F5 NETWORKS INC
Form 10-Q
July 27, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number 000-26041

F5 NETWORKS, INC.
(Exact name of registrant as specified in its charter)

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

401 Elliott Avenue West
Seattle, Washington 98119
(Address of principal executive offices and zip code)
(206) 272-5555
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ 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 þ	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ
The number of shares outstanding of the registrant's common stock as of July 22, 2016 was 66,204,638.

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For the Quarter Ended June 30, 2016
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
F5 NETWORKS, INC.
CONSOLIDATED BALANCE SHEETS
(unaudited, in thousands)

	June 30, 2016	September 30, 2015
ASSETS		
Current assets		
Cash and cash equivalents	$429,597	$390,460
Short-term investments	381,111	383,882
Accounts receivable, net of allowances of $1,700 and $1,979	263,249	279,434
Inventories	33,805	33,717
Deferred tax assets	49,460	50,128
Other current assets	50,741	50,519
Total current assets	1,207,963	1,188,140
Property and equipment, net	115,135	95,909
Long-term investments	313,488	397,656
Deferred tax assets	700	6,492
Goodwill	555,965	555,965
Other assets, net	60,532	68,128
Total assets	$2,253,783	$2,312,290
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$37,452	$50,814
Accrued liabilities	135,122	130,401
Deferred revenue	626,836	573,908
Total current liabilities	799,410	755,123
Other long-term liabilities	30,761	30,136
Deferred revenue, long-term	229,332	209,402
Deferred tax liabilities	7,215	901
Total long-term liabilities	267,308	240,439
Commitments and contingencies (Note 5)		
Shareholders' equity		
Preferred stock, no par value; 10,000 shares authorized, no shares outstanding	—	—
Common stock, no par value; 200,000 shares authorized, 66,204 and 70,138 shares issued and outstanding	9,996	10,159
Accumulated other comprehensive loss	(13,317)	(15,288)
Retained earnings	1,190,386	1,321,857
Total shareholders' equity	1,187,065	1,316,728
Total liabilities and shareholders' equity	$2,253,783	$2,312,290

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

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

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Net revenues				
Products	$231,366	$248,767	$691,485	$733,820
Services	265,156	234,819	778,200	684,702
Total	496,522	483,586	1,469,685	1,418,522
Cost of net revenues				
Products	40,474	44,050	123,033	129,720
Services	43,869	41,609	129,223	117,883
Total	84,343	85,659	252,256	247,603
Gross profit	412,179	397,927	1,217,429	1,170,919
Operating expenses				
Sales and marketing	156,620	150,833	470,545	450,887
Research and development	83,042	74,337	250,481	218,918
General and administrative	34,182	32,627	103,238	95,814
Litigation expense	(527)	—	8,421	—
Total	273,317	257,797	832,685	765,619
Income from operations	138,862	140,130	384,744	405,300
Other income, net	978	720	2,246	6,580
Income before income taxes	139,840	140,850	386,990	411,880
Provision for income taxes	48,051	47,678	130,070	143,903
Net income	$91,789	$93,172	$256,920	$267,977
Net income per share — basic	$1.37	$1.30	$3.78	$3.70
Weighted average shares — basic	66,851	71,509	67,990	72,370
Net income per share — diluted	$1.37	$1.29	$3.75	$3.67
Weighted average shares — diluted	67,235	71,957	68,429	72,937

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

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

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Net income	$91,789	$93,172	$256,920	$267,977
Other comprehensive income (loss):				
Foreign currency translation adjustment	(142)	470	1,449	(3,728)
Available-for-sale securities:				
Unrealized gains (losses) on securities, net of taxes of $236 and $(321) for the three months ended June 30, 2016 and 2015, respectively, and $310 and $25 for the nine months ended June 30, 2016 and 2015, respectively	393	(546)	516	43
Reclassification adjustment for realized (gains) losses included in net income, net of taxes of $6 and $33 for the three months ended June 30, 2016 and 2015, respectively, and $(3) and $51 for the nine months ended June 30, 2016 and 2015, respectively	(9)	(55)	6	(86)
Net change in unrealized gains (losses) on available-for-sale securities, net of tax	384	(601)	522	(43)
Total other comprehensive income (loss)	242	(131)	1,971	(3,771)
Comprehensive income	$92,031	$93,041	$258,891	$264,206

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

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

	Nine months ended June 30,	
	2016	2015
Operating activities		
Net income	$256,920	$267,977
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized loss (gain) on disposition of assets and investments	22	(69)
Stock-based compensation	118,443	103,919
Provisions for doubtful accounts and sales returns	876	1,268
Depreciation and amortization	42,284	39,225
Deferred income taxes	9,295	(5,203)
Changes in operating assets and liabilities:		
Accounts receivable	15,307	(20,094)
Inventories	(87)	(5,556)
Other current assets	(80)	(6,127)
Other assets	549	437
Accounts payable and accrued liabilities	(8,922)	19,625
Deferred revenue	72,858	105,796
Net cash provided by operating activities	507,465	501,198
Investing activities		
Purchases of investments	(225,226)	(347,683)
Maturities of investments	244,905	391,900
Sales of investments	62,836	198,401
Decrease (increase) in restricted cash	29	(401)
Acquisition of intangible assets	(3,250)	(6,224)
Purchases of property and equipment	(45,909)	(41,715)
Net cash provided by investing activities	33,385	194,278
Financing activities		
Excess tax benefit from stock-based compensation	1,596	6,611
Proceeds from the exercise of stock options and purchases of stock under employee stock purchase plan	44,848	40,426
Repurchase of common stock	(550,101)	(456,863)
Net cash used in financing activities	(503,657)	(409,826)
Net increase in cash and cash equivalents	37,193	285,650
Effect of exchange rate changes on cash and cash equivalents	1,944	(4,972)
Cash and cash equivalents, beginning of period	390,460	281,502
Cash and cash equivalents, end of period	$429,597	$562,180

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

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F5 NETWORKS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1. Summary of Significant Accounting Policies

Description of Business

F5 Networks, Inc. (the "Company") is the leading developer and provider of software-defined application services. The Company's core technology is a full-proxy, programmable, highly-scalable software platform called TMOS, which supports a broad array of features and functions designed to ensure that applications delivered over Internet Protocol (IP) networks are secure, fast and available. The Company's TMOS-based offerings include software products for local and global traffic management, network and application security, access management, web acceleration and a number of other network and application services. These products are available as modules that can run individually or as part of an integrated solution on the Company's high-performance, scalable, purpose-built BIG-IP appliances and VIPRION chassis-based hardware, or as software-only Virtual Editions. The Company also offers distributed denial-of-service (DDoS) protection, application security and other application services by subscription on its cloud-based Silverline platform. In connection with its products, the Company offers a broad range of support services including consulting, training, installation and maintenance.

Basis of Presentation

The year-end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. In the opinion of management, the unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for their fair statement in conformity with accounting principles generally accepted in the United States of America. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted in accordance with the rules and regulations of the Securities and Exchange Commission. The information included in this Form 10-Q should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2015.

Certain prior year amounts, specifically relating to the tax effects of unrealized gains and losses on securities, have been corrected and reclassified as tax expenses and benefits, respectively, to conform to the current year presentation in the Consolidated Statements of Comprehensive Income. The corrected and reclassified amounts are considered immaterial and there was no change to comprehensive income as a result.

Revenue Recognition

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

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

Revenue from the sale of products is generally recognized when the product has been shipped and the customer is obligated to pay for the product. When rights of return are present and the Company cannot estimate returns, revenue is recognized when such rights of return lapse. Payment terms to domestic customers are generally net 30 days to net 45 days. Payment terms to international customers range from net 30 days to net 120 days based on normal and customary trade practices in the individual markets. The Company offers extended payment terms to certain customers, in which case, revenue is recognized when payments are due.

Revenues for post-contract customer support (PCS) are recognized on a straight-line basis over the service contract term. PCS includes a limited period of telephone support, updates, repair or replacement of any failed product or component that fails during the term of the agreement, bug fixes and rights to upgrades, when and if available.

Consulting services are customarily

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billed at fixed hourly rates, plus out-of-pocket expenses, and revenues are recognized when the consulting has been completed. Training revenue is recognized when the training has been completed.

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

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

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

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

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

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

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

Goodwill and Acquired Intangible Assets

Goodwill represents the excess purchase price over the estimated fair value of net assets acquired as of the acquisition date. The Company tests goodwill for impairment on an annual basis and between annual tests when impairment indicators are identified, and goodwill is written down when impaired. Goodwill was recorded in connection with the

acquisition of Defense.Net, Inc. in fiscal year 2014, Versafe Ltd. and LineRate Systems, Inc. in fiscal year 2013, Traffix Systems in fiscal year 2012, Acopia Networks, Inc. in fiscal year 2007, Swan Labs, Inc. in fiscal year 2006, MagniFire Websystems, Inc. in fiscal year 2004 and uRoam, Inc. in fiscal year 2003. For its annual goodwill impairment test in all periods to date, the Company has operated under one reporting unit and the fair value of its reporting unit has been determined by the Company's enterprise value. The Company performs its annual goodwill impairment test during the second fiscal quarter.

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As part of the annual goodwill impairment test, the Company first performs a qualitative assessment to determine whether further impairment testing is necessary. If, as a result of its qualitative assessment, it is more-likely-than-not (i.e. greater than 50% chance) that the fair value of the Company's reporting unit is less than its carrying amount, the quantitative impairment test will be required. Otherwise, no further testing will be required.

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

If it is determined, as a result of the qualitative assessment, that it is more-likely-than-not that the fair value of the Company's reporting unit is less than its carrying amount, the provisions of authoritative guidance require that the Company perform a two-step impairment test on goodwill. The first step of the test identifies whether potential impairment may have occurred, while the second step of the test measures the amount of the impairment, if any. Impairment is recognized when the carrying amount of goodwill exceeds its fair value. In March 2016, the Company completed a qualitative assessment of potential impairment indicators and concluded that it was more-likely-than-not that the fair value of its reporting unit exceeded its carrying amount. The Company considered potential impairment indicators of goodwill and acquired intangible assets at June 30, 2016 and noted no indicators of impairment.

