long-lived assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives of these assets are no longer appropriate. The carrying value of the indefinite lived tradename is evaluated for potential impairment on an annual basis. At March 31, 2010, NetScout determined that there had been no impairment of acquired intangible assets or indefinite lived intangible assets. Significant judgment and estimates are made when estimating fair value and useful lives for acquired intangible assets.

NetScout assesses goodwill for impairment at the enterprise-level at least annually or more frequently when events and circumstances occur indicating that the recorded goodwill may be impaired. If the carrying amount of goodwill exceeds the implied fair value, an impairment loss will be recorded in an amount equal to that excess. At March 31, 2010 and March 31, 2009, NetScout determined that there had been no impairment of goodwill.

See Note 7 for additional disclosures on the Company's Goodwill and Acquired Intangible Assets.

**Capitalized Software Development Costs**

Costs incurred in the research and development of the Company's products are expensed as incurred, except for certain software development costs. Costs associated with the development of computer software are expensed prior to the establishment of technological feasibility and capitalized thereafter until the related software products are available for first customer shipment.

Capitalized software development costs are periodically assessed for recoverability in the event of changes to the anticipated future revenue for the software products or changes in product technologies. Unamortized capitalized software development costs that are determined to be in excess of the net realizable value of the software products would be expensed in the period in which such a determination is made. See Note 8 for additional disclosure on capitalized software development costs.

**Derivative Financial Instruments**

The FASB's authoritative guidance establishes accounting and reporting standards for derivative instruments and hedging activities. All hedging activities must be documented at the inception of the hedge and must meet the definition of highly effective in offsetting changes to future cash flows in order for the derivative to qualify for hedge accounting. Under the guidance, if an instrument qualifies for hedge accounting, the changes in the fair value each period for open contracts, measured as of the end of the period, are recorded to other comprehensive income. Otherwise, changes in the fair value are recorded in earnings each period. Management must perform initial and ongoing tests in order to qualify for hedge accounting. In accordance with the guidance, we account for our instruments under hedge accounting. The effectiveness and a measurement of ineffectiveness of qualifying hedge contracts is assessed by NetScout quarterly. We record the fair value of our derivatives in other current assets and other current liabilities. The effective portion of gains or losses resulting from changes in the fair value of qualifying hedges are recorded in other comprehensive income (loss) until the forecasted transaction occurs, with any ineffective portion classified directly to our consolidated statement of operations based on the expense categories of the items being hedged. When forecasted transactions occur, unrealized gains or losses associated with the effective portion of the hedge are reclassified to the respective expense categories in our consolidated statement of operations. Gains or losses related to hedging activity are included as operating activities in our consolidated statement of cash flows.



**Table of Contents**

**NetScout Systems, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

**Share-based Compensation**

NetScout recognizes compensation expense for all share-based payments granted after April 1, 2006 and those shares granted in prior periods but not yet vested as of April 1, 2006, in accordance with GAAP. Under the fair value recognition provisions, share-based compensation is calculated net of an estimated forfeiture rate and compensation cost is only recognized for those shares expected to vest on a straight-line basis over the requisite service period of the award.

**Foreign Currency**

NetScout accounts for its reporting of foreign operations in accordance with guidance which establishes guidelines for the determination of the functional currency of foreign subsidiaries. NetScout's foreign subsidiaries are an extension of NetScout's U.S. operations. All revenue transactions are generated out of the Company's U.S. headquarters in U.S. dollars. In accordance with the guidance, NetScout has determined its functional currency for its foreign subsidiaries to be the U.S. dollar. Foreign subsidiary expenses that are denominated in a currency other than the functional currency are translated at the foreign exchange rate in effect at the time the transaction is recorded.

NetScout will experience currency exchange risk with respect to those foreign currency denominated expenses. In order to partially offset the risks associated with the effects of certain foreign currency exposures, NetScout has established a program that utilizes foreign currency forward contracts. Under this program, increases or decreases in foreign currency exposures are partially offset by gains or losses on forward contracts, to mitigate the impact of foreign currency transaction gains or losses. The Company does not use forward contracts to engage in currency speculation. All outstanding foreign currency forward contracts are recorded at fair value at the end of each fiscal period. For further information see Note 9.

**Advertising Expense**

NetScout recognizes advertising expense as incurred. Advertising expense was \$201 thousand, \$366 thousand and \$267 thousand for the years ended March 31, 2010, 2009 and 2008, respectively.

**Comprehensive Income (Loss)**

Comprehensive income (loss) is comprised of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) typically consists of unrealized gains and losses on marketable securities and restricted investments, unrealized gain (loss) on hedge contracts and foreign currency translation adjustments.

**Income Taxes**

NetScout accounts for its income taxes under the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized based on anticipated future tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective tax bases, as well as the effect of any net operating loss and tax credit carryforwards. Income tax expense (benefit) is comprised of the current tax liability or benefit and the change in deferred tax assets and liabilities. A valuation allowance is established to the extent that it is more likely than not that the deferred tax assets will not be realized.

---

**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****2. Summary of Significant Accounting Policies (Continued)****Net Income (Loss) Per Share**

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period, excluding shares of common stock subject to repurchase. Diluted net income (loss) per share is computed by dividing net income (loss) by the sum of the weighted average number of shares of common stock outstanding during the period and the weighted average number of potential common stock from the assumed exercise of stock options assuming such potential shares are not antidilutive, repurchased shares of common stock and restricted stock units under the treasury stock method.

**Recent Accounting Standards**

**Fair Value Disclosures.** In January 2010, the FASB issued amended standards requiring additional fair value disclosures. The amended standards require disclosures of transfers in and out of Levels I and II of the fair value hierarchy, as well as requiring gross basis disclosures for purchases, sales, issuances and settlements within the Level III reconciliation which will replace the net presentation format. Additionally, the update clarifies the requirement to determine the level of disaggregation for fair value measurement disclosures and to disclose valuation techniques and inputs used for both recurring and nonrecurring fair value measurements in either Level II or Level III. The Company adopted the new guidance in the fourth quarter of our fiscal year 2010, except for the gross presentation of the Level III rollforward information which is effective for fiscal years beginning after December 15, 2010 (fiscal year 2012 for the Company). Because these new standards are related primarily to disclosures, their adoption has not had and is not expected to have a significant impact on the Company's financial position or results of operations.

**Revenue Arrangements with Multiple Deliverables.** In September 2009, authoritative guidance on software enabled products was issued. Under this guidance, tangible products that contain software components that work together with the hardware to provide the essential functionality of the tangible product will be removed from the scope of the software revenue recognition guidance. These products will be accounted for under guidance for multiple deliverable arrangements that do not include software. Products that contain software only will continue to be accounted for under the software revenue recognition guidance. Under the new guidance the Company will allocate any discount in an arrangement proportionally across all hardware-related deliverables using its best estimate of selling price, rather than under the residual method as described in its current revenue accounting policy footnote. This guidance is effective for fiscal years beginning on or after June 15, 2010 (fiscal year 2012 for the Company), and early adoption is permitted. The Company is early adopting the new guidance on April 1, 2010 and does not expect its impact to be significant.

**Variable Interest Entities.** In June 2009, the FASB issued an amendment to the accounting and disclosure requirements for the consolidation of qualifying special-purpose entities. This amendment contains new criteria for determining the primary beneficiary, and increases the frequency of required reassessments to determine whether a company is the primary beneficiary of a variable interest entity. This amendment also contains a new requirement that any term, transaction, or arrangement that does not have a substantive effect on an entity's status as a variable interest entity, a company's power over a variable interest entity, or a company's obligation to absorb losses or its right to receive benefits of an entity must be disregarded in applying the amendment. The elimination of the qualifying special-purpose entity concept and its consolidation exceptions means more entities will be subject to consolidation assessments and reassessments. The amendment is effective as of the beginning of an enterprise's first fiscal year beginning after November 15, 2009 (fiscal year 2011 for the Company), and for interim periods within that first period, with earlier adoption prohibited. The guidance is not expected to have an

**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****2. Summary of Significant Accounting Policies (Continued)**

impact on the Company's financial position or results of operations, since the Company does not have any variable interest entities and does not expect to have these entities at adoption.

