

F5 NETWORKS INC  
Form 10-K/A  
December 15, 2005

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

**Form 10-K/A  
Amendment No. 1  
FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
For the fiscal year ended September 30, 2005**

or

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

**Commission File Number 000-26041**

**F5 Networks, Inc.**

*(Exact name of Registrant as specified in its charter)*

**WASHINGTON**

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

**91-1714307**

*(I.R.S. Employer  
Identification No.)*

**401 Elliott Ave West**

**Seattle, Washington 98119**

*(Address of principal executive offices)*

**(206) 272-5555**

*(Registrant's telephone number, including area code)*

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

**None**

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

**Common Stock, no par value**

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

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

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

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

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

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

**DOCUMENTS INCORPORATED BY REFERENCE**

Information required in response to Part III of Form 10-K (Items 10, 11, 12, 13 and 14) is hereby incorporated by reference to the specified portions of the Registrant's Definitive Proxy Statement for the Annual Shareholders Meeting to be held on March 2, 2006, which Definitive Proxy Statement shall be filed with the Securities and Exchange Commission within 120 days of the end of the fiscal year to which this Report relates.

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**EXPLANATION OF AMENDMENT**

This Amendment No. 1 on Form 10-K/A is being filed to correct an error in note 1 to the Company's consolidated financial statements relating to the pro forma effect on the Company's net income per share for the year ended September 30, 2005 had stock-based compensation expense been included in net income pursuant to SFAS 123. There were no changes to the consolidated financial statements and this amendment had no effect on the Company's results of operations or financial condition. The Company has also included Item 15. Exhibits and Financial Statement Schedules of the Original 10-K to reflect updated management certifications.

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

**F5 NETWORKS, INC.**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

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

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

**Consolidated financial statements and financial statement schedule**

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

**Internal control over financial reporting**

Also, in our opinion, management's assessment, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of September 30, 2005 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2005 based on criteria established in *Internal Control - Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal

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

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

/s/ PricewaterhouseCoopers LLP

Seattle, Washington

December 9, 2005

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**F5 NETWORKS, INC.  
CONSOLIDATED BALANCE SHEETS**

	September 30,	
	2005	2004
	(In thousands)	
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 51,867	\$ 24,901
Short-term investments	184,314	115,600
Accounts receivable, net of allowances of \$2,969 and \$3,161	41,703	22,665
Inventories	2,699	1,696
Deferred tax assets	3,935	2,934
Other current assets	9,906	5,776
<b>Total current assets</b>	<b>294,424</b>	<b>173,572</b>
Restricted cash	3,871	6,243
Property and equipment, net	16,158	11,954
Long-term investments	128,834	81,792
Deferred tax assets	36,212	28,446
Goodwill	49,677	50,067
Other assets, net	8,323	8,279
<b>Total assets</b>	<b>\$ 537,499</b>	<b>\$ 360,353</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities		
Accounts payable	\$ 7,668	\$ 4,840
Accrued liabilities	19,648	15,948
Deferred revenue	36,009	25,692
<b>Total current liabilities</b>	<b>63,325</b>	<b>46,480</b>
Other long-term liabilities	6,650	3,856
Deferred revenue, long-term	3,314	2,372
<b>Total long-term liabilities</b>	<b>9,964</b>	<b>6,228</b>
Commitments and contingencies		
Shareholders equity		
Preferred stock, no par value; 10,000 shares authorized, no shares outstanding		
Common stock, no par value; 100,000 shares authorized, 38,593 and 34,772 shares issued and outstanding	412,419	306,655
Accumulated other comprehensive loss	(1,430)	(498)

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Retained earnings	53,221	1,488
Total shareholders' equity	464,210	307,645
Total liabilities and shareholders' equity	\$ 537,499	\$ 360,353