Software Development Costs

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

Internal Use Software

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

Stock-Based Compensation

The Company accounts for stock-based compensation using the straight-line attribution method for recognizing compensation expense. The Company recognized $38.4 million and $36.5 million of stock-based compensation expense for the three months ended June 30, 2016 and 2015, respectively, and $118.4 million and $103.9 million for the nine months ended June 30, 2016 and 2015, respectively. As of June 30, 2016, there was $153.8 million of total unrecognized stock-based compensation cost, the majority of which will be recognized over the next two years. Going forward, stock-based compensation expenses may increase as the Company issues additional equity-based awards to continue to attract and retain key employees.

The Company issues incentive awards to its employees through stock-based compensation consisting of restricted stock units (RSUs). On October 30, 2015, the Company's Compensation Committee approved 1,272,331 RSUs to employees and executive officers pursuant to the Company's annual equity awards program. The value of RSUs is determined using the fair value method, which in this case, is based on the number of shares granted and the quoted price of the Company's common stock on the date of grant.

The Company recognizes compensation expense for only the portion of restricted stock units that are expected to vest. Therefore, the Company applies estimated forfeiture rates that are derived from historical employee termination behavior. Based on historical differences with forfeitures of stock-based awards granted to the Company's executive officers and Board of Directors versus grants awarded to all other employees, the Company has developed separate forfeiture expectations for these two groups.

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

case, 70% of the quarterly performance stock grant is based on achieving at least 80% of the quarterly revenue goal set by the Company's Board of Directors, and the other 30% is based on achieving at least 80% of the quarterly EBITDA goal set by the Company's Board of

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Directors. The quarterly performance stock grant is paid linearly over 80% of the targeted goals. At least 100% of both goals must be attained in order for the quarterly performance stock grant to be awarded over 100%. Each goal is evaluated individually and subject to the 80% achievement threshold and the 100% over-achievement threshold. Each goal is also capped at achievement of 200% above target.

As of June 30, 2016, the following annual equity grants for executive officers or a portion thereof are outstanding:

Grant Date	RSUs Granted	Vesting Schedule	Vesting Period	Date Fully Vested
November 2, 2015	145,508	Quarterly	4 years	November 1, 2019
November 1, 2014	171,575	Quarterly	4 years	November 1, 2018
November 1, 2013	231,320	Quarterly	4 years	November 1, 2017
November 1, 2012	290,415	Quarterly	4 years	November 1, 2016

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

Common Stock Repurchase

On April 20, 2016, the Company announced that its Board of Directors authorized an additional $1.0 billion for its common stock share repurchase program. This new authorization is incremental to the existing $2.4 billion program, initially approved in October 2010 and expanded in each fiscal year. Acquisitions for the share repurchase programs will be made from time to time in private transactions or open market purchases as permitted by securities laws and other legal requirements. The programs can be terminated at any time. As of June 30, 2016, the Company had repurchased and retired 5,402,131 shares at an average price of $101.83 per share during fiscal year 2016 and the Company had $923.8 million remaining authorized to purchase shares.

Earnings Per Share

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

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

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Numerator				
Net income	$91,789	$93,172	$256,920	$267,977
Denominator				
Weighted average shares outstanding — basic	66,851	71,509	67,990	72,370
Dilutive effect of common shares from stock options and restricted stock units	384	448	439	567
Weighted average shares outstanding — diluted	67,235	71,957	68,429	72,937
Basic net income per share	$1.37	$1.30	$3.78	$3.70
Diluted net income per share	$1.37	$1.29	$3.75	$3.67

An immaterial amount of common shares potentially issuable from stock options for the three and nine months ended June 30, 2016 and 2015, are excluded from the calculation of diluted earnings per share because the exercise price was greater than the average market price of common stock for the respective period.

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Comprehensive Income

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

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09). ASU 2014-09 and the related amendments outline a new, single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The new model will require revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration a company expects to receive in exchange for those goods or services. The standard can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. In July 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which delays the effective date of ASU 2014-09 by one year. In accordance with the agreed upon delay, ASU 2014-09 and all related amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted but not before annual periods beginning after December 15, 2016. The Company is currently assessing the impact that this updated standard will have on its consolidated financial statements and footnote disclosures.

In June 2014, the FASB issued ASU 2014-12, Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide that a Performance Target Could be Achieved after the Requisite Service Period (ASU 2014-12), which requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant date fair value of the award. This update further clarifies that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The Company does not anticipate that the adoption of this standard will have a material impact on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, Intangibles-Goodwill and Other-Internal-Use Software: Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement (ASU 2015-05), which provides guidance on determining whether a cloud computing arrangement contains a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The Company is currently assessing the impact that this updated standard will have on its consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, Simplifying the Measurement of Inventory (ASU 2015-11), which changes the subsequent measurement of inventory from lower of cost or market to lower of cost and net realizable value. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The Company is currently assessing the impact that this updated standard will have on its consolidated financial statements and footnote disclosures.

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes (ASU 2015-17), which requires that all deferred tax assets and liabilities be classified as noncurrent in a classified balance sheet. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted as of the beginning of an interim or annual reporting period. The Company does not anticipate that the adoption of this standard will have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) (ASU 2016-02), which requires lessees to recognize on the balance sheet a right-of-use asset, representing its right to use the underlying asset for the lease term,

and a corresponding lease liability for all leases with terms greater than twelve months. The guidance also requires qualitative and quantitative disclosures designed to assess the amount, timing and uncertainty of cash flows arising from leases. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, and is required to be applied with a modified retrospective approach. Early adoption is permitted. The Company is currently assessing the impact that this updated standard will have on its consolidated financial statements and footnote disclosures.

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In March 2016, the FASB issued ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (ASU 2016-09), which is intended to simplify several aspects of the accounting for share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The Company is currently assessing the impact that this updated standard will have on its consolidated financial statements and footnote disclosures.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted. The Company is currently assessing the impact that this updated standard will have on its consolidated financial statements and footnote disclosures.

2. Fair Value Measurements

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

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

The levels of fair value hierarchy are:

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

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

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

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

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

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The Company's financial assets measured at fair value on a recurring basis subject to the disclosure requirements at June 30, 2016, were as follows (in thousands):

	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Securities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value at June 30, 2016
Cash equivalents	$49,907	$ —	$ —	$49,907
Short-term investments				
Available-for-sale securities — corporate bonds and notes	—	246,847	—	246,847
Available-for-sale securities — municipal bonds and notes	—	41,312	—	41,312
Available-for-sale securities — U.S. government securities	—	70,068	—	70,068
Available-for-sale securities — U.S. government agency securities	—	22,884	—	22,884
Long-term investments				
Available-for-sale securities — corporate bonds and notes	—	135,209	—	135,209
Available-for-sale securities — municipal bonds and notes	—	45,175	—	45,175
Available-for-sale securities — U.S. government securities	—	30,074	—	30,074
Available-for-sale securities — U.S. government agency securities	—	103,030	—	103,030
Total	$49,907	$ 694,599	$ —	$744,506

The Company's financial assets measured at fair value on a recurring basis subject to the disclosure requirements at September 30, 2015, were as follows (in thousands):

	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Securities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value at September 30, 2015
Cash equivalents	$60,142	$ —	$ —	$ 60,142
Short-term investments				
Available-for-sale securities — corporate bonds and notes	—	224,693	—	224,693
Available-for-sale securities — municipal bonds and notes	—	39,518	—	39,518
Available-for-sale securities — U.S. government securities	—	58,530	—	58,530
Available-for-sale securities — U.S. government agency securities	—	58,323	—	58,323
Available-for-sale securities — international government securities	—	2,818	—	2,818

Long-term investments				
Available-for-sale securities — corporate bonds and notes	—	244,973	—	244,973
Available-for-sale securities — municipal bonds and notes	—	74,505	—	74,505
Available-for-sale securities — U.S. government securities	—	26,089	—	26,089
Available-for-sale securities — U.S. government agency securities	—	52,089	—	52,089
Total	$60,142	$ 781,538	$	—$ 841,680

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

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ended June 30, 2016, the Company did not recognize any impairment charges related to goodwill, intangible assets, or long-lived assets.

3. Short-Term and Long-Term Investments

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

June 30, 2016	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds and notes	$246,805	$ 77	$ (35)	$246,847
Municipal bonds and notes	41,299	17	(4)	41,312
U.S. government securities	70,034	34	—	70,068
U.S. government agency securities	22,884	1	(1)	22,884
	$381,022	$ 129	$ (40)	$381,111

September 30, 2015	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds and notes	$224,635	$ 100	$ (42)	$224,693
Municipal bonds and notes	39,497	24	(3)	39,518
U.S. government securities	58,499	31	—	58,530
U.S. government agency securities	58,318	10	(5)	58,323
International government securities	2,819	—	(1)	2,818
	$383,768	$ 165	$ (51)	$383,882

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

June 30, 2016	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds and notes	$134,753	$ 485	$ (29)	$135,209
Municipal bonds and notes	45,010	166	(1)	45,175
U.S. government securities	29,966	108	—	30,074
U.S. government agency securities	102,933	110	(13)	103,030
	$312,662	$ 869	$ (43)	$313,488

September 30, 2015	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds and notes	$245,224	$ 152	$ (403)	$244,973
Municipal bonds and notes	74,349	169	(13)	74,505
U.S. government securities	26,075	15	(1)	26,089
U.S. government agency securities	52,042	47	—	52,089
	$397,690	$ 383	$ (417)	$397,656

The amortized cost and fair value of fixed maturities at June 30, 2016, by contractual years-to-maturity, are presented below (in thousands):

	Cost or Amortized Cost	Fair Value
One year or less	$381,022	$381,111

Over one year	312,662	313,488
	$ 693,684	$ 694,599

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The following table summarizes investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for more than 12 months as of June 30, 2016 (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
June 30, 2016	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds and notes	$50,180	$ (19)	$70,980	$ (45)	$121,160	$ (64)
Municipal bonds and notes	4,449	(1)	10,087	(4)	14,536	(5)
U.S. government agency securities	30,455	(13)	15,362	(1)	45,817	(14)
Total	$85,084	$ (33)	$96,429	$ (50)	$181,513	$ (83)

The Company invests in securities that are rated investment grade or better. The Company reviews the individual securities in its portfolio to determine whether a decline in a security's fair value below the amortized cost basis is other-than-temporary. The Company determined that as of June 30, 2016, there were no investments in its portfolio that were other-than-temporarily impaired.