**Transfers of Financial Assets.** In June 2009, the FASB issued an amendment to the accounting and disclosure requirements for transfers of financial assets. This amendment eliminates the concept of a qualifying special-purpose entity, creates more stringent conditions for reporting a transfer of a portion of a financial asset as a sale, clarifies other sale-accounting criteria, and changes the initial measurement of a transferor's interest in transferred financial assets. This amendment will be effective for transfers of financial assets in fiscal years beginning after November 15, 2009 (fiscal year 2011 for the Company), and in interim periods within those fiscal years with earlier adoption prohibited. The guidance is not expected to have an impact on the Company's financial position or results of operations, since the Company does not have any special-purpose entities and does not expect to have these entities at adoption.

**3. Cash, Cash Equivalents and Marketable Securities**

Cash and cash equivalents consisted of money market instruments and cash maintained with various financial institutions at March 31, 2010 and 2009.

The following is a summary of marketable securities held by NetScout at March 31, 2010 classified as short-term and long-term (in thousands):

|   | Amortized<br>Cost | Unrealized<br>Gains<br>(Losses) | Fair<br>Value |
|---|-------------------|---------------------------------|---------------|
| Type of security (see Note 4):            |                   |                                 |               |
| U.S. government and municipal obligations | \$ 42,026         | \$ 59                           | \$ 42,085     |
| Commercial paper                          | 8,993             |                                 | 8,993         |
| Corporate bonds                           | 9,039             | (15)                            | 9,024         |
| Certificate of deposits                   | 10,761            |                                 | 10,761        |
| Subtotal                                  | 70,819            | 44                              | 70,863        |
| Less: restricted investment               | 937               | 51                              | 988           |
| Total short-term marketable securities    | 69,882            | (7)                             | 69,875        |
| Auction rate securities                   | 32,399            | (3,924)                         | 28,475        |
| U.S. government and municipal obligations | 2,032             | (4)                             | 2,028         |
| Corporate bonds                           | 3,589             | (2)                             | 3,587         |
| Certificate of deposits                   | 3,266             | (2)                             | 3,264         |
| Total long-term marketable securities     | 41,286            | (3,932)                         | 37,354        |
|   | \$ 111,168        | \$ (3,939)                      | \$ 107,229    |

Maturity dates for short-term marketable securities held at March 31, 2010 range from April 2010 to March 2011. Maturity dates for long-term marketable securities held at March 31, 2010, which consist of auction rate securities, corporate bonds and certificate of deposits, range from April 2011 to December 2039.



**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****3. Cash, Cash Equivalents and Marketable Securities (Continued)**

The following is a summary of marketable securities held by NetScout at March 31, 2009, classified as short-term and long-term (in thousands):

|   | Amortized<br>Cost | Unrealized<br>Gains<br>(Losses) | Fair<br>Value |
|---|-------------------|---------------------------------|---------------|
| Type of security (see Note 4):            |                   |                                 |               |
| U.S. government and municipal obligations | \$ 20,911         | \$ 77                           | \$ 20,988     |
| Corporate bonds                           | 4,397             | (26)                            | 4,371         |
| Subtotal                                  | 25,308            | 51                              | 25,359        |
| Less: restricted investment               | 1,155             | 42                              | 1,197         |
| Total short-term marketable securities    | 24,153            | 9                               | 24,162        |
| Auction rate securities                   | 33,161            | (3,633)                         | 29,528        |
| Total long-term marketable securities     | 33,161            | (3,633)                         | 29,528        |
|   | 57,314            | (3,624)                         | 53,690        |

Maturity dates for short-term marketable securities held at March 31, 2009 range from April 2009 to March 2010. Maturity dates for long-term marketable securities held at March 31, 2010, which consist of auction rate securities, range from December 2032 to December 2039.

The Company's long-term marketable securities include investments in auction rate securities valued at \$28.5 million at March 31, 2010. Beginning in February 2008 and continuing through the March 31, 2010, auctions have failed resulting in a lack of short-term liquidity for these securities, which has caused the Company to classify its auction rate securities as long-term marketable securities on the consolidated balance sheet. As of March 31, 2010, the Company's auction rate securities consisted of six positions issued by municipal agencies with a total par value of \$32.4 million and a current estimated market value totaling \$28.5 million. These auction rate securities have maturity dates ranging from December 2032 through December 2039. As of March 31, 2010 these investments have investment grade ratings ranging from AAA to A by Standard and Poor's. These investments are collateralized by student loans with underlying support by the federal government through the Federal Family Education Loan Program and by monoline insurance companies. The Company has the ability and intent to hold these securities until a recovery in the auction process or other liquidity event occurs.

At March 31, 2010, the Company valued its auction rate securities at fair value using a discounted cash flow model. This model estimated future interest income using maximum rate formulas applicable to each of these securities which consider historical spreads for benchmark rates included in these formulas as well as rates for U.S. Treasuries. The model then discounts the estimated future interest income using a risk based discount rate that considers known U.S. Treasury yields as of March 31, 2010, historical spreads in comparison to U.S. Treasuries at the last date on which the market was considered active for these securities, and a liquidity risk premium of 350 basis points. As these securities have retained investment grade credit ratings with Standard and Poor's, the Company has not applied a credit spread to its discount rate. The valuation also includes assumptions as to when these securities will return to liquidity, of which the weighted average period is estimated at between 53 and 57 months depending on the security being valued. This valuation resulted in a cumulative temporary decline in value of \$3.9 million (\$2.4 million, net of tax) as of March 31, 2010 recorded within accumulated other comprehensive income (loss) on the balance sheet. This represents an incremental decline in the fair value of these securities by \$291 thousand (\$179 thousand, net of tax) during the fiscal year ended March 31, 2010. The decline during this time was due to changes in market interest rates used to value the securities.



**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****3. Cash, Cash Equivalents and Marketable Securities (Continued)**

The Company does not currently intend to sell its auction rate securities. Based on the Company's current cash position, expected operating cash flows and the Company's other sources of cash, the Company does not believe that it is more likely than not that it will be required to sell the securities for working capital before a recovery in the auction process or other liquidity event occurs. Additionally, the Company believes that the present value of expected future cash flows consisting of interest payments and the return of principal is sufficient to recover the amortized cost basis of the securities and expects to collect these cash flows. Therefore, the Company does not believe that the decline in value of its auction rate securities is other than temporary, or that any portion of the temporary decline is the result of a credit loss.

**4. Fair Value Measurements**

On April 1, 2008, the first day of the Company's fiscal year 2009, the Company adopted the authoritative guidance for fair value measurements and the fair value option for financial assets and financial liabilities. The guidance did not have a material impact on its financial position or results of operations.

The guidance clarifies the definition of fair value as an exit price representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. The following summarizes the three-tier value hierarchy, which prioritizes, in descending order, the inputs used in measuring fair value as follows:

|           |  |
|-----------|--|
| Level I   | Observable inputs such as quoted prices in active markets,   |
| Level II  | Inputs other than the quoted prices in active markets that are observable either directly or indirectly, and               |
| Level III | Unobservable inputs in which there is little or no market data, which requires the Company to develop its own assumptions. |

This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company measures certain financial assets and liabilities at fair value, including its marketable securities and derivative financial instruments. The Company's investment instruments, except for auction rate securities, listed below are classified within Level I of the fair value hierarchy because they are valued using quoted market prices or alternative pricing sources with reasonable levels of price transparency. The Company's derivative financial instruments consist of forward foreign exchange contracts and are classified as Level II because the fair values of these derivatives are determined using models based on market observable inputs, including spot prices for foreign currencies and credit derivatives, as well as an interest rate factor. For further information on the Company's derivative instruments refer to Note 9. The Company's auction rate securities are classified as Level III of the fair value hierarchy due to the limited market data for pricing these securities.