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



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**F5 NETWORKS, INC.**  
**CONSOLIDATED INCOME STATEMENTS**

**Years Ended September 30,**

**2005                      2004                      2003**

**(In thousands, except per share data)**

<b>Net revenues</b>			
Products	\$ 219,603	\$ 126,169	\$ 84,197
Services	61,807	45,021	31,698
Total	281,410	171,190	115,895
<b>Cost of net revenues</b>			
Products	48,985	28,404	17,837
Services	16,172	10,975	9,068
Total	65,157	39,379	26,905
Gross profit	216,253	131,811	88,990
<b>Operating expenses</b>			
Sales and marketing	89,253	65,378	53,504
Research and development	31,349	24,361	19,260
General and administrative	23,760	15,744	12,037
Total	144,362	105,483	84,801
Income from operations	71,891	26,328	4,189
Other income, net	8,076	2,731	751
Income before income taxes	79,967	29,059	4,940
Provision (benefit) for income taxes	28,234	(3,894)	853
Net income	\$ 51,733	\$ 32,953	\$ 4,087
Net income per share basic	\$ 1.39	\$ 0.99	\$ 0.15
Weighted average shares basic	37,220	33,221	26,453
Net income per share diluted	\$ 1.34	\$ 0.92	\$ 0.14
Weighted average shares diluted	38,733	35,992	28,220

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



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**F5 NETWORKS, INC.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**

	Common Stock		Accumulated Other Unearned Comprehensive		Retained	Total
	Shares	Amount	Compensation	Income/(Loss)	Earnings (Deficit)	Shareholders Equity
(In thousands)						
<b>Balance, September 30, 2002</b>	25,730	\$ 128,876	\$ (93)	\$ 454	\$ (35,552)	\$ 93,685
Exercise of employee stock options	1,424	10,827				10,827
Issuance of stock under employee stock purchase plan	249	2,006				2,006
Amortization of unearned compensation			83			83
Net income					4,087	
Foreign currency translation adjustment				(161)		
Unrealized loss on securities				(98)		
Comprehensive income						3,828
<b>Balance, September 30, 2003</b>	27,403	\$ 141,709	\$ (10)	\$ 195	\$ (31,465)	\$ 110,429
Exercise of employee stock options	2,032	22,349				22,349
Issuance of stock under employee stock purchase plan	162	2,579				2,579
Issuance of common stock in a public offering (net of issuance costs of \$6,682)	5,175	113,636				113,636
Tax benefit from employee stock transactions		26,382				26,382
Amortization of unearned compensation			10			10
Net income					32,953	
Foreign currency translation adjustment				144		
Unrealized loss on securities				(838)		
Comprehensive income						32,260
<b>Balance, September 30, 2004</b>	34,772	\$ 306,655	\$	\$ (498)	\$ 1,488	\$ 307,645
	3,685	65,056				65,056

Exercise of employee stock options							
Issuance of stock under employee stock purchase plan	136	3,837					3,837
Tax benefit from employee stock transactions		32,298					32,298
Stock based compensation		4,573					4,573
Net income					51,733		
Foreign currency translation adjustment				(161)			
Unrealized loss on securities				(771)			
Comprehensive income							50,801
<b>Balance, September 30, 2005</b>	38,593	\$ 412,419	\$	\$ (1,430)	\$ 53,221	\$	464,210

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

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**F5 NETWORKS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Years Ended September 30,

2005                      2004                      2003

(In thousands)

**Operating activities**

Net income	\$ 51,733	\$ 32,953	\$ 4,087
Adjustments to reconcile net income to net cash provided by operating activities:			
Realized loss (gain) on disposition of assets	569	21	(14)
Realized (gain) loss on sale of investments		(3)	232
Stock based compensation	4,573	10	83
Provision for doubtful accounts and sales returns	1,419	1,189	1,148
Depreciation and amortization	6,797	5,355	5,162
Deferred income taxes	(7,733)	(33,886)	
Tax benefit from employee stock option plans	32,298	26,382	
Changes in operating assets and liabilities, net of amounts acquired:			
Accounts receivable	(20,456)	(4,152)	354
Inventories	(1,002)	(928)	(408)
Other current assets	(3,604)	(642)	(54)
Other assets	(149)	(630)	(512)
Accounts payable and accrued liabilities	9,283	6,163	(320)
Deferred revenue	11,259	8,758	4,852
Net cash provided by operating activities	84,987	40,590	14,610