4. Inventories

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

Inventories consist of the following (in thousands):

	June 30, 2016	September 30, 2015
Finished goods	$24,296	$ 24,346
Raw materials	9,509	9,371
	$33,805	$ 33,717

5. Commitments and Contingencies

Guarantees and Product Warranties

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

The Company generally offers warranties of one year for hardware for those customers without service contracts, with the option of purchasing additional warranty coverage in yearly increments. The Company accrues for warranty costs as part of its cost of sales based on associated material product costs and technical support labor costs. Accrued warranty costs as of June 30, 2016 and June 30, 2015 were not considered material.

Commitments

As of June 30, 2016, the Company’s principal commitments consisted of obligations outstanding under operating leases. The Company leases its facilities under operating leases that expire at various dates through 2025. There have

been no material changes in the Company's principal lease commitments compared to those discussed in Note 7 to its annual consolidated financial statements.

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The Company currently has arrangements with contract manufacturers and other suppliers for the manufacturing of its products. The arrangement with the primary contract manufacturer allows them to procure component inventory on the Company's behalf based on a rolling production forecast provided by the Company. The Company is obligated to the purchase of component inventory that the contract manufacturer procures in accordance with the forecast, unless it gives notice of order cancellation in advance of applicable lead times. There have been no material changes in the Company's inventory purchase obligations compared to those discussed in Note 7 to its annual consolidated financial statements.

Legal Proceedings

On May 1, 2013, Radware, Ltd. and Radware, Inc. (Radware), filed a complaint for patent infringement against the Company in the United States District Court for the Northern District of California seeking an unspecified amount of monetary damages, as well as interest, costs, and injunctive relief based upon allegations that the Company infringed three Radware patents related to devices for ISP link load balancing. The Company answered the Complaint, denied the substantive allegations, and sought a declaratory judgment that the asserted claims were invalid. The Company also counter-claimed alleging that Radware infringes certain Company patents and is seeking an unspecified amount of monetary damages, as well as interest, costs, and injunctive relief for Radware's infringement of its patents. F5 was granted summary judgment of non-infringement of one of Radware's three patents before trial. Radware's remaining infringement claims proceeded to trial and on March 15, 2016, the jury returned a verdict finding that F5 had not proven that the asserted patents were invalid, that the Company willfully infringed one of the two patents and awarded Radware $6.4 million in damages against the Company. On July 11, 2016, Radware filed various post-trial motions seeking permanent injunctive relief, an accounting with respect to infringing sales that were not accounted for at trial, and a motion seeking treble damages and attorneys' fees. F5 had previously moved for judgment as a matter of law on Radware's willfulness claim, and that motion is still pending before the court. Radware's motions are currently scheduled to be heard on August 19, 2016.

The Company's counter-claims against Radware were resolved through an acceptance of an offer for judgment. In addition, on April 4, 2016, the Company sued Radware, Inc. in the United States District Court for the Western District of Washington accusing Radware products of infringing three additional Company patents. The Company's complaint seeks a jury trial and an unspecified amount of monetary damages, as well as interest, costs, and injunctive relief.

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

The Company records an accrual for loss contingencies for legal proceedings when it believes that an unfavorable outcome is both (a) probable and (b) the amount or range of any possible loss is reasonably estimable. In the second quarter of fiscal 2016, the Company recorded an accrual related to the Radware litigation mentioned above of $6.4 million for the verdict and $2.5 million for legal fees and other costs associated with the litigation. In the current quarter, the Company recorded a credit of $0.5 million related to other costs associated with the litigation. The Company has not recorded any other accruals for loss contingencies associated with other legal proceedings.

6. Income Taxes

The effective tax rate was 34.4% and 33.6% for the three and nine months ended June 30, 2016, respectively, compared to 33.8% and 34.9% for the three and nine months ended June 30, 2015, respectively.

At June 30, 2016, the Company had $10.5 million of unrecognized tax benefits that, if recognized, would affect the effective tax rate. It is anticipated that the Company's existing liabilities for unrecognized tax benefits will change within the next twelve months due to audit settlements or the expiration of statutes of limitations. The Company does not expect these changes to be material to the consolidated financial statements. The Company recognizes interest

and, if applicable, penalties for any uncertain tax positions as a component of income tax expense.
The Company and its subsidiaries are subject to U.S. federal income tax as well as the income tax of multiple state and foreign jurisdictions. The Company has concluded all U.S. federal income tax matters for fiscal years through September 30, 2012. The Company is currently under audit by the IRS for fiscal year 2014 and by various states for fiscal years 2011 through 2014. Major jurisdictions where there are wholly owned subsidiaries of F5 Networks, Inc. which require income tax filings include the United Kingdom, Japan, Singapore and Australia. The earliest periods open for review by local taxing authorities

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are fiscal years 2013 for the United Kingdom, 2010 for Japan, 2011 for Singapore, and 2012 for Australia. Within the next four fiscal quarters, the statute of limitations will begin to close on the fiscal years 2011, 2012 and 2013 state income tax returns.

7. Geographic Sales and Significant Customers

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

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

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Americas:				
United States	$256,518	$259,916	$737,792	$735,620
Other	23,835	22,403	81,574	73,707
Total Americas	280,353	282,319	819,366	809,327
EMEA	117,286	118,095	367,155	348,370
Japan	24,034	20,896	71,345	67,494
Asia Pacific	74,849	62,276	211,819	193,331
	$496,522	$483,586	$1,469,685	$1,418,522

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

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
Westcon Group, Inc.	18.8%	19.2%	18.9%	17.8%
Ingram Micro, Inc.	14.9%	16.7%	14.8%	16.3%
Avnet Technology Solutions	13.7%	13.5%	13.6%	13.6%
Arrow ECS [1]	—	—	10.1%	10.6%

1.
Arrow ECS accounted for under 10% of total net revenue
for the three months ended June 30, 2016 and June 30, 2015

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

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

The following discussion of our financial condition and results of operations contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933. These statements include, but are not limited to, statements about our plans, objectives, expectations, strategies, intentions or other characterizations of future events or circumstances and are generally identified by the words "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," and similar expressions. These forward-looking statements are based on current information and expectations and are subject to a number of risks and uncertainties.

Our actual results could differ materially from those expressed or implied by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed under “Item 1A. Risk Factors” herein and in other documents we file from time to time with the Securities and Exchange Commission. We assume no obligation to revise or update any such forward-looking statements.

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Overview

We are a global provider of software-defined application delivery services designed to ensure the fast, secure and reliable delivery of applications and data. Our products include hardware-based software, software-only solutions, cloud-based subscription services and a common management framework that enable customers to accelerate, optimize, secure and manage applications across hybrid computing infrastructures that combine traditional networks and data centers with software-defined networks, virtualized data centers and cloud-based resources. We market and sell our products primarily through multiple indirect sales channels in the Americas (primarily the United States); Europe, the Middle East, and Africa (EMEA); Japan; and the Asia Pacific region (APAC). Enterprise customers (Fortune 1000 or Business Week Global 1000 companies) in the technology, telecommunications, financial services, transportation, education, manufacturing and health care industries, along with government customers, continue to make up the largest percentage of our customer base.

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

- Revenues. The majority of our revenues are derived from sales of our application delivery networking (ADN) products including our BIG-IP appliances and high end VIPRION chassis and related software modules; Local Traffic Manager (LTM), DNS Services (formerly Global Traffic Manager); Advanced Firewall Manager (AFM) and Policy Enforcement Manager (PEM), that leverage the unique performance characteristics of our hardware and software architecture; and products that incorporate acquired technology, including Application Security Manager (ASM) and Access Policy Manager (APM); signaling delivery controller products (SDC); and the WebSafe, MobileSafe, Secure Web Gateway and Silverline DDoS and Application security offerings which are sold to customers on a subscription basis. We also derive revenues from the sales of services including annual maintenance contracts, training and consulting services. We carefully monitor the sales mix of our revenues within each reporting period. We believe customer acceptance rates of our new products and feature enhancements are indicators of future trends. We also consider overall revenue concentration by customer and by geographic region as additional indicators of current and future trends.
- Cost of revenues and gross margins. We strive to control our cost of revenues and thereby maintain our gross margins. Significant items impacting cost of revenues are hardware costs paid to our contract manufacturers, third-party software license fees, Silverline infrastructure, amortization of developed technology and personnel and overhead expenses. Our margins have remained relatively stable; however, factors such as sales price, product and services mix, inventory obsolescence, returns, component price increases and warranty costs could significantly impact our gross margins from quarter to quarter and represent significant indicators we monitor on a regular basis.
- Operating expenses. Operating expenses are substantially driven by personnel and related overhead expenses. Existing headcount and future hiring plans are the predominant factors in analyzing and forecasting future operating expense trends. Other significant operating expenses that we monitor include marketing and promotions, travel, professional fees, computer costs related to the development of new products and provision of services, facilities and depreciation expenses.
- Liquidity and cash flows. Our financial condition remains strong with significant cash and investments and no long term debt. The decrease in cash and investments for the first nine months of fiscal year 2016 was primarily due to cash used to repurchase outstanding common stock under our stock repurchase program of $550.1 million, partially offset by $507.5 million of cash provided by operating activities. Going forward, we believe the primary driver of cash flows will be net income from operations. Capital expenditures of $45.9 million for the first nine months of fiscal year 2016 were primarily related to the expansion of our facilities to support our operations worldwide. We will continue to evaluate possible acquisitions of, or investments in businesses, products, or technologies that we believe are strategic, which may require the use of cash.
- Balance sheet. We view cash, short-term and long-term investments, deferred revenue, accounts receivable balances and days sales outstanding as important indicators of our financial health. Deferred revenues increased in the third quarter of fiscal year 2016 due to growth in the amount of annual maintenance contracts purchased on new products and maintenance renewal contracts related to our existing product installation base. Our days sales outstanding for the third quarter of fiscal year 2016 was 48.