**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****4. Fair Value Measurements (Continued)**

The following table summarizes the valuation of the Company's financial assets and liabilities by the above categories as of March 31, 2010 (in thousands):

|   | <b>Total<br/>Fair Value</b> | <b>Level I</b> | <b>Level II</b> | <b>Level III</b> |
|---|-----------------------------|----------------|-----------------|------------------|
| <b>ASSETS:</b>                            |                             |                |                 |                  |
| Cash and cash equivalents                 | \$ 63,322                   | \$ 63,322      |                 |                  |
| U.S. government and municipal obligations | 44,113                      | 44,113         |                 |                  |
| Commercial paper                          | 8,993                       | 8,993          |                 |                  |
| Corporate bonds                           | 12,611                      | 12,611         |                 |                  |
| Certificate of deposits                   | 14,025                      | 14,025         |                 |                  |
| Less: restricted investment               | (988)                       | (988)          |                 |                  |
| Auction rate securities                   | 28,475                      |                |                 | 28,475           |
| Derivative asset                          | 94                          |                | 94              |                  |
|   | \$ 170,645                  | \$ 142,076     | \$ 94           | \$ 28,475        |
| <b>LIABILITIES:</b>                       |                             |                |                 |                  |
| Derivative financial instruments          | \$ 359                      | \$             | \$ 359          | \$               |
|   | \$ 359                      | \$             | \$ 359          | \$               |

Effective April 1, 2009, the Company adopted the authoritative guidance which provides additional guidelines for making fair value measurements more consistent with the principles presented and provides authoritative guidance in determining whether a market is active or inactive, and whether a transaction is distressed. This guidance is applicable to all assets and liabilities (i.e. financial and nonfinancial) and requires enhanced disclosures, including interim and annual disclosure of the input and valuation techniques (or changes in techniques) used to measure fair value and defining the major security types comprising debt and equity securities held based upon the nature and risk of the security. The adoption of this guidance did not impact our financial position or results of operations.

The Company has concluded that no other-than-temporary impairment of its auction rate securities has occurred because it believes that the declines in fair value that have occurred are due to general market conditions and these investments continue to be of high credit quality. Additionally, the Company does not currently intend to sell these securities, it is more likely than not that the Company will not be required to sell these securities before recovering their cost basis and the Company expects to recover the entire amortized cost basis in these securities. The Company will continue to analyze its auction rate securities each reporting period for impairment and it may be required to record an impairment charge in the consolidated statement of operations if the decline in fair value is determined to be other-than-temporary. The estimated fair value of the Company's auction rate securities could change significantly based on market and economic conditions, including changes in market rates, the estimated timing until a liquidity event, or the discount factor associated with illiquidity and the credit ratings of its securities. There is no assurance as to when liquidity will return to this investment class, and therefore, the Company continues to monitor and evaluate these securities. For further information on the Company's approach to valuing these securities refer to Note 3.

In April 2009, the FASB amended the existing guidance on determining whether an impairment for investments in debt securities is other-than-temporary. The impairment model for equity securities was not affected. For debt securities, under the new guidance, an other-than-temporary impairment must be recognized





**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****4. Fair Value Measurements (Continued)**

through earnings if an investor has the intent to sell the debt security or if it is more likely than not that the investor will be required to sell the debt security before recovery of its amortized cost basis. Also, even if an investor does not expect to sell a debt security, it must evaluate expected cash flows to be received to determine if the amortized cost basis of the security exceeds the present value of expected future cash flows. In the event of an expected credit loss, only the amount associated with the credit loss is recognized in income. The amount of loss relating to other factors is recorded in accumulated other comprehensive income. The guidance also requires additional disclosures regarding the calculation of expected credit losses and the factors considered in reaching a conclusion that an investment is not other-than-temporarily impaired. The Company does not currently intend to sell its auction rate securities. Based on the Company's expected operating cash flows and the Company's other sources of cash, the Company does not expect the lack of liquidity in these investments to affect its ability to continue to hold the securities until a recovery in the auction process or other liquidity event occurs. Additionally, the Company believes that the present value of expected future cash flows is sufficient to recover the amortized cost basis of the securities. Therefore, the Company does not believe that the decline in value of its auction rate securities is other than temporary or any portion of the temporary decline is the result of a credit loss. As such, the adoption of the new guidance did not have a material impact on its financial position or results of operations and the Company continues to classify impairments of auction rate securities as temporary.

The following table provides a summary of changes in fair value of our Level III financial assets (in thousands):

|   | March 31, |           |
|---|-----------|-----------|
|   | 2010      | 2009      |
| Balance at beginning of period  | \$ 29,528 | \$ 33,764 |
| Total gains or (losses) (realized or unrealized)                            |           |           |
| Change in accrued interest receivable                                       | (112)     | (487)     |
| Unrealized losses included in accumulated other comprehensive income (loss) | (291)     | (3,349)   |
| Redemptions   | (650)     | (400)     |
| Balance at end of period  | \$ 28,475 | \$ 29,528 |

**5. Inventories**

Inventories are stated at the lower of actual cost or net realizable value. Cost is determined by using the first-in, first-out, or FIFO, method. Inventories consist of the following (in thousands):

|                 | March 31, |          |
|-----------------|-----------|----------|
|                 | 2010      | 2009     |
| Raw materials   | \$ 5,184  | \$ 4,138 |
| Work in process | 269       | 249      |
| Finished goods  | 3,728     | 2,463    |
|                 | \$ 9,181  | \$ 6,850 |

**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****6. Fixed Assets**

Fixed assets consist of the following (in thousands):

|  | Estimated<br>Useful<br>Life in<br>Years | March 31, |           |
|--|---|-----------|-----------|
|  |   | 2010      | 2009      |
| Furniture and fixtures                       | 3-7                                     | \$ 3,149  | \$ 2,999  |
| Computer equipment and internal use software | 3-5                                     | 35,081    | 37,231    |
| Demonstration and spare part units           | 2                                       | 3,966     | 5,032     |
| Leasehold improvements                       | 4-12                                    | 4,941     | 4,807     |
|  |   | 47,137    | 50,069    |
| Less accumulated depreciation                |   | (34,364)  | (36,221)  |
|  |   | \$ 12,773 | \$ 13,848 |

Depreciation expense on fixed assets for the years ended March 31, 2010, 2009 and 2008 was \$8.3 million, \$7.8 million and \$5.7 million, respectively.

Through April 13, 2007, certain costs incurred in the procurement and development of an Enterprise Resource Planning, or ERP, system were capitalized in accordance with authoritative guidance. Preliminary project planning costs associated with the project were expensed as incurred, while software license, integration, testing and other direct costs associated with the application development phase were capitalized. As of March 31, 2010, capitalized software costs for the ERP system totaling \$3.8 million are included on the consolidated balance sheet within fixed assets. Amortization of internal use software began on August 1, 2007 and is being recorded on a straight-line basis over five years. Amortization of internal use software was \$768 thousand, \$768 thousand and \$512 thousand for the years ended March 31, 2010, 2009 and 2008.

**7. Goodwill & Acquired Intangible Assets****Goodwill**

The carrying amount of goodwill was \$128.2 million as of March 31, 2010 and 2009. The Company's goodwill resulted from the acquisition of Network General in November 2007, the acquisition of substantially all of the assets of Quantiva, Inc. in April 2005 and the acquisition of NextPoint Networks, Inc. in July 2000.