**Investing activities**

Purchases of investments	(407,533)	(335,231)	(157,834)
Sales of investments	290,351	205,662	149,724
Investment of restricted cash	2,369	(168)	
Proceeds from the sale of property and equipment			14
Acquisition of intangible assets, net	(2,259)		
Acquisition of businesses, net of cash acquired	(395)	(29,201)	(27,373)
Purchases of property and equipment	(9,293)	(5,775)	(2,584)
Net cash used in investing activities	(126,760)	(164,713)	(38,053)

**Financing activities**

Proceeds from secondary offering, net of issuance costs		113,636	
Proceeds from the exercise of stock options	68,867	24,832	12,833
Net cash provided by financing activities	68,867	138,468	12,833
Net increase (decrease) in cash and cash equivalents	27,094	14,345	(10,610)

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

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

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

**1. Summary of Significant Accounting Policies**

**The Company**

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

**Certain Risks and Uncertainties**

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

**Accounting Principles**

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

**Principles of Consolidation**

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

**Reclassifications**

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

**Use of Estimates**

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

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**F5 NETWORKS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Cash and Cash Equivalents**

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

**Investments**

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

**Concentration of Credit Risk**

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

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

**Fair Value of Financial Instruments**

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

**Inventories**

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



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

Inventories consist of the following (in thousands):

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

**Restricted Cash**

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

**Property and Equipment**

Property and equipment is stated at cost. Depreciation of property and equipment are provided using the straight-line method over the estimated useful lives of the assets, ranging from two to five years. Leasehold improvements are amortized over the lesser of the lease term or the estimated useful life of the improvements. The cost of normal maintenance and repairs is charged to expense as incurred and expenditures for major improvements are capitalized at cost. Gains or losses on the disposition of assets are reflected in the income statements at the time of disposal.

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

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

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

**Goodwill**

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

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**F5 NETWORKS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

with the acquisition of MagniFire Websystems Inc., in fiscal year 2004. The Company completed its annual impairment test in the second quarter of each fiscal year and concluded that there was no impairment of goodwill in either fiscal year 2005 or 2004.

**Other Assets**

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

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

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

**Impairment of Long-Lived Assets**

The Company assesses the impairment of long-lived assets whenever events or changes in business circumstances indicate that the carrying amount of an asset may not be recoverable. When such events occur, management determines whether there has been an impairment by comparing the anticipated undiscounted net future cash flows to the related asset's carrying value. If an impairment exists, the asset is written down to its estimated fair value.

**Revenue Recognition**

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

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

**Table of Contents****F5 NETWORKS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

the individual markets. The Company has offered extended payment terms ranging from three to six months to certain customers, in which case, revenue is recognized when payments are received.

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

**Shipping and Handling**

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

**Guarantees and Product Warranties**

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

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

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

	<b>Years Ended September 30</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
Balance, beginning of fiscal year	\$ 1,062	\$ 827	\$ 650
Provision for warranties issued	2,233	923	291
Payments	(1,730)	(688)	(114)
Balance, end of fiscal year	\$ 1,565	\$ 1,062	\$ 827

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**F5 NETWORKS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Research and Development**

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

**Advertising**

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

**Income Taxes**

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

**Foreign Currency**

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

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

**Segments**

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

**Table of Contents****F5 NETWORKS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Stock-Based Compensation**

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

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

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

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

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

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



**Table of Contents****F5 NETWORKS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

forfeitures differs from those estimated by management, additional adjustments to compensation expense may be required in future periods.