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Summary of Critical Accounting Policies and Estimates

The preparation of our financial condition and results of operations requires us to make judgments and estimates that may have a significant impact upon our financial results. We believe that, of our significant accounting policies, the following require estimates and assumptions that require complex, subjective judgments by management, which can materially impact reported results: revenue recognition; reserve for doubtful accounts; reserve for product returns; accounting for income taxes; stock-based compensation; goodwill and intangible assets; and investments. None of these accounting policies and estimates have significantly changed since our annual report on Form 10-K for the year ended September 30, 2015 (Form 10-K). Critical accounting policies and estimates are more fully described in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Form 10-K. Actual results may differ from these estimates under different assumptions or conditions.

Results of Operations

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

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
	(in thousands, except percentages)			
Net Revenues				
Products	$231,366	$248,767	$691,485	$733,820
Services	265,156	234,819	778,200	684,702
Total	$496,522	$483,586	$1,469,685	$1,418,522
Percentage of net revenues				
Products	46.6 %	51.4 %	47.0 %	51.7 %
Services	53.4	48.6	53.0	48.3
Total	100.0 %	100.0 %	100.0 %	100.0 %

Net revenues. Total net revenues increased 2.7% and 3.6% for the three and nine months ended June 30, 2016, respectively, from the same periods in the prior year. Overall revenue growth for the three and nine months ended June 30, 2016 was primarily due to increased service revenues as a result of our increased installed base of products. International revenues represented 48.3% and 49.8% of total net revenues for the three and nine months ended June 30, 2016, respectively, compared to 46.3% and 48.1% for the same periods in the prior year, respectively. We expect international sales will continue to represent a significant portion of net revenues, although we cannot provide assurance that international revenues as a percentage of net revenues will remain at current levels.

Net product revenues decreased 7.0% and 5.8% for the three and nine months ended June 30, 2016, respectively, from the same periods in the prior year. The decrease in net product revenues for the three and nine months ended June 30, 2016 was due to a decrease of $18.2 million and $44.0 million in sales of our ADN products from the same periods in the prior year, respectively. Sales of our ADN products represented 98.7% of product revenues for both the three and nine months ended June 30, 2016, compared to 99.1% and 99.0% of product revenues for the three and nine months ended June 30, 2015, respectively.

Net service revenues increased 12.9% and 13.7% for the three and nine months ended June 30, 2016, respectively, from the same periods in the prior year. The increase in net service revenues was primarily due to increases in the purchase or renewal of maintenance contracts driven by additions to our installed base of products.

Westcon, Ingram Micro and Avnet Technology Solutions, three of our worldwide distributors, accounted for 18.8%, 14.9% and 13.7% of our total net revenue for the three months ended June 30, 2016, respectively. Westcon, Ingram Micro, Avnet Technology Solutions and Arrow ECS, four of our worldwide distributors, accounted for 18.9%, 14.8%, 13.6% and 10.1% of our total net revenue for the nine months ended June 30, 2016, respectively. Westcon, Ingram Micro and Avnet Technology Solutions accounted for 19.2%, 16.7%, and 13.5% of our total net revenue for the three months ended June 30, 2015, respectively. Westcon, Ingram Micro, Avnet Technology Solutions and Arrow ECS accounted for 17.8%, 16.3%, 13.6% and 10.6% of our total net revenue for the nine months ended June 30, 2015,

respectively. Westcon, Ingram Micro and Arrow ECS accounted for 18.5%, 13.6% and 11.9% of our accounts receivable as of June 30, 2016, respectively. Westcon and Ingram Micro accounted for 20.3% and 14.5% of our accounts receivable as of June 30, 2015, respectively. No other distributors accounted for more than 10% of total net revenue or receivables.

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	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
	(in thousands, except percentages)			
Cost of net revenues and Gross Margin				
Products	$40,474	$44,050	$123,033	$129,720
Services	43,869	41,609	129,223	117,883
Total	84,343	85,659	252,256	247,603
Gross profit	$412,179	$397,927	$1,217,429	$1,170,919
Percentage of net revenues and Gross Margin (as a percentage of related net revenue)				
Products	17.5 %	17.7 %	17.8 %	17.7 %
Services	16.5	17.7	16.6	17.2
Total	17.0	17.7	17.2	17.5
Gross profit	83.0 %	82.3 %	82.8 %	82.5 %

Cost of net product revenues. Cost of net product revenues consist of finished products purchased from our contract manufacturers, manufacturing overhead, freight, warranty, provisions for excess and obsolete inventory and amortization expenses in connection with developed technology from acquisitions. Cost of net product revenues decreased 8.1% and 5.2% for the three and nine months ended June 30, 2016, respectively, as compared to the same periods in the prior year. The decrease in cost of net product revenues is primarily due to a reduction in the volume of product sales.

Cost of net service revenues. Cost of net service revenues consist of the salaries and related benefits of our professional services staff, travel, facilities and depreciation expenses. For the three and nine months ended June 30, 2016, cost of net service revenues as a percentage of net service revenues was 16.5% and 16.6%, respectively, compared to 17.7% and 17.2% for the same periods in the prior year, respectively. The decrease in cost of net service revenues as a percentage of net service revenues is primarily due to the scalability of our existing customer support infrastructure and increased revenue from maintenance contracts. Professional services headcount at the end of June 2016 increased to 1,114 from 1,043 at the end of June 2015. In addition, cost of net service revenues included stock-based compensation expense of $4.2 million and $12.5 million for the three and nine months ended June 30, 2016, respectively, compared to $3.4 million and $9.4 million for the same periods in the prior year, respectively.

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
	(in thousands, except percentages)			
Operating expenses				
Sales and marketing	$156,620	$150,833	$470,545	$450,887
Research and development	83,042	74,337	250,481	218,918
General and administrative	34,182	32,627	103,238	95,814
Litigation expense	(527)	—	8,421	—
Total	$273,317	$257,797	$832,685	$765,619
Operating expenses (as a percentage of net revenue)				
Sales and marketing	31.5 %	31.2 %	32.0 %	31.8 %
Research and development	16.7	15.4	17.0	15.4
General and administrative	6.9	6.7	7.0	6.8
Litigation expense	(0.1)	—	0.6	—
Total	55.0 %	53.3 %	56.6 %	54.0 %

Sales and marketing. Sales and marketing expenses consist of salaries, commissions and related benefits of our sales and marketing staff, the costs of our marketing programs, including public relations, advertising and trade shows, travel, facilities, and depreciation expenses. Sales and marketing expenses increased 3.8% and 4.4% for the three and nine months ended June 30, 2016, respectively, from the comparable periods in the prior year. The increase in sales

and marketing expense was primarily due to an increase of $6.6 million and $18.4 million in commissions and personnel costs for the three and nine months ended June 30, 2016, respectively, from the comparable periods in the prior year. The increased commissions and personnel costs were driven primarily by growth in sales and marketing employee headcount for the corresponding periods. Sales and marketing headcount at the end of June 2016 increased to 1,595 from 1,529 at the end of June 2015. Sales and

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marketing expense included stock-based compensation expense of $15.2 million and $46.0 million for the three and nine months ended June 30, 2016, respectively, compared to $14.8 million and $42.8 million for the same periods in the prior year, respectively.

Research and development. Research and development expenses consist of the salaries and related benefits of our product development personnel, prototype materials and other expenses related to the development of new and improved products, facilities and depreciation expenses. Research and development expenses increased 11.7% and 14.4% for the three and nine months ended June 30, 2016, respectively, from the comparable periods in the prior year. The increase in research and development expense was primarily due to an increase of $6.7 million and $20.8 million in personnel costs for the three and nine months ended June 30, 2016, respectively, from the comparable periods in the prior year. Research and development headcount at the end of June 2016 increased to 1,166 from 1,124 at the end of June 2015. Research and development expense included stock-based compensation expense of $13.0 million and $39.6 million for the three and nine months ended June 30, 2016, respectively, compared to $11.9 million and $34.5 million for the same periods in the prior year, respectively. We expect research and development expenses to remain consistent as a percentage of net revenue in the foreseeable future.

General and administrative. General and administrative expenses consist of the salaries, benefits and related costs of our executive, finance, information technology, human resource and legal personnel, third-party professional service fees, bad debt charges, facilities and depreciation expenses. General and administrative expenses increased 4.8% and 7.7% for the three and nine months ended June 30, 2016, respectively, from the comparable periods in the prior year. The increase in general and administrative expense was primarily due to an increase of $2.2 million and $6.7 million in personnel costs for the three and nine months ended June 30, 2016, respectively, from the comparable periods in the prior year. General and administrative headcount at the end of June 2016 increased to 451 from 412 at the end of June 2015. Stock-based compensation expense was $5.7 million and $19.0 million for the three and nine months ended June 30, 2016, respectively, compared to $6.2 million and $16.2 million for the same periods in the prior year, respectively.

Litigation expense. In the second quarter of fiscal 2016, we accrued a litigation expense of $8.9 million, which included a patent-related jury verdict for $6.4 million and $2.5 million in legal fees and other costs associated with the litigation. The accrual was adjusted down by $0.5 million in the third quarter of fiscal 2016 to better reflect our total expected litigation expense.