The change in the carrying amount of goodwill for the fiscal years ended March 31, 2010 and 2009 is as follows (in thousands):

|                                      |            |
|--------------------------------------|------------|
| Balance as of March 31, 2008         | \$ 131,802 |
| Purchase price allocation adjustment | (3,625)    |
| Balance as of March 31, 2009         | \$ 128,177 |

Balance as of March 31, 2010

\$ 128,177

F-18

**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****7. Goodwill & Acquired Intangible Assets (Continued)****Acquired Intangible Assets**

Acquired intangible assets consist of the following as of March 31, 2010 (in thousands):

|                            | Cost      | Accumulated<br>Amortization | Net       |
|----------------------------|-----------|-----------------------------|-----------|
| Acquired software          | \$ 19,900 | \$ (9,618)                  | \$ 10,282 |
| Customer relationships     | 29,200    | (4,553)                     | 24,647    |
| Indefinite lived tradename | 18,600    |                             | 18,600    |
| Net beneficial leases      | 336       | (292)                       | 44        |
|                            | \$ 68,036 | \$ (14,463)                 | \$ 53,573 |

Acquired intangible assets consist of the following as of March 31, 2009 (in thousands):

|                            | Cost      | Accumulated<br>Amortization | Net       |
|----------------------------|-----------|-----------------------------|-----------|
| Acquired software          | \$ 19,900 | \$ (5,638)                  | \$ 14,262 |
| Customer relationships     | 29,200    | (2,669)                     | 26,531    |
| Indefinite lived tradename | 18,600    |                             | 18,600    |
| Net beneficial leases      | 336       | (119)                       | 217       |
|                            | \$ 68,036 | \$ (8,426)                  | \$ 59,610 |

Amortization of acquired software included as cost of product revenue was \$4.0 million, \$4.0 million and \$2.1 million for the fiscal years ended March 31, 2010, 2009 and 2008, respectively. Amortization of other acquired intangible assets included as operating expense was \$2.1 million, \$2.0 million and \$832 thousand for the fiscal years ended March 31, 2010, 2009 and 2008, respectively.

The following is the expected future amortization expense as of March 31, 2010 for the years ended March 31 (in thousands):

|              |                  |
|--------------|------------------|
| 2011         | \$ 5,887         |
| 2012         | 5,885            |
| 2013         | 4,206            |
| 2014         | 1,884            |
| 2015         | 1,884            |
| Thereafter   | 15,227           |
| <b>Total</b> | <b>\$ 34,973</b> |

The weighted average useful life of acquired intangible assets is 11 years.

**8. Capitalized Software Development Costs**

As of March 31, 2010, capitalized software development costs totaled \$408 thousand. Amortization of capitalized software development costs will begin once the project is ready for sale to the general public, which is expected to be in the first half of the Company's fiscal year 2011. No other costs were capitalized related to

**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****8. Capitalized Software Development Costs (Continued)**

other research and development projects during fiscal years ended March 31, 2010, 2009 and 2008 since the amounts subject to capitalization were not material according to guidance from the FASB. Amortization of capitalized software development costs for previously capitalized software products, which became fully amortized during fiscal year 2009, was \$6 thousand and \$164 thousand for the fiscal years ended March 31, 2009 and 2008, respectively.

**9. Derivative Instruments and Hedging Activities**

NetScout operates internationally and, in the normal course of business, is exposed to fluctuations in foreign currency exchange rates. The exposures result from costs that are denominated in currencies other than the U.S. dollar, primarily the Euro, British Pound, Canadian Dollar, and Indian Rupee. During the year ended March 31, 2010, the Company began managing its foreign currency transaction risk by hedging forecasted cash flows for operating expenses for up to twelve months, within specified guidelines through the use of forward contracts. The Company enters into foreign currency exchange contracts to hedge cash flow exposures from costs that are denominated in currencies other than the U.S. dollar. These hedges are designated as cash flow hedges at inception.

All of the Company's derivative instruments are utilized for risk management purposes, and the Company does not use derivatives for speculative trading purposes. As of March 31, 2010, the Company had open contracts with notional amounts totaling \$9.4 million that mature over the next twelve months.

The following table summarizes the Company's fair value of outstanding derivatives at March 31, 2010 (in thousands):

|  | Asset Derivatives<br>Balance Sheet<br>Location | Fair<br>Value | Liability Derivatives<br>Balance Sheet Location | Fair<br>Value |
|--|--|---------------|---|---------------|
| Derivatives designated as hedging instruments: |  |               |   |               |
| Foreign currency exchange forward contracts    | Other current assets                           | \$ 94         | Accrued other liabilities                       | \$ 359        |
| <b>Total</b>                                   |  | <b>\$ 94</b>  |   | <b>\$ 359</b> |

The following table provides the effect foreign exchange forward contracts had on other comprehensive loss and results of operations as of March 31, 2010 (in thousands):

|   | Effective Portion  |  |  | Ineffective Portion   |   |
|---|--|--|--|---|---|
|   | Amount of<br>Gain or (Loss)<br>Recognized<br>in<br>OCI on<br>Derivative<br>(a) | Location of<br>Gain or (Loss)<br>Reclassified from<br>Accumulated OCI<br>into Income | Amount of<br>Gain or (Loss)<br>Reclassified from<br>Accumulated<br>OCI into<br>Income<br>(b) | Location of<br>Gain or (Loss)<br>Recognized in<br>Income on<br>Derivative | Amount of<br>Gain or (Loss)<br>Recognized in<br>Income on Derivative<br>(amount excluded from<br>effectiveness<br>testing)<br>(c) |
| Derivatives in<br>Cash Flow<br>Hedging<br>Relationships |  |  |  |   |   |
| Forward contracts                                       | \$ (474)   | Research and<br>development  | \$ (6)   | Research and<br>development   | (\$ 3)  |

Edgar Filing: NETSCOUT SYSTEMS INC - Form 10-K

|  |                     |    |       |                     |    |     |
|--|---------------------|----|-------|---------------------|----|-----|
|  | Sales and marketing | \$ | (209) | Sales and marketing | \$ | 1   |
|  |                     | \$ | (474) |                     | \$ | (2) |

F-20



**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****9. Derivative Instruments and Hedging Activities (Continued)**

- (a) The amount represents the change in fair value of derivative contracts due to changes in spot rates.
- (b) The amount represents reclassification from other comprehensive income to earnings that occurs when the hedged item affects earnings.
- (c) The amount represents the change in fair value of derivative contracts due to changes in the difference between the spot price and forward price that is excluded from the assessment of hedge effectiveness and therefore recognized in earnings. No amounts were recognized in income due to ineffectiveness.

**10. Long-term Debt**

In December 2007, the Company entered into a credit facility with a syndicate of lenders led by KeyBank National Association, or KeyBank, providing a term loan of \$100 million and a \$10 million revolving credit facility, or the Credit Facility, pursuant to a Credit Agreement, dated as of December 21, 2007, by and among the Company, KeyBank and the other parties thereto, or the Credit Agreement. The proceeds of the \$100 million term loan were used to redeem all of the Company's outstanding senior secured floating rate notes issued in connection with the acquisition of Network General on November 1, 2007. The \$10 million revolving credit facility replaced a previous \$5 million revolving credit facility with Silicon Valley Bank. No amounts were outstanding under the revolving credit facility as of March 31, 2010.

At the Company's election, revolving loans and the term loan under the Credit Agreement bear interest at either (1) a rate per annum equal to the greater of KeyBank's prime rate or 0.5% in excess of the federal funds effective rate, or the Alternative Base Rate, or (2) the one-, two-, three-, or six-month per annum LIBOR, as selected by the Company, multiplied by the statutory reserve adjustment, collectively the Eurodollar Rate, in each case plus an applicable margin. The applicable margin varies depending on the Company's consolidated leverage ratio ranging from 175 basis points for Alternative Base Rate loans and 300 basis points for Eurodollar Rate loans if the Company's consolidated leverage ratio is 2.50 to 1.00 or higher, down to 75 basis points for Alternative Base Rate loans and 200 basis points for Eurodollar Rate loans if the Company's consolidated leverage ratio is 1.00 to 1.00 or less. The consolidated leverage ratio is the ratio of funded indebtedness to adjusted earnings before interest, taxes, depreciation and amortization, or EBITDA. At March 31, 2009, the term loan incurred interest at 4.375%. As of March 31, 2010, the applicable interest rate on the term loan was 2.688%, and the Company expects this to be the rate in effect until June 30, 2010.