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

The following table shows the pro forma effect on the Company's net income (loss) and net income (loss) per share for the years ended September 30, 2005, 2004 and 2003, had compensation expense been determined based upon the fair value at the grant date for awards consistent with the methodology prescribed by SFAS 123. The Company adopted SFAS 123R on July 1, 2005 the beginning of its fourth quarter of fiscal 2005; therefore, stock-based compensation expense shown in the pro forma table relates to expense through June 30, 2005 while the Company was still under the disclosure only provisions of SFAS 123. Stock-based compensation expense for the fourth quarter of fiscal 2005 has been included in results of operations. These pro forma effects may not be representative of expense in future periods since the estimated fair value of stock options on the date of grant is amortized to expense over the vesting period, and additional options may be granted or options may be cancelled in future years:

	<b>Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
Net income, as reported	\$ 51,733	\$ 32,953	\$ 4,087
Add: Stock-based employee compensation expense under APB No. 25 included in reported net income, net of tax effect		10	83
Deduct: Total stock-based employee compensation expense determined under the fair value methods, net of tax effect	7,020	18,913	23,371
Pro forma net income (loss)	\$ 44,713	\$ 14,050	\$ (19,201)
Net income (loss) per share:			
As reported basic	\$ 1.39	\$ 0.99	\$ 0.15
Pro forma basic	\$ 1.20	\$ 0.42	\$ (0.73)
As reported diluted	\$ 1.34	\$ 0.92	\$ 0.14
Pro forma diluted	\$ 1.15	\$ 0.39	\$ (0.73)

**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.



**Table of Contents****F5 NETWORKS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

	<b>Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Numerator</b>			
Net income	\$ 51,733	\$ 32,953	\$ 4,087
<b>Denominator</b>			
Weighted average shares outstanding basic	37,220	33,221	26,453
Dilutive effect of common shares from stock options and restricted stock units	1,513	2,771	1,767
Weighted average shares outstanding diluted	38,733	35,992	28,220
Basic net income per share	\$ 1.39	\$ 0.99	\$ 0.15
Diluted net income per share	\$ 1.34	\$ 0.92	\$ 0.14

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

**Recent Accounting Pronouncements**

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

In May of 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections - A Replacement of APB Opinion No. 20 and FASB Statement No. 3, which changes the requirements for the accounting and reporting of a change in accounting principle. The Statement applies to all voluntary changes in accounting principle and to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. This Statement requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the

cumulative effect of the change. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning

**Table of Contents****F5 NETWORKS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

after December 15, 2005. The Company does not expect the adoption of this statement to have a material impact on the Company's financial condition or results of operations.

**2. Short-Term and Long-Term Investments**

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

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

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

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

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

Amortized	Gross Unrealized	Gross Unrealized
-----------	---------------------	---------------------

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

**Table of Contents****F5 NETWORKS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

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

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

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

	<b>Less Than 12 Months</b>		<b>12 Months of Greater</b>		<b>Total</b>	
	<b>Fair Value</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>	<b>Gross Unrealized Losses</b>
<b>September 30, 2005</b>						
Corporate bonds and notes	\$ 74,686	\$ 796	\$ 33,316	\$ 486	\$ 108,002	\$ 1,283
U.S. government securities	107,912	605	37,733	307	145,645	912
Total	\$ 182,598	\$ 1,401	\$ 71,049	\$ 793	\$ 253,647	\$ 2,195

**3. Business Combinations**

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

**2004 Acquisition of MagniFire Websystems, Inc.**

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

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

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

<b>Assets acquired</b>	
Cash	\$ 895
Accounts receivable, net	152
Restricted cash	76
Other assets	625
Property and equipment	81
Developed technology	5,000
Goodwill	25,488
<b>Total assets acquired</b>	<b>\$ 32,317</b>
<b>Liabilities assumed</b>	
Accrued liabilities	\$ (723)
Deferred tax liability	(1,069)
Deferred revenue	(25)
<b>Total liabilities assumed</b>	<b>(1,817)</b>
<b>Net assets acquired</b>	<b>\$ 30,500</b>