	Three months ended June 30,		Nine months ended June 30,	
	2016	2015	2016	2015
	(in thousands, except percentages)			
Other income and income taxes				
Income from operations	$138,862	$140,130	$384,744	$405,300
Other income, net	978	720	2,246	6,580
Income before income taxes	139,840	140,850	386,990	411,880
Provision for income taxes	48,051	47,678	130,070	143,903
Net income	$91,789	$93,172	$256,920	$267,977
Other income and income taxes (as percentage of net revenue)				
Income from operations	28.0 %	29.0 %	26.2 %	28.5 %
Other income, net	0.2	0.1	0.2	0.5
Income before income taxes	28.2	29.1	26.4	29.0
Provision for income taxes	9.7	9.8	8.9	10.1
Net income	18.5 %	19.3 %	17.5 %	18.9 %

Other income, net. Other income, net consists primarily of interest income and foreign currency transaction gains and losses. Other income, net for the three months ended June 30, 2016 remained relatively consistent compared to the same period in the prior year. The decrease in other income, net for the nine months ended June 30, 2016, from the

same period in the prior year was primarily due to $5.2 million in foreign currency losses.

Provision for income taxes. The effective tax rate was 34.4% and 33.6% for the three and nine months ended June 30, 2016, respectively, compared to 33.8% and 34.9% for the three and nine months ended June 30, 2015, respectively. The increase in the effective tax rate for the three months ended June 30, 2016 is due to the impact of foreign income and a tax

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benefit recognized during the three months ended June 30, 2015 relating to a reduction in disallowed compensation expense. The decrease in the effective tax rate for the nine months ended June 30, 2016 is primarily due to the impact of foreign income, and the permanent extension of the United States Federal Credit for Increasing Research Activities.

We record a valuation allowance to reduce our deferred tax assets to the amount we believe is more likely than not to be realized. In making these determinations we consider historical and projected taxable income, and ongoing prudent and feasible tax planning strategies in assessing the appropriateness of a valuation allowance. Our net deferred tax assets at June 30, 2016 and June 30, 2015 were $42.9 million and $47.6 million, respectively. The net deferred tax assets include valuation allowances of $13.3 million and $9.5 million as of June 30, 2016 and June 30, 2015, respectively, which are primarily related to tax net operating losses incurred in certain foreign jurisdictions, and state tax carryforwards.

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

Liquidity and Capital Resources

Cash and cash equivalents, short-term investments and long-term investments totaled $1,124.2 million as of June 30, 2016, compared to $1,172.0 million as of September 30, 2015, representing a decrease of $47.8 million. The decrease was primarily due to cash used for the repurchase of outstanding common stock under our stock repurchase program of $550.1 million for the nine months ended June 30, 2016, which was partially offset by $507.5 million of cash provided by operating activities for the nine months ended June 30, 2016. Cash provided by operating activities for the first nine months of fiscal year 2016 resulted from net income of $256.9 million combined with changes in operating assets and liabilities, as adjusted for various non-cash items including stock-based compensation, deferred revenue, depreciation and amortization charges. Based on our current operating and capital expenditure forecasts, we believe that our existing cash and investment balances, together with cash generated from operations should be sufficient to meet our operating requirements for at least the next twelve months.

Cash provided by investing activities was $33.4 million for the nine months ended June 30, 2016, compared to cash provided by investing activities of $194.3 million for the same period in the prior year. Investing activities include purchases, sales and maturities of available-for-sale securities, business acquisitions, capital expenditures and changes in restricted cash requirements. The amount of cash provided by investing activities for the nine months ended June 30, 2016 was primarily due to the sales and maturity of investments partially offset by purchases of investments and capital expenditures related to the expansion of our facilities to support our operations worldwide.

Cash used in financing activities was $503.7 million for the nine months ended June 30, 2016, compared to cash used in financing activities of $409.8 million for the same period in the prior year. Our financing activities for the nine months ended June 30, 2016 consisted primarily of cash required for the repurchase of outstanding common stock under our stock repurchase program of $550.1 million, partially offset by cash received from the exercise of employee stock options and stock purchases under our employee stock purchase plan of $44.8 million.

Obligations and Commitments

As of June 30, 2016, our principal commitments consisted of obligations outstanding under operating leases. We lease our facilities under operating leases that expire at various dates through 2025. There have been no material changes in our principal lease commitments compared to those discussed in Management’s Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2015.

We outsource the manufacturing of our pre-configured hardware platforms to contract manufacturers who assemble each product to our specifications. Our agreement with our largest contract manufacturer allows them to procure component inventory on our behalf based upon a rolling production forecast. We are contractually obligated to

purchase the component inventory in accordance with the forecast, unless we give notice of order cancellation in advance of applicable lead times. There have been no material changes in our inventory purchase obligations compared to those discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2015.

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Recent Accounting Pronouncements

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

Risk Factors that May Affect Future Results

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. Our business, operating results, financial performance and share price may be materially adversely affected by a number of factors, including but not limited to the following risk factors, any one of which could cause actual results to vary materially from anticipated results or from those expressed in any forward-looking statements made by us in this Quarterly Report on Form 10-Q or in other reports, press releases or other statements issued from time to time. Additional factors that may cause such a difference are set forth elsewhere in this Quarterly Report on Form 10-Q.

Our business could be adversely impacted by conditions affecting the information technology market

A substantial portion of our business depends on the demand for information technology by large enterprise customers and service providers. In addition to the challenges presented by new cloud computing models, we are dependent upon the overall economic health of our current and prospective customers and the continued growth and evolution of the Internet. International, national, regional and local economic conditions, such as recessionary economic cycles, protracted economic slowdown or further deterioration of the economy could adversely impact demand for our products. Demand for our products and services depends substantially upon the general demand for application delivery products and associated services, which fluctuates based on numerous factors, including capital spending levels and growth of our current and prospective customers, as well as general economic conditions. Moreover, the purchase of our products is often discretionary and may involve a significant commitment of capital and other resources. Future economic projections for the information technology sector are uncertain as companies continue to reassess their spending for technology projects and embrace new models for delivery of IT services, such as cloud computing and highly orchestrated software defined networking environments. As a result, spending priorities for our current and future customers may vary and demand for our products and services may be impacted. In addition, customer buying patterns are changing over time and more customers seek to rent software on a subscription basis and to reduce their total cost of ownership. These evolving business models could lead to changes in demand and licensing strategies, which could have a material adverse effect on our business, results of operations and financial condition.

Cloud based computing trends present competitive and execution risks

Customers are transitioning to a hybrid computing environment utilizing various cloud-based software and services accessed via various smart client devices. Pricing and delivery models are evolving and our competitors are developing and deploying cloud-based services for customers. We are devoting significant resources to develop and deploy our own competing cloud-based software and services strategies. While we believe our expertise and investments in software and infrastructure for cloud-based services provides us with a strong foundation to compete, it is uncertain whether our strategies will attract the customers or generate the revenue required to be successful. In addition to software development costs, we are incurring costs to build and maintain infrastructure to support cloud-computing services. These costs may reduce the operating margins we have previously achieved. Whether we are successful in this new business model depends on our execution in a number of areas, including:

- continuing to innovate and bring to market compelling cloud-based services that generate increasing traffic and market share;
- maintaining the utility, compatibility and performance of our software on the growing array of cloud computing platforms and the enhanced interoperability requirements associated with orchestration of cloud computing environments; and
- implementing the infrastructure to deliver our own cloud based services.

These new business models may reduce our revenues or operating margins and could have a material adverse effect on our business, results of operations and financial condition.

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Industry consolidation may result in increased competition

Some of our competitors have made acquisitions or entered into partnerships or other strategic relationships to offer a more comprehensive solution than they had previously offered. We have also entered into large, strategic partnerships to enhance our competitive position in the marketplace. As IT companies attempt to strengthen or maintain their market positions in the evolving application delivery, mobility, cloud networking and cloud platform markets, these companies continue to seek to deliver comprehensive IT solutions to end users and combine enterprise-level hardware and software solutions that may compete with our solutions and which could negatively impact our partnerships. These consolidators or potential consolidators may have significantly greater financial, technical and other resources than we do and may be better positioned to acquire and offer complementary products and services. The companies resulting from these possible combinations may create more compelling product and service offerings and be able to offer greater pricing flexibility or sales and marketing support for such offerings than we can. These heightened competitive pressures could result in a loss of customers or a reduction in our revenues or revenue growth rates, all of which could adversely affect our business, results of operations and financial condition.

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

The markets we serve are new, rapidly evolving and highly competitive, and we expect competition to persist and intensify in the future. Our principal competitors in the application delivery networking market include Brocade Communications Systems, Inc., Citrix Systems, Inc., Radware Ltd. and A10 Networks. In related ADC markets, we compete with the following:

- Cisco, Juniper Networks and Checkpoint Systems in the network firewall market;
- Cisco, Imperva and Citrix in the web application firewall market;
- Cisco, Juniper and A10 in Carrier Grade NAT;
- Procera, Allot, Sandvine and other DPI vendors with our PEM offerings;
- Oracle via the acquisition of Tekelec and Acme Packet in the Diameter signaling market;
- IBM in end-user protection against malware, phishing and other cyberthreats;
- Akamai Networks in cloud-based DDoS protection; and
- Blue Coat Systems in protecting enterprises from inbound and outbound malware.

We expect to continue to face additional competition as new participants enter our markets. As we continue to expand globally, we may see new competitors in different geographic regions. In addition, larger companies with significant resources, brand recognition, and sales channels may form alliances with or acquire competing application delivery networking solutions from other companies and emerge as significant competitors. Potential competitors may bundle their products or incorporate an Internet traffic management or security component into existing products in a manner that discourages users from purchasing our products. Any of these circumstances may limit our opportunities for growth and negatively impact our financial performance.

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

The markets for our products and services are characterized by:

- rapid technological change;
- evolving industry standards;
- consolidation of network and application functions into existing network infrastructure products;
- requirements that our products interoperate with those of other IT vendors to enable ease of management;
- fluctuations in customer demand;
- changes in customer requirements; and
- frequent new product and service introductions and enhancements.