Payments of principal on the term loan commenced on March 31, 2008, and will be made in regular quarterly installments. As of March 31, 2010, the aggregate annual repayment amounts are as follows for the years ended March 31 (in thousands):

|       |           |
|-------|-----------|
| 2011  | \$ 11,250 |
| 2012  | 15,000    |
| 2013  | 53,106    |
| Total | \$ 79,356 |

The Credit Agreement contains financial covenants that stipulate a maximum leverage ratio of 3.00 to 1.00 and a minimum fixed-charge coverage ratio of 1.25 to 1.00. As of March 31, 2010, the Company was in compliance with all covenants. Substantially all of the Company's assets serve as collateral under the Credit Agreement. Subject to certain exceptions, the Credit Agreement contains provisions for mandatory prepayments including from (a) 100% of the net proceeds from certain asset sales by the Company and its subsidiaries,

**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****10. Long-term Debt (Continued)**

(b) 100% of the net proceeds from the issuance of debt, (c) annually, subject to the Company's leverage ratio, either 25% or 50% of the annual excess cash flow of the Company and its subsidiaries as defined in the Credit Agreement, (d) 50% of the net proceeds from the issuance of equity by the Company and its subsidiaries and (e) 100% of the net proceeds from insurance recovery and condemnation events of the Company and its subsidiaries. The Company made a \$3.1 million payment during the second quarter of fiscal year 2010 as a result of the annual excess cash flow calculation based on the year ended March 31, 2009 financial results. An excess cash flow payment was not triggered for the year ended March 31, 2010. The Company may also prepay loans under the Credit Agreement, including the term loan, at any time, without penalty, subject to certain notice requirements.

**11. Net Income (Loss) Per Share**

Calculations of the basic and diluted net income (loss) per share and potential common shares are as follows (in thousands, except share and per share data):

|  | 2010       | Year ended March 31,<br>2009 | 2008       |
|--|------------|------------------------------|------------|
| <b>Basic:</b>                              |            |                              |            |
| Net income (loss)                          | \$ 27,917  | \$ 20,048                    | \$ (2,088) |
| Weighted average common shares outstanding | 40,690,854 | 39,351,294                   | 34,912,980 |
| Basic net income (loss) per share          | \$ 0.69    | \$ 0.51                      | \$ (0.06)  |
| <b>Diluted:</b>                            |            |                              |            |
| Net income (loss)                          | \$ 27,917  | \$ 20,048                    | \$ (2,088) |
| Weighted average common shares outstanding | 40,690,854 | 39,351,294                   | 34,912,980 |
| Weighted average stock options             | 710,763    | 1,026,331                    |            |
| Weighted average restricted stock units    | 513,402    | 547,711                      |            |
| Diluted weighted average shares            | 41,915,019 | 40,925,336                   | 34,912,980 |
| Diluted net income (loss) per share        | \$ 0.67    | \$ 0.49                      | \$ (0.06)  |

The following table sets forth common stock and restricted stock units excluded from the calculation of diluted net income (loss) per share, since their inclusion would be antidilutive. This is due to the exercise prices exceeding the average market price of the Company's common stock during the years ended March 31, 2010 and 2009 or due to the net loss incurred during the year ended March 31, 2008.

|                        | Year ended March 31, |         |           |
|------------------------|----------------------|---------|-----------|
|                        | 2010                 | 2009    | 2008      |
| Stock options          | 200,497              | 223,719 | 1,456,476 |
| Restricted stock units | 5,697                | 30,903  | 199,747   |

**12. Treasury Stock**

## Edgar Filing: NETSCOUT SYSTEMS INC - Form 10-K

On September 17, 2001, the Company announced an open market stock repurchase program to purchase up to one million shares of outstanding Company common stock, subject to market conditions and other factors. Any purchases under the Company's stock repurchase program may be made from time to time without

F-22

---

**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****12. Treasury Stock (Continued)**

prior notice. On July 26, 2006, the Company announced that it had expanded the existing open market stock repurchase program to enable the Company to purchase up to an additional three million shares of the Company's outstanding common stock, bringing the total number of shares authorized for repurchase to four million shares. Through March 31, 2010, the Company had repurchased a total of 486,794 shares of common stock through the open market stock repurchase program. The Company did not repurchase any shares during the fiscal years ended March 31, 2010, 2009 and 2008, respectively.

In connection with the vesting and release of the restriction on previously vested shares of restricted stock, we repurchased 188,567 shares for \$2.8 million related to minimum statutory tax withholding requirements on these restricted stock units during the fiscal year ended March 31, 2010. We did not have any such repurchases during the fiscal years ended March 31, 2009 and 2008, respectively. These repurchase transactions do not fall under the repurchase program described above, and therefore do not reduce the amount that is available for repurchase under that program.

**13. Stock Plans****1999 Stock Option and Incentive Plan**

In April 1999, NetScout adopted the 1999 Stock Option and Incentive Plan, or the 1999 Stock Option Plan. The 1999 Stock Option Plan, which was replaced by the 2007 Equity Incentive Plan effective September 12, 2007, provided for the grant of share-based awards to employees, officers and directors, consultants or advisors. Under the 1999 Stock Option Plan, NetScout could grant options that were intended to qualify as incentive stock options, options not intended to qualify as incentive stock options, restricted stock and other share-based awards. Incentive stock options could be granted only to employees of NetScout. As of March 31, 2010, options to purchase an aggregate of 812,751 shares of common stock at a weighted average exercise price of \$7.60 per share were outstanding under the 1999 Stock Option Plan. No additional grants can be made under the 1999 Stock Option Plan.

**2007 Equity Incentive Plan**

In September 2007, the 2007 Equity Incentive Plan, or the 2007 Plan, replaced the 1999 Stock Option Plan. The 2007 Plan permits the granting of stock options, restricted stock and restricted stock units, collectively referred to as share-based awards. Periodically, the Company grants share-based awards to employees and officers of the Company and its subsidiaries. The Company accounts for these share-based awards in accordance with GAAP, which requires the measurement and recognition of compensation expense based on estimated fair values for all share-based payment awards made to our employees and directors. Share-based award grants are generally measured at fair value on the date of grant based on the number of shares granted and the quoted price of the Company's common stock. Such value is recognized as a cost of revenue or an operating expense over the corresponding vesting period. A total of 5,000,000 equity awards are reserved for issuance under the 2007 Plan. As of March 31, 2010, an aggregate of 1,073,497 equity awards were outstanding under the 2007 Plan.

The 2007 Plan is administered by the Compensation Committee of the Board of Directors. For administrative convenience, the Board of Directors established the Equity Compensation Committee, which was responsible until April 29, 2009 for granting share-based awards to employees and consultants of the Company who are not directors or executive officers of the Company. The Equity Compensation Committee operated under guidelines established by the Board of Directors. The Equity Compensation Committee had the authority to select the employees and consultants to whom awards are granted (except for directors and executive officers) and determine the terms of each award, including the number of shares of common stock subject to the award.

**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****13. Stock Plans (Continued)**

On April 29, 2009, the activities previously undertaken by the Equity Compensation Committee reverted to the Compensation Committee.

Share-based awards generally vest over four years. The exercise price of incentive stock options shall not be less than 100% of the fair market value of the common stock at the date of grant (110% for incentive stock options granted to holders of more than 10% of the voting stock of NetScout). The term of options granted cannot exceed ten years (five years for incentive stock options granted to holders of more than 10% of the voting stock of NetScout).

Based on historical experience, the Company assumed an annualized forfeiture rate of 0% for awards granted to its directors during fiscal years 2010, 2009, and 2008, and an annualized forfeiture rate of 10% for awards granted to its senior executives and remaining employees during fiscal years 2010, 2009 and 2008.