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

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

**2003 Acquisition of uRoam, Inc.**

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

**Table of Contents****F5 NETWORKS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

<b>Assets acquired</b>		
Accounts receivable, net	\$	335
Property and equipment		4
Developed technology		3,000
Goodwill		24,188
Total assets acquired	\$	27,527
<b>Liabilities assumed</b>		
Accrued liabilities	\$	(29)
Deferred revenue		(125)
Total liabilities assumed		(154)
<b>Net assets acquired</b>	<b>\$</b>	<b>27,373</b>

**Pro Forma Results**

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

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

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

Net pro forma adjustments (unaudited) of \$1.5 million and \$2.2 million for the fiscal years 2004 and 2003, respectively, have been made to the combined results of operations reflecting the amortization of the developed technology acquired and the net change in interest income (expense) had the respective acquisition taken place at the beginning of the period. The unaudited pro forma financial information does not reflect integration costs, or cost savings or other synergies anticipated as a result of the acquisition. This information is not necessarily indicative of the operating results that would have occurred if the acquisition had been consummated on the date indicated nor is it necessarily indicative of future operating results of the combined enterprise.



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

**4. Balance Sheet Details**

Other assets consist of the following (in thousands):

	<b>Years Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
Software development costs	\$ 521	\$ 793
Acquired technology	5,367	6,967
Deposits and other	2,436	519
	\$ 8,323	\$ 8,279

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

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

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

Accrued liabilities consist of the following (in thousands):

	<b>Years Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
Payroll and benefits	\$ 11,572	\$ 9,007
Sales and marketing	1,544	1,997
Restructuring	559	625
Warranty	1,564	1,062
Income taxes	1,682	800
Other	2,727	2,457
	\$ 19,648	\$ 15,948

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

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

	<b>Balance at September 30, 2004</b>	<b>Additional Charges</b>	<b>Cash Payments and Write-Offs</b>	<b>Balance at September 30, 2005</b>
Excess facilities	\$ 625	\$	\$ (66)	\$ 559
Other				
	\$ 625	\$	\$ (66)	\$ 559

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

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

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

**5. Income Taxes**

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

	<b>Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>

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United States	\$ 76,330	\$ 27,715	\$ 3,524
International	3,637	1,344	1,416
	\$ 79,967	\$ 29,059	\$ 4,940

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

	<b>Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Current</b>			
U.S. federal	\$ 31,516	\$	\$
State	2,319	122	45
Foreign	750	923	657
Total	34,585	1,045	702
<b>Deferred</b>			
U.S. federal	(5,984)	(4,591)	141
State	(653)	(348)	10
Foreign	286		
Total	(6,351)	(4,939)	151
	\$ 28,234	\$ (3,894)	\$ 853

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

	<b>Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
Income tax provision at statutory rate	\$ 27,988	\$ 10,219	\$ 1,729
State taxes, net of federal benefit	1,908	706	36
Impact of international operations	2,417	357	91
Research and development and other credits	(2,057)	(1,397)	(1,017)
Other	627	(1,638)	(60)
Change in valuation allowance	(2,649)	(28,062)	4,382
Impact of stock option compensation on valuation allowance		15,921	(4,308)
	\$ 28,234	\$ (3,894)	\$ 853

**Table of Contents****F5 NETWORKS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

	<b>Years Ended September 30,</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Deferred tax assets</b>			
Net operating loss carry-forwards	\$ 25,002	\$ 26,427	\$ 22,318
Allowance for doubtful accounts	915	810	844
Accrued compensation and benefits	1,140	690	591
Inventories and related reserves	417	210	198
Other accruals and reserves	5,857	2,008	1,773
Depreciation	462	838	831
Tax credit carry-forwards	7,631	5,552	4,156
	41,424	36,535	30,711
<b>Valuation allowance</b>		(2,649)	(30,711)
<b>Deferred tax liabilities</b>			
Purchased intangibles and other	(1,277)	(2,506)	(151)
<b>Net deferred tax assets (liabilities)</b>	<b>\$ 40,147</b>	<b>\$ 31,380</b>	<b>\$ (151)</b>