Our continued success depends on our ability to identify and develop new products and new features for our existing products to meet the demands of these changes, and the acceptance of those products and features by our existing and target customers. In addition, our products must interoperate with our end customers' IT infrastructure, which often have different specifications, deploy products from multiple vendors, and utilize multiple protocol standards. Our customers' IT infrastructure

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is becoming more complex and we may be reliant on orchestration and interoperability with third party vendors on whom we are reliant for testing and support of new product versions and configurations. If we are unable to identify, develop and deploy new products and new product features on a timely basis, our business and results of operations may be harmed.

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

Our success depends on sales and continued innovation of our application delivery networking product lines

For the fiscal year ended September 30, 2015 and the three and nine months ended June 30, 2016, we derived approximately 98.9%, 98.7% and 98.7% of our net product revenues, respectively, or approximately 51.1%, 46.0% and 46.5% of our total net revenues, respectively, from sales of our application delivery networking (ADN) product lines. We expect to continue to derive a significant portion of our net revenues from sales of our ADN products in the future. Implementation of our strategy depends upon these products being able to solve critical network availability, performance and security problems for our customers. If our ADN products are unable to solve these problems for our customers or if we are unable to sustain the high levels of innovation in our ADN product feature set needed to maintain leadership in what will continue to be a competitive market environment, our business and results of operations will be harmed.

Undetected software or hardware errors or security vulnerabilities may harm our business and results of operations

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

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

Our products are used to manage critical applications and data for customers and third parties may attempt to exploit security vulnerabilities in our products as well as our internal IT systems. As we continue to focus on the development and marketing of security solutions, we become a bigger target for malicious computer hackers who wish to exploit security vulnerabilities in our products or IT systems. These problems may cause us to incur significant remediation costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relations problems. Adverse publicity related to security vulnerabilities or damage to a customer’s operations due to exploitation of security vulnerability in our products or IT systems may harm our business and results of operations.

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

- expenditures of significant financial and product development resources in efforts to analyze, correct, eliminate, or work-around errors and defects or to address and eliminate vulnerabilities;
- loss of existing or potential customers or channel partners;
- negative publicity and damage to our reputation;
- delayed or lost revenue;

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- delay or failure to attain market acceptance;
- an increase in warranty claims compared with our historical experience, or an increased cost of servicing warranty claims, either of which would adversely affect our gross margins; and
- litigation, regulatory inquiries, or investigations that may be costly and harm our reputation.

We are dependent on various information technology systems, and failures of or interruptions to those systems could harm our business

Many of our business processes depend upon our IT systems, the systems and processes of third parties, and on interfaces with the systems of third parties. For example, our order entry system provides information to the systems of our contract manufacturers, which enables them to build and ship our products. If those systems fail or are interrupted, or if our ability to connect to or interact with one or more networks is interrupted, our processes may function at a diminished level or not at all. This would harm our ability to ship products, and our financial results may be harmed.

In addition, reconfiguring our IT systems or other business processes in response to changing business needs may be time-consuming and costly. To the extent this impacted our ability to react timely to specific market or business opportunities, our financial results may be harmed.

Our failure to adequately protect personal information could have a material adverse effect on our business

A wide variety of local, state, national, and international laws, directives and regulations apply to the collection, use, retention, protection, disclosure, transfer, and other processing of personal data. These data protection and privacy-related laws and regulations continue to evolve and may result in ever-increasing regulatory and public scrutiny and escalating levels of enforcement and sanctions and increased costs of compliance. Certain safe-harbor exemptions upon which the Company relies for data transfers have been challenged and may no longer available to us in the future. Our failure to comply with applicable laws and regulations, or to protect such data, could result in enforcement action against us, including fines, imprisonment of company officials and public censure, claims for damages by end-customers and other affected individuals, damage to our reputation and loss of goodwill (both in relation to existing end-customers and prospective end-customers), any of which could have a material adverse effect on our operations, financial performance, and business. Changing definitions of personal data and personal information, within the European Union, the United States, and elsewhere, especially relating to classification of IP addresses, machine identification, location data, and other information, may limit or inhibit our ability to operate or expand our business, including limiting strategic partnerships that may involve the sharing of data. The evolving data protection regulatory environment may require significant management attention and financial resources to analyze and modify our IT infrastructure to meet these changing requirements all of which could reduce our operating margins and impact our operating results and financial condition.

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

Our success depends, in large part, on our ability to attract, engage, retain, and integrate qualified executives and other key employees throughout all areas of our business. In order to attract and retain executives and other key employees in a competitive marketplace, we must provide a competitive compensation package, including cash- and equity-based compensation. If we do not obtain the stockholder approval needed to continue granting equity compensation in a competitive manner, our ability to attract, retain, and motivate executives and key employees could be weakened. Failure to successfully hire executives and key employees or the loss of any executives and key employees could have a significant impact on our operations. Further, changes in our management team may be disruptive to our business, and any failure to successfully integrate key new hires or promoted employees could adversely affect our business and results of operations. In addition, we recently announced the Board of Directors has formed a committee to initiate a search for a replacement for John McAdam as the Company’s CEO upon his retirement. The process of searching for and transitioning to a new chief executive could be disruptive to our business and could adversely affect our business and results of operations. The complexity of our application delivery networking products and their integration into existing networks and ongoing support, as well as the sophistication of our sales and marketing effort, requires us to retain highly trained developers, professional services, customer support and sales personnel. Competition for qualified developers, professional services, customer support and sales personnel in our industry is intense, especially

in Silicon Valley and Seattle where we have substantial operations and a need for highly skilled personnel, because of the limited number of people available with the necessary technical skills and understanding of our products. Also, to the extent we hire personnel from competitors, we may be subject to allegations that they have been improperly solicited, that they have divulged proprietary or other confidential information, that they have violated non-compete obligations to their prior employers, or that their former employers own their inventions or other work product. Our ability to hire and retain these personnel may be adversely affected by volatility or reductions in the price of our common stock or our ability to get approval

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from shareholders to offer additional common stock to our employees, since these employees are generally granted restricted stock units. The loss of services of any of our key personnel, the inability to retain and attract qualified personnel in the future or delays in hiring qualified personnel may harm our business and results of operations.

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

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

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

We outsource the manufacturing of our hardware platforms to third party contract manufacturers who assemble these hardware platforms to our specifications. We have experienced minor delays in shipments from contract manufacturers in the past. However, if we experience major delays in the future or other problems, such as inferior quality and insufficient quantity of product, any one or a combination of these factors may harm our business and results of operations. The inability of our contract manufacturers to provide us with adequate supplies of our products or the loss of one or more of our contract manufacturers may cause a delay in our ability to fulfill orders while we obtain a replacement manufacturer and may harm our business and results of operations. In particular, we currently subcontract manufacturing of our application delivery networking products to a single contract manufacturer with whom we do not have a long-term contract. If our arrangement with this single source of hardware assembly was terminated or otherwise impaired, and we were not able to engage another contract manufacturer in a timely manner, our business, financial condition and results of operation could be adversely affected.

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

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

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

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

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

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

We sell our products and services through multiple distribution channels in the United States and internationally, including leading industry distributors, value-added resellers, systems integrators, service providers and other indirect channel partners. We have a limited number of agreements with companies in these channels, and we may not be able to increase our

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number of distribution relationships or maintain our existing relationships. Recruiting and retaining qualified channel partners and training them in our technologies requires significant time and resources. These channel partners may also market, sell and support products and services that are competitive with ours and may devote more resources to the marketing, sales and support of such competitive products. Our indirect sales channel structure could subject us to lawsuits, potential liability, and reputational harm if, for example, any of our channel partners misrepresent the functionality of our products or services to customers or violate laws or our corporate policies. If we are unable to establish or maintain our indirect sales channels, our business and results of operations will be harmed. In addition, four worldwide distributors of our products accounted for 57.9% of our total net revenue for fiscal year 2015. Three worldwide distributors of our products accounted for 45.9% of our total net revenue for fiscal year 2014. Three worldwide distributors of our products accounted for 47.4% of our total revenue for the three months ended June 30, 2016. Four worldwide distributors of our products accounted for 57.4% of our total net revenue for the nine months ended June 30, 2016. A substantial reduction or delay in sales of our products to these distribution partners, if not replaced by sales to other indirect channel partners and distributors, could harm our business, operating results and financial condition.

A portion of our revenue is generated by sales to government entities, which are subject to a number of challenges and risks

Sales to U.S. and foreign, federal, state, and local governmental agency end-customers account for a significant portion of our revenues and we may in the future increase sales to government entities. Sales to government entities are subject to a number of risks. Selling to government entities can be highly competitive, expensive, and time consuming, often requiring significant upfront time and expense without any assurance that these efforts will generate a sale. The substantial majority of our sales to date to government entities have been made indirectly through our channel partners. Government certification requirements for products like ours may change, thereby restricting our ability to sell into the federal government sector until we have attained the revised certification. Government demand and payment for our products and services may be impacted by public sector budgetary cycles and funding authorizations, with funding reductions or delays adversely affecting public sector demand for our products and services. Government entities may have statutory, contractual or other legal rights to terminate contracts with our distributors and resellers for convenience or due to a default, and any such termination may adversely impact our future operating results. Governments routinely investigate and audit government contractors' administrative processes, and any unfavorable audit could result in the government refusing to continue buying our products and services, a reduction of revenue or fines or civil or criminal liability if the audit uncovers improper or illegal activities, which could adversely impact our operating results in a material way. Finally, for purchases by the U.S. government, the government may require certain products to be manufactured in the United States and other relatively high cost manufacturing locations, and we may not manufacture all products in locations that meet the requirements of the U.S. government, affecting our ability to sell these products to the U.S. government.

Misuse of our products could harm our reputation

Our products may be misused by end-customers or third parties that obtain access to our products. For example, our products could be used to censor private access to certain information on the Internet. Such use of our products for censorship could result in negative publicity and damage to our reputation. In addition, as many of our products are subject to export control regulations, diversion of our products to restricted third parties by others could result in investigations, penalties, fines, trade restrictions and negative publicity that could damage our reputation and materially impact our business, operating results, and financial condition.