The following is a summary of share-based compensation expense for the years ended March 31, 2010, 2009 and 2008 (in thousands):

|                            | Year ended March 31, |          |          |
|----------------------------|----------------------|----------|----------|
|                            | 2010                 | 2009     | 2008     |
| Cost of product revenue    | \$ 129               | \$ 119   | \$ 57    |
| Cost of service revenue    | 237                  | 217      | 78       |
| Research and development   | 1,364                | 1,278    | 502      |
| Sales and marketing        | 2,299                | 2,232    | 997      |
| General and administrative | 1,427                | 1,276    | 435      |
|                            | \$ 5,456             | \$ 5,122 | \$ 2,069 |

Transactions under the 1990 and 1999 Stock Option Plans, the 1997 and 2000 Stock Incentive Plans and the 2007 Equity Incentive Plan during the fiscal years ended March 31, 2008, 2009 and 2010 are summarized as follows:

|                                    | Stock Options    |                                 | Restricted Stock Units |                             |
|------------------------------------|------------------|---------------------------------|------------------------|-----------------------------|
|                                    | Number of Shares | Weighted Average Exercise Price | Number of Awards       | Weighted Average Fair Value |
| Outstanding-March 31, 2007         | 3,274,289        | \$ 6.28                         | 617,624                | \$ 6.42                     |
| Granted                            |                  |                                 | 1,981,647              | 9.51                        |
| Exercised (Options)/Issued (RSU s) | (532,211)        | 5.14                            | (256,739)              | 5.97                        |
| Canceled                           | (26,117)         | 7.70                            | (55,516)               | 7.96                        |
| Outstanding-March 31, 2008         | 2,715,961        | 6.49                            | 2,287,016              | 9.11                        |
| Granted                            |                  |                                 | 263,102                | 11.65                       |
| Exercised (Options)/Issued (RSU s) | (819,580)        | 5.58                            | (621,445)              | 8.84                        |
| Canceled                           | (3,450)          | 6.22                            | (176,972)              | 9.21                        |
| Outstanding-March 31, 2009         | 1,892,931        | 6.89                            | 1,751,701              | 9.58                        |
| Granted                            |                  |                                 | 120,279                | 11.19                       |

Edgar Filing: NETSCOUT SYSTEMS INC - Form 10-K

|                                    |             |         |           |         |
|------------------------------------|-------------|---------|-----------|---------|
| Exercised (Options)/Issued (RSU s) | (1,026,771) | 5.64    | (651,666) | 9.21    |
| Canceled                           | (52,419)    | 20.50   | (107,938) | 9.64    |
| Outstanding-March 31, 2010         | 813,741     | \$ 7.60 | 1,112,376 | \$ 9.96 |

F-24

**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****13. Stock Plans (Continued)**

As of March 31, 2010, there were 2,970,730 shares of common stock available for grant under the 2007 Plan.

The aggregate intrinsic values of stock options and restricted stock units as of March 31, 2010, 2009 and 2008 were as follows (in thousands):

|                           | Year ended March 31, |           |           |
|---------------------------|----------------------|-----------|-----------|
|                           | 2010                 | 2009      | 2008      |
| Options:                  |                      |           |           |
| Outstanding(1)            | \$ 6,084             | \$ 3,177  | \$ 9,450  |
| Exercisable(1)            | \$ 6,084             | \$ 3,158  | \$ 9,242  |
| Restricted Stock Units(2) | \$ 16,452            | \$ 12,542 | \$ 21,282 |

- (1) The aggregate intrinsic values in this table were calculated based on the positive difference between the closing market value of the Company's common stock on March 31, 2010 (\$14.79), 2009 (\$7.16) and 2008 (\$9.30) and the exercise price of the underlying options.
- (2) The aggregate intrinsic values in this table were calculated based on the closing market value of the Company's common stock on March 31, 2010 (\$14.79), 2009 (\$7.16) and 2008 (\$9.30) for the underlying restricted stock units.

As of March 31, 2010, there was no unrecognized compensation cost related to stock options.

As of March 31, 2010, the total unrecognized compensation cost related to restricted stock unit awards was \$8.1 million, which is expected to be amortized over a weighted-average period of 1.9 years.

**14. Retirement Plan**

In 1996, NetScout established an employee savings plan, which is intended to qualify under Section 401(k) of the Internal Revenue Code of 1986, as amended. NetScout matches 50% of the employee's contribution up to 6% of the employee's salary. NetScout contributions vest at a rate of 25% per year of service. NetScout made matching contributions of \$1.9 million, \$1.7 million and \$1.4 million to the plans for the years ended March 31, 2010, 2009 and 2008, respectively.

**15. Income Taxes**

Income (loss) before income tax expense (benefit) consisted of the following:

|          | Year ended March 31, |           |            |
|----------|----------------------|-----------|------------|
|          | 2010                 | 2009      | 2008       |
| Domestic | \$ 40,371            | \$ 28,284 | \$ (9,345) |
| Foreign  | 2,700                | 2,757     | 2,796      |
|          | \$ 43,071            | \$ 31,041 | \$ (6,549) |

**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****15. Income Taxes (Continued)**

The components of the income tax expense (benefit) are as follows:

|  | Year ended March 31, |           |            |
|--|----------------------|-----------|------------|
|  | 2010                 | 2009      | 2008       |
| Current income tax expense (benefit):  |                      |           |            |
| Federal                                | \$ 8,499             | \$ 369    | \$ (3,695) |
| State                                  | 611                  | 232       | 72         |
| Foreign                                | 856                  | 1,101     | 561        |
|  | 9,966                | 1,702     | (3,062)    |
| Deferred income tax expense (benefit): |                      |           |            |
| Federal                                | 4,825                | 8,606     | (765)      |
| State                                  | 363                  | 685       | (634)      |
|  | 5,188                | 9,291     | (1,399)    |
|  | \$ 15,154            | \$ 10,993 | \$ (4,461) |

The income tax expense (benefit) computed using the federal statutory income tax rate differs from NetScout's effective tax rate primarily due to the following:

|   | Year ended March 31, |       |         |
|---|----------------------|-------|---------|
|   | 2010                 | 2009  | 2008    |
| Statutory U.S. federal tax rate             | 35.0%                | 35.0% | (35.0)% |
| State taxes, net of federal tax effect      | 3.1                  | 3.1   | (5.1)   |
| Share-based compensation expense            |                      |       | 0.8     |
| Tax-exempt interest                         | (0.2)                | (1.3) | (14.2)  |
| Research and development tax credits        | (1.7)                | (3.4) | (10.0)  |
| Tax rate differential of foreign operations | (0.2)                | (0.4) | (6.4)   |
| Meals and entertainment                     | 0.7                  | 1.2   | 3.0     |
| Other                                       | (1.5)                | 1.2   | (1.2)   |
|   | 35.2%                | 35.4% | (68.1)% |

Deferred tax assets and liabilities are recognized based on the anticipated future tax consequences, attributable to differences between financial statement carrying amounts of assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance is established if, based on management's review of both positive and negative evidence, it is more likely than not that all or a portion of the deferred tax asset will not be realized. A valuation allowance has been established for certain federal foreign tax credits related to the Network General acquisition, which the Company believes do not meet the more likely than not criteria established under generally accepted accounting standards for income taxes. If it is later determined the Company is able to use all or a portion of the deferred tax assets for which a valuation allowance has been established, then the Company may be required to recognize these deferred tax assets through a charge to income tax expense in the period such determination is



## Edgar Filing: NETSCOUT SYSTEMS INC - Form 10-K

made. Deferred income taxes were not provided on approximately \$9.9 million of undistributed earnings of certain foreign subsidiaries as of March 31, 2010 because such undistributed foreign earnings are to be indefinitely reinvested outside of the United States. As of March 31, 2010, the Company has deemed it impracticable to determine the amount of any taxes payable if these amounts were to be repatriated to the United States.

F-26

**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****15. Income Taxes (Continued)**

At March 31, 2010, the Company had United States federal net operating loss carryforwards of \$56.0 million. At March 31, 2010, the Company had state net operating loss carryforwards of \$75.5 million. At March 31, 2010, the Company had federal and state research and development tax carryforwards of \$2.2 million. The net operating loss and credit carryforwards will expire at various dates beginning in 2023 and extending through 2027, if not utilized. Utilization of the net operating losses and credits are subject to an annual limitation due to the ownership change limitations provided by the Internal Revenue Code of 1986, as amended, and similar state tax provisions.