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

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

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

On October 22, 2004, the American Jobs Creation Act of 2004 (AJCA) was signed into law. The AJCA provides for a temporary 85% dividends received deduction on certain earnings repatriated during either fiscal year 2005 or fiscal year 2006. The deduction would result in an approximate 5.25% federal tax rate on the repatriated earnings. To

qualify for the deduction, the earnings must be reinvested in the

**Table of Contents****F5 NETWORKS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

U.S. pursuant to a domestic reinvestment plan established by a company's chief executive officer and approved by the company's board of directors. Additionally, certain other significant criteria, as outlined in the AJCA, must also be met. F5 Networks did not elect this provision in fiscal year 2005, and does not intend to make an election in fiscal year 2006.

**6. Shareholders' Equity****Common Stock**

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

**Equity Incentive Plans**

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

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

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

*2000 Equity Incentive Plan.* In July 2000, the Company adopted the 2000 Employee Equity Incentive Plan, or the 2000 Plan, which provides for discretionary grants of non-qualified stock options, stock purchase awards and stock bonuses for non-executive employees and other service providers. A total



**Table of Contents****F5 NETWORKS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

of 3,500,000 shares of common stock have been reserved for issuance under the 2000 Plan. Upon certain changes in control of the Company, all outstanding and unvested options or stock awards under the 2000 Plan will vest at the rate of 50%, unless assumed or substituted by the acquiring entity. As of September 30, 2005, there were options to purchase 1,144,991 shares outstanding and 55,853 shares available for awards under the 2000 Plan.

*New Hire Incentive Plans.* In October 2000, the Company adopted a non-qualified stock option plan, or the Pancottine Plan, in connection with the hiring of Jeff Pancottine, the Company's Senior Vice President and General Manager, Security Business Unit. The Pancottine Plan provided for a grant of 200,000 non-qualified stock options for Mr. Pancottine. As of September 30, 2005, there were no options outstanding and no shares available for awards under the Pancottine Plan. In May 2001, the Company adopted a non-qualified stock option plan, or the Coburn Plan, in connection with the hiring of Steve Coburn, the Company's former Senior Vice President of Finance and Chief Financial Officer. The Coburn Plan provided for a grant of 200,000 non-qualified stock options for Mr. Coburn. As of September 30, 2005, there were no options outstanding and no shares available for awards under the Coburn Plan. In October 2003, the company adopted a non-qualified stock option plan, or the Hull Plan, in connection with the hiring of Thomas Hull, the Company's Senior Vice President of Worldwide Sales. The Hull plan provided for a grant of 225,000 non-qualified stock options for Mr. Hull. As of September 30, 2005, there were options to purchase 170,000 shares outstanding and no shares available for awards under the Hull Plan. In August 2004, the Company adopted a non-qualified stock option plan, or the Triebes Plan, in connection with the hiring of Karl Triebes, the Company's Senior Vice President of Product Development and Chief Technology Officer. The Triebes Plan provided for a grant of 300,000 non-qualified stock options for Mr. Triebes. As of September 30, 2005, there were options to purchase 250,000 shares outstanding and no shares available for awards under the Triebes Plan. Upon certain changes in control of the Company, 100% of all outstanding and unvested options remaining under the Hull Plan and the Triebes Plan will vest and become immediately exercisable.