Our quarterly and annual operating results may fluctuate in future periods, which may cause our stock price to fluctuate

Our quarterly and annual operating results have varied significantly in the past and could vary significantly in the future, which makes it difficult for us to predict our future operating results. Our operating results may fluctuate due to a variety of factors, many of which are outside of our control, including the changing and recently volatile U.S. and global economic environment, which may cause our stock price to fluctuate. In particular, we anticipate that the size of customer orders may increase as we continue to focus on larger business accounts. A delay in the recognition of revenue, even from just one account, may have a significant negative impact on our results of operations for a given

period. In the past, a majority of our sales have been realized near the end of a quarter. Accordingly, a delay in an anticipated sale past the end of a particular quarter may negatively impact our results of operations for that quarter, or in some cases, that fiscal year. Additionally, we have exposure to the credit risks of some of our customers and sub-tenants. Although we have programs in place that are designed to monitor and mitigate the associated risk, there can be no assurance that such programs will be effective in reducing our credit risks adequately. We monitor individual payment capability in granting credit arrangements, seek to limit the total credit to amounts we believe our customers can pay and maintain reserves we believe are adequate to cover exposure for potential losses. If there is a deterioration of a sub-tenant's or a major customer's creditworthiness or actual defaults are higher than expected, future losses, if incurred, could harm our business and have a material adverse effect on our operating results. Further, our operating

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results may be below the expectations of securities analysts and investors in future quarters or years. Our failure to meet these expectations will likely harm the market price of our common stock. Such a decline could occur, and has occurred in the past, even when we have met our publicly stated revenue and/or earnings guidance.

Reliance on shipments at the end of the quarter could cause our revenue for the applicable period to fall below expected levels

As a result of customer buying patterns and the efforts of our sales force and channel partners to meet or exceed their sales objectives, we have historically received a substantial portion of sales orders and generated a substantial portion of revenue during the last few weeks of each fiscal quarter. In addition, any significant interruption in our information technology systems, which manage critical functions such as order processing, revenue recognition, financial forecasts, inventory and supply chain management, and trade compliance reviews, could result in delayed order fulfillment and decreased revenue for that fiscal quarter. If expected revenue at the end of any fiscal quarter is delayed for any reason, including the failure of anticipated purchase orders to materialize, our third party contract manufacturers' inability to manufacture and ship products prior to fiscal quarter-end to fulfill purchase orders received near the end of the fiscal quarter, our failure to manage inventory to meet demand, our inability to release new products on schedule, any failure of our systems related to order review and processing, or any delays in shipments based on trade compliance requirements, our revenue for that quarter could fall below our expectations, resulting in a decline in the trading price of our common stock.

Changes in financial accounting standards may cause adverse unexpected revenue fluctuations and affect our reported results of operations

A change in accounting policies can have a significant effect on our reported results and may even affect our reporting of transactions completed before the change is effective. New pronouncements and varying interpretations of existing pronouncements have occurred with frequency and may occur in the future. Changes to existing rules, or changes to the interpretations of existing rules, could lead to changes in our accounting practices, and such changes could adversely affect our reported financial results or the way we conduct our business.

We may have exposure to greater than anticipated tax liabilities

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

We are subject to governmental export and import controls that could subject us to liability or impair our ability to compete in international markets

Our products are subject to U.S. export controls and may be exported outside the U.S. only with the required level of export license or through an export license exception because we incorporate encryption technology into our products. In addition, various countries regulate the import of certain encryption technology and have enacted laws that could limit our ability to distribute our products or our customers' ability to implement our products in those countries. Changes in our products or changes in export and import regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products throughout their global systems or, in some cases, prevent the export or import of our products to certain countries altogether. Any change in export or import regulations or related legislation, shift in approach to the enforcement or scope of existing regulations or change in the countries, persons or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers with international operations. Any decreased use of our products or limitation on our ability to export or sell our products would likely adversely affect our business, operating results and financial condition.

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

We rely on a combination of patent, copyright, trademark and trade secret laws, and restrictions on disclosure of confidential and proprietary information to protect our intellectual property rights. Despite our efforts to protect our proprietary

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rights, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. Monitoring unauthorized use of our products is difficult, and we cannot be certain that the steps we have taken will prevent misappropriation of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States.

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. In the ordinary course of our business, we are involved in disputes and licensing discussions with others regarding their claimed proprietary rights and cannot provide assurance that we will always successfully defend ourselves against such claims and such matters are subject to many uncertainties and outcomes are not predictable with assurance. We expect that infringement claims may increase as the number of products and competitors in our market increases and overlaps occur. Also, as we have gained greater visibility, market exposure and competitive success, we face a higher risk of being the subject of intellectual property infringement claims. If we are found to infringe the proprietary rights of others, or if we otherwise settle such claims, we could be compelled to pay damages or royalties and either obtain a license to those intellectual property rights or alter our products so that they no longer infringe upon such proprietary rights. Any license could be very expensive to obtain or may not be available at all or may require us to make royalty payments which could adversely affect gross margins in future periods. The actual liability in any such matters may be materially different from our estimate, if any, which could result in the need to adjust the liability and record additional expenses. Similarly, changing our products or processes to avoid infringing upon the rights of others may be costly or impractical. In addition, we have initiated, and may in the future initiate, claims or litigation against third parties for infringement of our proprietary rights, or to determine the scope and validity of our proprietary rights or those of our competitors. Any of these claims, whether claims that we are infringing the proprietary rights of others, or vice versa, with or without merit, may be time-consuming, result in costly litigation and diversion of technical and management personnel or require us to cease using infringing technology, develop non-infringing technology or enter into royalty or licensing agreements. Further, our license agreements typically require us to indemnify our customers, distributors and resellers for infringement actions related to our technology, which could cause us to become involved in infringement claims made against our customers, distributors or resellers. Any of the above-described circumstances relating to intellectual property rights disputes could result in our business and results of operations being harmed.

We incorporate open source software into our products. Although we monitor our use of open source closely, the terms of many open source licenses have not been interpreted by U.S. courts, and there is a risk that such licenses could be construed in a manner that could impose unanticipated conditions or restrictions on our ability to commercialize our products. We could also be subject to similar conditions or restrictions should there be any changes in the licensing terms of the open source software incorporated into our products. In either event, we could be required to seek licenses from third parties in order to continue offering our products, to re-engineer our products or to discontinue the sale of our products in the event re-engineering cannot be accomplished on a timely or successful basis, any of which could adversely affect our business, operating results and financial condition.

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

Our operating results are exposed to risks associated with international commerce

As our international sales increase, our operating results become more exposed to international operating risks. Additionally, our international sales and operations are subject to a number of risks, including the following:

- greater difficulty in enforcing contracts and accounts receivable collection and longer collection periods;
- the uncertainty of protection for intellectual property rights in some countries;
- greater risk of unexpected changes in regulatory practices, tariffs, and tax laws and treaties;
-

risks associated with trade restrictions and foreign legal requirements, including the importation, certification, and localization of our products required in foreign countries;

- greater risk of a failure of foreign employees, partners, distributors, and resellers to comply with both U.S. and foreign laws, including antitrust regulations, the U.S. Foreign Corrupt Practices Act, and any trade regulations ensuring fair trade practices;

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- heightened risk of unfair or corrupt business practices in certain geographies and of improper or fraudulent sales arrangements that may impact financial results and result in restatements of, or irregularities in, financial statements;
- increased expenses incurred in establishing and maintaining office space and equipment for our international operations;
- greater difficulty in recruiting local experienced personnel, and the costs and expenses associated with such activities;
- management communication and integration problems resulting from cultural and geographic dispersion;
- fluctuations in exchange rates between the U.S. dollar and foreign currencies in markets where we do business;
- economic uncertainty around the world, including continued economic uncertainty as a result of sovereign debt issues in Europe; and
- general economic and political conditions in these foreign markets.

We must hire and train experienced personnel to staff and manage our foreign operations. To the extent that we experience difficulties in recruiting, training, managing, and retaining an international staff, and specifically staff related to sales management and sales personnel, we may experience difficulties in sales productivity in foreign markets. We also enter into strategic distributor and reseller relationships with companies in certain international markets where we do not have a local presence. If we are not able to maintain successful strategic distributor relationships internationally or recruit additional companies to enter into strategic distributor relationships, our future success in these international markets could be limited. Business practices in the international markets that we serve may differ from those in the United States and may require us in the future to include terms other than our standard terms in customer contracts. We intend to continue expanding into international markets. Sales outside of the Americas represented 42.7% and 43.1% of our net revenues for the fiscal years ended September 30, 2015 and 2014, respectively, and 43.5% and 44.2% for the three and nine months ended June 30, 2016, respectively.

These factors and other factors could harm our ability to gain future international revenues and, consequently, materially impact our business, operating results, and financial condition. The expansion of our existing international operations and entry into additional international markets will require significant management attention and financial resources. Our failure to successfully manage our international operations and the associated risks effectively could limit the future growth of our business.

Changes in governmental regulations could negatively affect our revenues

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

New regulations related to conflict minerals may force us to incur additional expenses and could limit the supply and increase the costs of certain metals and minerals used in the manufacturing of our products

In August 2012, the SEC adopted new requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (or the Dodd-Frank Act) for companies that use certain minerals and derivative metals (referred to as conflict minerals, regardless of their country of origin) in their products, whether or not these products are manufactured by third parties. The Dodd-Frank Act requires companies to perform due diligence and disclose whether or not such minerals originate from the Democratic Republic of Congo or adjoining countries. We filed a report on Form SD with the SEC regarding such matters on May 31, 2016. These new requirements could adversely affect the sourcing, availability and pricing of minerals or metals used in the manufacture of our products and the numerous components that go into our products all of which could adversely affect our business, financial condition, and operating results. In addition, we will incur additional costs to comply with the disclosure requirements, including costs related to determining the source of any relevant minerals and metals used in our products. We have a complex supply chain and many components are sourced through our contract manufacturer and we may not be able to sufficiently verify the origins for these minerals and metals used in our products through the due diligence procedures that we implement. As a result, we may face reputational challenges with our customers and other stakeholders and

possible regulatory risk.