The components of net deferred tax assets are as follows:

|  | <b>Year ended March 31,</b> |                  |
|--|-----------------------------|------------------|
|  | <b>2010</b>                 | <b>2009</b>      |
| <b>Assets:</b>                               |                             |                  |
| Accrued expenses                             | \$ 2,923                    | \$ 3,342         |
| Depreciation                                 | 619                         | 421              |
| Deferred revenue                             | 6,798                       | 2,940            |
| Reserves                                     | 603                         | 613              |
| Net operating loss carryforwards             | 23,504                      | 26,155           |
| Tax credit carryforwards                     | 1,994                       | 4,180            |
| Share-based compensation                     |                             | 81               |
| Auction rate securities temporary impairment | 1,506                       | 1,394            |
| Other  | 160                         | 130              |
|  | <b>38,107</b>               | <b>39,256</b>    |
| <b>Liabilities:</b>                          |                             |                  |
| Intangible assets                            | (4,978)                     | (1,270)          |
| Share-based compensation                     | (120)                       |                  |
| Valuation allowance                          | (249)                       | (249)            |
|  | <b>\$ 32,760</b>            | <b>\$ 37,737</b> |

The Company files U.S. federal tax returns and files returns in various states, local and foreign jurisdictions. With respect to the U.S. federal and primary state jurisdictions, the Company is no longer subject to examinations by tax authorities for tax years before 2006, although carryforward attributes that were generated prior to 2006 may still be adjusted upon examination if they either have been or will be used in a future period. The Company also receives inquiries from various tax jurisdictions during the year, and some of those inquiries may include an audit of the tax return previously filed.

Effective April 1, 2007, the Company adopted new generally accepted accounting principles for the provision of uncertain tax positions. The implementation did not have a material impact on our consolidated financial position or results of operations. A reconciliation of the beginning and ending amount of unrecognized tax benefits for the fiscal years ended March 31, 2010 and 2009 is as follows (in thousands):

|                     | <b>Year ended</b> |             |
|---------------------|-------------------|-------------|
|                     | <b>March 31,</b>  |             |
|                     | <b>2010</b>       | <b>2009</b> |
| Balance at April 1, | \$ 314            | \$ 135      |

Edgar Filing: NETSCOUT SYSTEMS INC - Form 10-K

|  |        |        |
|--|--------|--------|
| Additions based on tax positions related to the current year | 35     | 53     |
| Additions for tax positions of prior years                   |        | 126    |
| Balance at March 31,   | \$ 349 | \$ 314 |

F-27

**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****15. Income Taxes (Continued)**

The Company's policy to include interest and penalties, related to unrecognized tax benefits, as a component of interest expense on the condensed consolidated statements of operations did not change as a result of implementing the new accounting standards for uncertain tax positions. Accrued interest and penalties as of March 31, 2010 is \$22 thousand. The Company does not reasonably estimate that its unrecognized tax benefit will change significantly within the next twelve months.

Significant accounting judgments and estimates are made when determining whether it is more likely than not that our deferred income tax assets will be realized and, accordingly, do not require a valuation allowance. If these judgments and estimates prove to be materially inaccurate, a valuation allowance may be required and our financial results could be materially and adversely impacted in the future. If the Company determines that it will not be able to realize some or all of the deferred income taxes in the future, an adjustment to the deferred income tax assets will be charged to income tax expense in the period such determination is made.

**16. Commitments and Contingencies****Leases**

NetScout leases office space under non-cancelable operating leases. Total rent expense under the leases was \$6.5 million, \$6.8 million and \$5.2 million for the fiscal years ended March 31, 2010, 2009 and 2008, respectively.

As of March 31, 2010, future non-cancelable minimum lease commitments (including office space, copiers and automobiles) are as follows:

|                                     |                  |
|-------------------------------------|------------------|
| <b>Year ending March 31,</b>        |                  |
| 2011                                | \$ 5,961         |
| 2012                                | 5,057            |
| 2013                                | 3,758            |
| 2014                                | 1,378            |
| <b>Total minimum lease payments</b> | <b>\$ 16,154</b> |

**Contingencies**

On November 14, 2008, certain former shareholders of Fidelia Technology, Inc. filed an amended complaint in the Superior Court of California, San Francisco County, against Network General Corporation and certain of its officers and directors relating to the consideration received by the shareholders in the merger between Fidelia and Network General in January 2006. NetScout acquired Network General in November 2007. Following full legal briefing and a hearing held on February 18, 2009, the court dismissed the amended complaint against certain of the former officers and directors of Network General, and permitted certain claims to proceed against Network General and its former president. As of May 6, 2010, subsequent to our fiscal year end, without admission or finding of liability by any party and to avoid further expense and inconvenience of this litigation, the plaintiffs and the remaining defendants agreed to a confidential Settlement Agreement and Mutual Release, resolving all claims the parties had or may have had against one another, with dismissal of the lawsuit to follow. The settlement of the claims are immaterial to the ongoing operations and financial condition of the Company because all settlement payments will be made directly by the Company's insurance carrier.

**Table of Contents****NetScout Systems, Inc.****Notes to Consolidated Financial Statements (Continued)****17. Segment and Geographic Information**

The Company reports revenues and income under one reportable industry segment. The Company's management assesses operating results on an aggregate basis to make decisions about the allocation of resources.

The Company manages its business in the following geographic areas: United States, Europe (including the United Kingdom, Germany, France, Spain, Italy and Norway), Asia (including China, Hong Kong, Japan, Korea, Malaysia, Singapore and Taiwan) and the Rest of World (including South Africa, Australia, Canada, India, Brazil, Mexico and the United Arab Emirates). In accordance with United States export control regulations, the Company does not sell or do business with countries subject to economic sanctions and export controls.

Total revenue by geography is as follows (in thousands):

|               | Year ended March 31, |            |            |
|---------------|----------------------|------------|------------|
|               | 2010                 | 2009       | 2008       |
| United States | \$ 189,517           | \$ 199,737 | \$ 123,321 |
| Europe        | 35,072               | 37,618     | 27,188     |
| Asia          | 13,694               | 12,973     | 11,093     |
| Rest of World | 22,059               | 17,276     | 7,354      |
|               | \$ 260,342           | \$ 267,604 | \$ 168,956 |

The United States revenue includes sales to resellers in the United States. These resellers fulfill customer orders and may subsequently ship the Company's products to international locations. The Company reports these shipments as United States revenue since the Company ships the products to a United States location. Revenue attributable to locations outside of the United States is a result of export sales. Substantially all of the Company's identifiable assets are located in the United States.

**18. Subsequent Events**

The Company has evaluated subsequent events for potential recognition or disclosure in these financial statements. No material subsequent events have occurred since March 31, 2010 that required recognition or disclosure in these financial statements, except the disclosure in Note 16.

**19. Quarterly Results of Operations - Unaudited**

The following table sets forth certain unaudited quarterly results of operations of NetScout for the fiscal years ended March 31, 2010 and 2009. In the opinion of management, this information has been prepared on the same basis as the audited consolidated financial statements and all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts stated below to present fairly the quarterly information when read in conjunction with the audited consolidated financial statements and notes thereto included elsewhere in this Annual Report on Form 10-K. The quarterly operating results are not necessarily indicative of future results of operations.

|              | Three Months Ended |                  |                   |                  |                   |                  |                   |                  |
|--------------|--------------------|------------------|-------------------|------------------|-------------------|------------------|-------------------|------------------|
|              | March 31,<br>2010  | Dec. 31,<br>2009 | Sept. 30,<br>2009 | June 30,<br>2009 | March 31,<br>2009 | Dec. 31,<br>2008 | Sept. 30,<br>2008 | June 30,<br>2008 |
| Revenue      | \$ 71,874          | \$ 70,715        | \$ 59,691         | \$ 58,062        | \$ 66,086         | \$ 72,050        | \$ 68,861         | \$ 60,607        |
| Gross profit | 56,256             | 55,310           | 46,818            | 45,894           | 50,656            | 56,024           | 51,515            | 45,269           |
| Net income   | 7,053              | 8,541            | 7,086             | 5,237            | 5,674             | 7,935            | 4,942             | 1,497            |