*Acquisition Incentive Plans.* In July 2003, the Company adopted the uRoam Acquisition Equity Incentive Plan, or the uRoam Plan, in connection with the hiring of the former employees of uRoam, Inc. A total of 250,000 shares of common stock were reserved for issuance under the uRoam Plan. The plan provided for discretionary grants of non-qualified and incentive stock options, stock purchase awards and stock bonuses. The Company has not granted any stock purchase awards or stock bonuses under this plan. As of September 30, 2005 there were options to purchase 38,044 shares outstanding and no shares available for awards under the uRoam Plan. In July 2004, the Company adopted the MagniFire Acquisition Equity Incentive Plan, or the MagniFire Plan, in connection with the hiring of the former employees of MagniFire Websystems, Inc. A total of 415,000 shares of common stock were reserved for issuance under the MagniFire Plan. The plan provides for discretionary grants of non-qualified and incentive stock options, stock purchase awards and stock bonuses. The Company has not granted any stock purchase awards or stock bonuses under this plan. As of September 30, 2005 there were options to purchase 234,606 shares outstanding and no shares available for awards under the MagniFire Plan. Options that expire under the uRoam Plan or the MagniFire Plan, whether due to termination of employment or otherwise, are not available for future grant.

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

**Table of Contents****F5 NETWORKS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

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

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

	<b>Options Outstanding</b>	
	<b>Number of Shares</b>	<b>Weighted Average Exercise Price per Share</b>
Balance, September 30, 2002	7,240,850	\$ 17.30
Options granted	2,195,300	15.24
Options exercised	(1,423,550)	7.60
Options cancelled	(504,771)	25.65
Balance, September 30, 2003	7,507,829	17.92
Options granted	2,230,515	24.79
Options exercised	(2,031,552)	11.00
Options cancelled	(353,232)	26.07
Balance, September 30, 2004	7,353,560	21.52
Options granted	224,100	43.73
Options exercised	(3,684,558)	17.66
Options cancelled	(297,786)	34.08
Balance at September 30, 2005	3,595,316	\$ 25.82

Stock options were granted with exercise prices equal to the market value of the Company's common stock at the date of grant. The weighted-average fair values per share at the date of grant for options granted were \$18.68, \$8.32, and \$7.46 for the fiscal years 2005, 2004, and 2003, respectively.

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

**Table of Contents****F5 NETWORKS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

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

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

**7. Commitments and Contingencies****Operating Leases**

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

**Table of Contents****F5 NETWORKS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

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

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

**Litigation**

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

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



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

**8. Employee Benefit Plans**

The Company has a 401(k) savings plan whereby eligible employees may voluntarily contribute a percentage of their compensation. The Company may, at its discretion, match a portion of the employees' eligible contributions. Contributions by the Company to the plan during the years ended September 30, 2005, 2004, and 2003 were approximately \$1.2 million, \$1.0 million and \$0.9 million, respectively. Contributions made by the Company vest over four years.

**9. Geographic Sales and Significant Customers**

Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company is organized as, and operates in, one reportable segment: the development, marketing and selling of a comprehensive suite of application networking solutions that helps customers efficiently and securely manage application traffic on their Internet-based networks. We manage our business based on four geographic regions: the Americas (primarily the United States); Europe, the Middle East, and Africa (EMEA); Japan; and Asia Pacific. Our chief operating decision-making group reviews financial information presented on a consolidated basis accompanied by information about revenues by geographic region. Our foreign offices conduct sales, marketing and support activities. The Company's management evaluates performance based primarily on revenues in the geographic locations in which the Company operates. Revenues are attributed by geographic location based on the location of the customer. The Company's assets are primarily located in the United States and not allocated to any specific region. Therefore, geographic information is presented only for net product revenue.

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

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

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

**10. Subsequent Events**

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





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

**11. Quarterly Results of Operations**

The following presents the Company's unaudited quarterly results of operations for the eight quarters ended September 30, 2005. The information should be read in conjunction with the Company's financial statements and related notes included elsewhere in this report. This unaudited information has been prepared on the same basis as the audited financial statements and includes all adjustments, consisting only of normal recurring adjustments that were considered necessary for a fair statement of our operating results for the quarters presented.