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We face litigation risks

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

Acquisitions present many risks and we may not realize the financial and strategic goals that are contemplated at the time of the transaction

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

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

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

Our Board of Directors has the authority to issue up to 10,000,000 shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by the shareholders. The rights of the holders of common stock may be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock may have the effect of delaying, deferring or preventing a change of control of our company without further action by our shareholders and may adversely affect the voting and other rights of the holders of common stock.

Further, certain provisions of our bylaws, including a provision limiting the ability of shareholders to raise matters at a meeting of shareholders without giving advance notice, may have the effect of delaying or preventing changes in control or management of our company, which could have an adverse effect on the market price of our common stock.

Similarly, state anti-takeover laws in the State of Washington related to corporate takeovers may prevent or delay a change of control of our company.

Our stock price could be volatile, particularly during times of economic uncertainty and volatility in domestic and international stock markets

Our stock price has been volatile and has fluctuated significantly in the past. The trading price of our stock is likely to continue to be volatile and subject to fluctuations in the future. Some of the factors that could significantly affect the market price of our stock include:

- Actual or anticipated variations in operating and financial results;
- Analyst reports or recommendations;
- Rumors, announcements or press articles regarding our competitors' operations, management, organization, financial condition or financial statements; and
- Other events or factors, many of which are beyond our control.

The stock market in general and the market for technology companies in particular, have experienced extreme price and volume fluctuations. These fluctuations have often been unrelated or disproportionate to operating performance. The fluctuations may continue in the future and this could significantly impact the value of our stock and your investment.

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Significant U.K. or European developments stemming from the U.K.'s referendum on membership in the European Union could have a material adverse effect on us

On June 23, 2016, the United Kingdom held a referendum and voted in favor of leaving the European Union. This has created political and economic uncertainty, particularly in the United Kingdom and the European Union, and this uncertainty may last for years. Our business in the United Kingdom, the European Union, and worldwide could be affected during this period of uncertainty, and perhaps longer, by the impact of the United Kingdom's referendum. There are many ways in which our business could be affected, only some of which we can identify as of the date of this report.

The referendum, and the likely withdrawal of the United Kingdom from the European Union it triggers, has caused and, along with events that could occur in the future as a consequence of the United Kingdom's withdrawal, including the possible breakup of the United Kingdom, may continue to cause significant volatility in global financial markets, including in global currency and debt markets. This volatility could cause a slowdown in economic activity in the United Kingdom, Europe or globally, which could adversely affect our operating results and growth prospects. In addition, our business could be negatively affected by new trade agreements between the United Kingdom and other countries, including the United States, and by the possible imposition of trade or other regulatory barriers in the United Kingdom. These possible negative impacts, and others resulting from the United Kingdom's actual or threatened withdrawal from the European Union, may adversely affect our operating results and growth prospects.

We face risks associated with having operations and employees located in Israel

We have offices and employees located in Israel. As a result, political, economic, and military conditions in Israel directly affect our operations. The future of peace efforts between Israel and its Arab neighbors remains uncertain. There has been a significant increase in hostilities and political unrest in Israel in the past year. The effects of these hostilities and violence on the Israeli economy and our operations in Israel are unclear, and we cannot predict the effect on us of further increases in these hostilities or future armed conflict, political instability or violence in the region. In addition, many of our employees in Israel are obligated to perform annual reserve duty in the Israeli military and are subject to being called for active duty under emergency circumstances. We cannot predict the full impact of these conditions on us in the future, particularly if emergency circumstances or an escalation in the political situation occurs. If many of our employees in Israel are called for active duty for a significant period of time, our operations and our business could be disrupted and may not be able to function at full capacity. Current or future tensions and conflicts in the Middle East could adversely affect our business, operating results, financial condition and cash flows.

Our business is subject to the risks of earthquakes, fire, power outages, floods, and other catastrophic events, and to interruption by man-made problems such as terrorism

A significant natural disaster, such as an earthquake, a fire, a flood, or a significant power outage could have a material adverse impact on our business, operating results, and financial condition. We have an administrative and product development office and a third party contract manufacturer located in the San Francisco Bay Area, a region known for seismic activity. In addition, natural disasters could affect our supply chain, manufacturing vendors, or logistics providers' ability to provide materials and perform services such as manufacturing products or assisting with shipments on a timely basis. In the event our or our service providers' information technology systems or manufacturing or logistics abilities are hindered by any of the events discussed above, shipments could be delayed, resulting in missed financial targets, such as revenue and shipment targets, for a particular quarter. In addition, cyber-attacks, acts of terrorism, or other geo-political unrest could cause disruptions in our business or the business of our supply chain, manufacturers, logistics providers, partners, or end-customers or the economy as a whole. Any disruption in the business of our supply chain, manufacturers, logistics providers, partners or end-customers that impacts sales at the end of a fiscal quarter could have a significant adverse impact on our quarterly results. All of the aforementioned risks may be further increased if the disaster recovery plans for us and our suppliers prove to be inadequate. To the extent that any of the above should result in delays or cancellations of customer orders, or the delay in the manufacture, deployment or shipment of our products, our business, financial condition and operating results would be adversely affected.

In addition to other risks listed in this "Risk Factors" section, factors that may affect our operating results include, but are not limited to:

- fluctuations in demand for our products and services due to changing market conditions, pricing conditions, technology evolution, seasonality, or other changes in the global economic environment;
- changes or fluctuations in sales and implementation cycles for our products and services;
- changes in the mix of our products and services, including increases in subscription based offerings;
- changes in the growth rate of the application delivery market;

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- reduced visibility into our customers' spending and implementation plans;
- reductions in customers' budgets for data center and other IT purchases or delays in these purchases;
- changes in end-user customer attach rates and renewal rates for our services;
- fluctuations in our gross margins, including the factors described herein, which may contribute to such fluctuations;
- our ability to control costs, including operating expenses, the costs of hardware and software components, and other manufacturing costs;
- our ability to develop, introduce and gain market acceptance of new products, technologies and services, and our success in new and evolving markets;
- any significant changes in the competitive environment, including the entry of new competitors or the substantial discounting of products or services;
- the timing and execution of product transitions or new product introductions, and related inventory costs;
- variations in sales channels, product costs, or mix of products sold;
- our ability to establish and manage our distribution channels, and the effectiveness of any changes we make to our distribution model;
- the ability of our contract manufacturers and suppliers to provide component parts, hardware platforms and other products in a timely manner;
- benefits anticipated from our investments in sales, marketing, product development, manufacturing or other activities;
- impacts on our overall tax rate caused by any reorganization in our corporate structure;
- changes in tax laws or regulations, or other accounting rules; and
- general economic conditions, both domestically and in our foreign markets.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk. We maintain an investment portfolio of various holdings, types, and maturities. Our primary objective for holding fixed income securities is to achieve an appropriate investment return consistent with preserving principal and managing risk. At any time, a sharp rise in market interest rates could have a material adverse impact on the fair value of our fixed income investment portfolio. Conversely, declines in interest rates, including the impact from lower credit spreads, could have a material adverse impact on interest income for our investment portfolio. Our fixed income investments are held for purposes other than trading. Our fixed income investments were not leveraged as of June 30, 2016. We monitor our interest rate and credit risks, including our credit exposures to specific rating categories and to individual issuers. As of June 30, 2016, 32.5% of our fixed income securities balance consisted of U.S. government and U.S. government agency securities. We believe the overall credit quality of our portfolio is strong.

Management believes there have been no material changes to our quantitative and qualitative disclosures about market risk during the nine month period ended June 30, 2016, compared to those discussed in our Annual Report on Form 10-K for the year ended September 30, 2015.

Item 4. Controls and Procedures

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

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2016. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of June 30, 2016.

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

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

Information regarding risk factors appears in Part I — Item 2 of this Quarterly Report on Form 10-Q, “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Risk Factors that May Affect Future Results.” This information includes previously disclosed material changes to the risk factors set forth in Part I — Item 1A of the Form 10-K.

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

On April 20, 2016, the Company announced that its Board of Directors authorized an additional $1 billion for its common stock share repurchase program. This new authorization is incremental to the existing $2.4 billion program, initially approved in October 2010 and expanded in each fiscal year. Acquisitions for the share repurchase programs will be made from time to time in private transactions or open market purchases as permitted by securities laws and other legal requirements. The programs can be terminated at any time. As of June 30, 2016, the Company had repurchased and retired 5,402,131 shares at an average price of $101.83 per share during fiscal year 2016 and the Company had $923.8 million remaining authorized to purchase shares.

Shares repurchased and retired as of June 30, 2016 are as follows (in thousands, except shares and per share data):

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased per the Publicly Announced Plan	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plan
October 1, 2015 — October 31, 2015	—	$ —	—	$ 473,867
November 1, 2015 — November 30, 2015	1,888,266	$ 105.94	1,888,266	$ 273,832
December 1, 2015 — December 31, 2015	—	$ —	—	$ 273,832
January 1, 2016 — January 31, 2016	1,194,000	$ 94.57	1,194,000	$ 160,916
February 1, 2016 — February 29, 2016	920,165	$ 94.68	920,165	$ 73,790
March 1, 2016 — March 31, 2016	—	$ —	—	$ 73,790
April 1, 2016 — April 30, 2016	—	$ —	—	$ 1,073,790
May 1, 2016 — May 31, 2016	1,000,000	$ 106.30	1,000,000	$ 967,490
June 1, 2016 — June 30, 2016	399,700	$ 109.39	399,700	$ 923,766

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Item 6. Exhibits

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

*Filed herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 27th day of July, 2016.

F5 NETWORKS, INC.

By: /s/ ANDY REINLAND
Andy Reinland
Executive Vice President,
Chief Financial Officer
(principal financial officer and principal accounting officer)