Edgar Filing: NETSCOUT SYSTEMS INC - Form 10-K

Diluted net income per share                                      \$ 0.17    \$ 0.20    \$ 0.17    \$ 0.13    \$ 0.14    \$ 0.20    \$ 0.12    \$ 0.04

F-29

**Table of Contents**

## NetScout Systems, Inc.

**Schedule II Valuation and Qualifying Accounts**

| Description                            | Balance at Beginning of Year | Additions (Deductions) Resulting in Charges (Benefits) to Operations | Additions Resulting in Charges to Other Accounts (in thousands) | Deductions due to Write-Offs | Balance at End of Year |
|--|------------------------------|--|---|------------------------------|------------------------|
| Year ended March 31, 2008              |                              |  |   |                              |                        |
| Allowance for doubtful accounts        | \$ 9                         | \$ 77  | \$  | \$                           | \$ 86                  |
| Deferred tax asset valuation allowance | \$                           | \$   | \$ 3,505(1)   | \$                           | \$ 3,505               |
| Year ended March 31, 2009              |                              |  |   |                              |                        |
| Allowance for doubtful accounts        | \$ 86                        | \$ 608   | \$  | \$ (122)                     | \$ 572                 |
| Deferred tax asset valuation allowance | \$ 3,505                     | \$   | \$ (3,256)(2)   | \$                           | \$ 249                 |
| Year ended March 31, 2010              |                              |  |   |                              |                        |
| Allowance for doubtful accounts        | \$ 572                       | \$ 187   | \$  | \$ (332)                     | \$ 427                 |
| Deferred tax asset valuation allowance | \$ 249                       | \$   | \$  | \$                           | \$ 249                 |

- (1) Recorded in connection with the acquisition of Network General.  
(2) Adjustment recorded to goodwill.

S-1

**Table of Contents**

**NetScout Systems, Inc**

**Index to Exhibits**

|          |   |
|----------|---|
| 3.1, 4.1 | Third Amended and Restated Certificate of Incorporation of NetScout (filed as Exhibit 3.3, 4.1 to NetScout's Registration Statement on Form S-1 (No. 333-76843) and incorporated herein by reference).  |
| 3.2, 4.2 | Composite copy of Amended and Restated By-laws of NetScout (filed as Exhibit 3.1 to NetScout's current Report on Form 8-K filed on January 27, 2009 and incorporated herein by reference).  |
| 4.3      | Specimen Certificate for shares of NetScout's Common Stock (filed as Exhibit 4.3 to NetScout's Annual Report on Form 10-K for the fiscal year ended March 31, 2001 and incorporated herein by reference).   |
| 4.4      | Stockholders Agreement, dated September 19, 2007, by and among NetScout and certain stockholders of Network General Central Corporation (filed as Exhibit 10.1 to NetScout's Current Report on Form 8-K filed on September 25, 2007 and incorporated herein by reference).  |
| 10.1     | 1997 Stock Incentive Plan of NextPoint Networks, Inc., assumed by NetScout (filed as Exhibit 4.3 to NetScout's Registration Statement on Form S-8 (No. 333-41880) and incorporated herein by reference).*   |
| 10.2     | 1999 Stock Option and Incentive Plan, as amended (filed as Exhibit 10.1 to NetScout's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2001 and incorporated herein by reference).*   |
| 10.3     | Form of Incentive Stock Option Agreement Incorporated Terms and Conditions pursuant to 1999 Stock Option and Incentive Plan, as amended (filed as Exhibit 10.1 to NetScout's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2004 and incorporated herein by reference).*  |
| 10.4     | Form of Restricted Stock Unit Agreement with respect to the NetScout 1999 Stock Option and Incentive Plan (filed as Exhibit 10.2 to NetScout's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2005 and incorporated herein by reference).*  |
| 10.5     | 1999 Employee Stock Purchase Plan, as amended (included as Annex A to NetScout's Definitive Proxy Statement on Schedule 14A filed with the Securities and Exchange Commission on August 15, 2003 and incorporated herein by reference).*  |
| 10.6     | Lease between Arturo J. Gutierrez and John A. Cataldo, Trustees of Nashoba Westford Realty Trust, u/d/t dated April 27, 2000 and recorded with the Middlesex North Registry of Deeds in Book 10813, Page 38 and NetScout for Westford Technology Park West, as amended (filed as Exhibit 10.26 to NetScout's Annual Report on Form 10-K for the fiscal year ended March 31, 2001 and incorporated herein by reference). |
| 10.7     | 2000 Stock Incentive Plan of NextPoint Networks, Inc., assumed by NetScout (filed as Exhibit 4.4 to NetScout's Registration Statement on Form S-8 (No. 333-41880) and incorporated herein by reference).*   |
| 10.8     | Form of Indemnification Agreement (filed as Exhibit 10.2 to NetScout's Current Report on Form 8-K filed on September 19, 2006 and incorporated herein by reference).*   |
| 10.9     | Summary of Non-Employee Director Compensation (filed as exhibit 10.1 to NetScout's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2006 and incorporated herein by reference).*  |
| 10.10    | Agreement Relating to Employment, dated January 3, 2007, by and between NetScout and Anil K. Singhal (filed as Exhibit 10.2 to NetScout's Current Report on Form 8-K filed on January 5, 2007 and incorporated herein by reference).*   |



**Table of Contents**

|       |  |
|-------|--|
| 10.11 | Amendment No. 1 to Agreement Relating to Employment, dated February 2, 2007, by and between the Company and Anil K. Singhal (filed as exhibit 10.1 to NetScout s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2006 and incorporated herein by reference).*  |
| 10.12 | Amendment No. 2 to Agreement Relating to Employment, dated December 22, 2008, by and between the Company and Anil K. Singhal (filed as exhibit 10.1 to NetScout s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2008 and incorporated herein by reference).*   |
| 10.13 | Separation Agreement, dated January 3, 2007, by and between NetScout and Narendra V. Popat (filed as Exhibit 10.1 to NetScout s Current Report on Form 8-K filed on January 5, 2007 and incorporated herein by reference).*  |
| 10.14 | NetScout 2007 Equity Incentive Plan. (filed as Exhibit 10.1 to NetScout s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2007 and incorporated herein by reference).*  |
| 10.15 | NetScout Form of Restricted Stock Unit Agreement with respect to the NetScout 2007 Equity Incentive Plan (filed as Exhibit 99.2 to NetScout s Registration Statement on Form S-8 (No. 333-148364) and incorporated herein by reference).*  |
| 10.16 | Credit and Security Agreement, dated as of December 21, 2007, by and among, NetScout, KeyBank National Association, as lead arranger, sole book runner and administrative agent, Silicon Valley Bank and Wells Fargo Foothill, LLC, as co-syndication agents, and Comerica Bank, as documentation agent, and the Lenders party thereto (filed as Exhibit 10.1 to NetScout s Current Report on Form 8-K filed on December 31, 2007 and incorporated herein by reference).   |
| 10.17 | Form of Severance Agreement for Executive Officers (filed as Exhibit 10.17 to NetScout s Annual Report on Form 10-K for the fiscal year ended March 31, 2009 and incorporated herein by reference).*   |
| 10.18 | Form of Severance Agreement for Executive Officers (change of control only) (filed as Exhibit 10.18 to NetScout s Annual Report on Form 10-K for the fiscal year ended March 31, 2009 and incorporated herein by reference).*  |
| 10.19 | First Amendment Agreement, dated as of December 4, 2009, to the Credit and Security Agreement, dated as of December 21, 2007, by and among NetScout, Keybank National Association, as lead arranger, sole book runner and administrative agent, Silicon Valley Bank and Wells Fargo Foothill, LLC, as co-syndication agents, and Comerica Bank, as documentation agent, and the Lenders party thereto (filed as Exhibit 10.1 to NetScout s Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2009 and incorporated herein by reference). |
| 21    | Subsidiaries of NetScout.  |
| 23    | Consent of PricewaterhouseCoopers LLP.   |
| 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.   |
| 32.2  | Certification Pursuant to Section 906 of the Sarbanes Oxley Act of 2002.   |

\* Indicates a management contract or compensatory plan or arrangement.