**Three Months Ended**

	<b>Sept. 30, 2005(1)</b>	<b>June 30, 2005</b>	<b>March 31, 2005</b>	<b>Dec. 31, 2004</b>	<b>Sept. 30, 2004(2)</b>	<b>June 30, 2004</b>	<b>March 31, 2004</b>	<b>Dec. 31, 2003</b>
<b>(Unaudited and in thousands)</b>								
<b>Net revenues</b>								
Products	\$ 62,762	\$ 57,112	\$ 53,332	\$ 46,397	\$ 37,536	\$ 32,537	\$ 29,720	\$ 26,376
Services	17,845	15,952	14,398	13,612	12,683	11,706	10,927	9,705
Total	80,607	73,064	67,730	60,009	50,219	44,243	40,647	36,081
<b>Cost of net revenues</b>								
Products	13,886	12,751	11,820	10,528	8,489	7,267	6,799	5,849
Services	4,572	4,306	3,908	3,386	3,055	2,832	2,626	2,462
Total	18,458	17,057	15,728	13,914	11,544	10,009	9,425	8,311
Gross profit	62,149	56,007	52,002	46,095	38,675	34,144	31,222	27,770
<b>Operating expenses</b>								
Sales and marketing	25,521	23,207	20,885	19,640	17,597	16,907	15,920	14,954
Research and development	9,039	7,547	7,789	6,974	6,764	6,253	5,900	5,444
General and administrative	7,067	5,833	5,854	5,006	4,463	4,069	3,855	3,357
Total operating expenses	41,627	36,587	34,528	31,620	28,824	27,229	25,675	23,755
<b>Income from operations</b>								
Income from operations	20,522	19,420	17,474	14,475	9,851	6,915	5,547	4,015
Other income, net	2,925	2,123	1,641	1,387	891	848	808	184
<b>Income before income taxes</b>								
Income before income taxes	23,447	21,543	19,115	15,862	10,742	7,763	6,355	4,199

Provision (benefit) for income taxes	7,796	7,566	7,003	5,869	(5,039)	347	400	398
Net income	\$ 15,651	\$ 13,977	\$ 12,112	\$ 9,993	\$ 15,781	\$ 7,416	\$ 5,955	\$ 3,801
Net income per share basic	\$ 0.41	\$ 0.37	\$ 0.33	\$ 0.28	\$ 0.46	\$ 0.22	\$ 0.18	\$ 0.13
Weighted average shares basic	38,479	37,918	36,905	35,577	34,593	34,382	33,768	30,159
Net income per share diluted	\$ 0.39	\$ 0.35	\$ 0.31	\$ 0.26	\$ 0.43	\$ 0.20	\$ 0.16	\$ 0.11
Weighted average shares diluted	40,015	39,418	38,921	37,818	36,779	36,969	36,946	33,121

- (1) The Company adopted FAS123R on July 1, 2005, and as a result recognized \$4.6 million of compensation expense related to stock-based compensation charges included in operating expenses in the fourth quarter of fiscal 2005.
- (2) During the fourth quarter of fiscal 2004, the Company reversed the valuation allowance on U.S. deferred tax assets and as a result realized an income tax benefit of \$7.3 million. The credit from the reversal of the valuation allowance was partially offset by actual U.S. and international tax expenses during the period.

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

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

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

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

1. *Consolidated Financial Statements:*

See Index to Consolidated Financial Statements included under Item 8 of this Annual Report, as amended, on Form 10-K.

2. *Exhibits:*

The required exhibits are included at the end of this Annual Report, as amended, on Form 10-K and are described in the Exhibit Index immediately preceding the first exhibit.

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**SIGNATURES**

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

F5 Networks, Inc.

By: /s/ JOHN RODRIGUEZ

John Rodriguez

*Senior Vice President, Chief Accounting Officer*

Dated: December 15, 2005

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**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Exhibit Description</b>
23.1	Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm
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