F5 NETWORKS INC

FORM 10-Q
(Quarterly Report)

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Industry	Computer Networks
Sector	Technology
Fiscal Year	09/30

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

FORM 10-Q

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

For the quarterly period ended June 30, 2003

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 ☒ No ☐

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

The number of shares outstanding of the registrant's common stock as of August 5, 2003 was 26,960,844.

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F5 NETWORKS, INC.

QUARTERLY REPORT ON FORM 10-Q

For the Quarter Ended June 30, 2003

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

F5 NETWORKS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited, in thousands except per share amounts)

	Three months ended June 30,		Nine months ended June 30,	
	2003	2002	2003	2002
Net revenues				
Products	$21,310	$20,750	$61,149	$62,190
Services	7,879	6,315	23,113	19,001
Total	29,189	27,065	84,262	81,191
Cost of net revenues				
Products	4,491	5,081	12,751	16,195
Services	2,290	2,504	6,726	7,878
Total	6,781	7,585	19,477	24,073
Gross profit	22,408	19,480	64,785	57,118
Operating expenses				
Sales and marketing	13,593	13,256	39,413	37,519
Research and development	4,810	4,785	14,091	13,673
General and administrative	2,800	3,049	9,050	11,618
Restructuring charges		2,771		2,771
Amortization of unearned compensation	6	106	77	353
Total	21,209	23,967	62,631	65,934
Income (loss) from operations	1,199	(4,487)	2,154	(8,816)
Other income, net	352	287	1,126	1,065
Income (loss) before income taxes	1,551	(4,200)	3,280	(7,751)
Provision for income taxes	152	146	546	436
Net income (loss)	$ 1,399	$ (4,346)	$ 2,734	$ (8,187)
Net income (loss) per share – basic	$ 0.05	$ (0.17)	$ 0.10	$ (0.32)
Weighted average shares – basic	26,638	25,537	26,227	25,206
Net income (loss) per share – diluted	$ 0.05	$ (0.17)	$ 0.10	$ (0.32)
Weighted average shares – diluted	28,467	25,537	27,525	25,206

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

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F5 NETWORKS, INC.

CONSOLIDATED BALANCE SHEETS
(unaudited, in thousands)

	June 30, 2003	September 30, 2002
ASSETS		
Current assets		
Cash and cash equivalents	$ 18,998	$ 20,801
Short-term investments	45,166	59,532
Accounts receivable, net of allowances of $4,226 and $5,452	20,372	20,404
Inventories	667	349
Other current assets	4,373	4,713
Total current assets	89,576	105,799
Restricted cash	6,000	6,000
Property and equipment, net	10,495	12,211
Long-term investments	32,680	1,346
Other assets, net	1,033	933
Total assets	$139,784	$126,289
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 3,896	$ 3,685
Accrued liabilities	12,728	13,546
Deferred revenue	17,423	14,058
Total current liabilities	34,047	31,289
Long-term liabilities	1,506	1,315
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, 26,905 and 25,730 shares issued and outstanding	137,647	128,876
Accumulated other comprehensive income (loss)	(582)	454
Unearned compensation	(16)	(93)
Accumulated deficit	(32,818)	(35,552)
Total shareholders' equity	104,231	93,685
Total liabilities and shareholders' equity	$139,784	$126,289

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

F5 Networks, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

	Nine months ended June 30, 2003	Nine months ended June 30, 2002
Operating activities		
Net income (loss)	$ 2,734	$ (8,187)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Restructuring charges		2,771
Provision for asset write downs		877
Realized (gain) loss on sale of assets	(14)	
Realized (gain) loss on sale of investments	(1)	74
Amortization of unearned compensation	77	353
Provision for doubtful accounts and sales returns	887	5,447
Depreciation and amortization	3,878	4,233
Changes in operating assets and liabilities:		
Accounts receivable	(786)	(3,667)
Inventories	(313)	1,934
Other assets	(53)	1,524
Accounts payable and accrued liabilities	(674)	952
Deferred revenue	3,270	1,701
Net cash provided by operating activities	9,005	8,012
Investing activities		
Purchase of investments	(136,844)	(85,624)
Sale of investments	119,291	75,238
Proceeds from sale of property and equipment	14	30
Purchase of property and equipment	(1,876)	(2,375)
Net cash used in investing activities	(19,415)	(12,731)
Financing activities		
Proceeds from the exercise of stock options and warrants	8,771	4,751
Net cash provided by financing activities	8,771	4,751
Net (decrease) increase in cash and cash equivalents	(1,639)	33
Effect of exchange rate differences	(164)	143
Cash and cash equivalents, at beginning of period	20,801	18,321
Cash and cash equivalents, at end of period	$ 18,998	$ 18,496

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

F5 Networks, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Description of Business

F5 Networks provides integrated products and services to manage, control and optimize Internet traffic. Our core products, the BIG-IP® Controller, 3-DNS® Controller, and the BIG-IP Link Controller, help manage traffic to servers and network devices in a way that maximizes availability and throughput. Our unique iControl™ Architecture integrates our products and also allows our customers to integrate them with other third party products. Our solutions address many elements required for successful Internet and Intranet business applications, including high availability, high performance, intelligent load balancing, fault tolerance, security and streamlined manageability. By enhancing Internet performance and availability, our solutions enable our customers and partners to maximize the use of the Internet in their business.

2. Basis of Presentation

In the opinion of management, the unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America. The consolidated balance sheet as of September 30, 2002 has been derived from the audited consolidated balance sheet as of that date, but does not include all disclosures required by generally accepted accounting principles for complete financial statements. 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, 2002.

3. Short-Term and Long-Term Investments

Investments in securities with maturities of less than one year are classified as short-term investments. We consider our securities as available-for-sale, which are reported at fair value with the related unrealized gains and losses included as a component of 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.

Long-term investments consist of securities with maturities of greater than one year and an investment in Artel Solutions Group Holdings Limited ("Artel.") All long-term investments are classified as available-for-sale and are carried at fair value, with unrealized gains and losses reflected as a component of comprehensive income based on changes in the fair value of investment. In December of 2001, we purchased, from a third-party, approximately 16 million shares of common stock of Artel, which represents an approximate 1% ownership percentage. At June 30, 2003, the cost basis of our investment in Artel was $1.3 million and the fair market value was $0.7 million.

4. Inventories

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). We outsource the manufacturing of our pre-configured hardware platforms to a contract manufacturer who assembles each product to our specifications. Our agreement with the 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 outside of applicable lead times. For any product inventory carried by the contract manufacturer beyond 30 days, the contract manufacturer will charge us a monthly carrying fee of 1.5% of the inventory's carrying value. We have the option to purchase inventory held by the contract manufacturer beyond 30 days to avoid incurring the related carrying charges. As of June 30, 2003, we were committed to purchase approximately $2.4 million of inventory. As protection against component shortages and to provide replacement parts for our service teams, we also stock limited supplies of certain key components for our products.

F5 Networks, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

5. Comprehensive Income (Loss)

The following reconciles net income (loss) to comprehensive income (loss) (in thousands):

	Three months ended June 30,		Nine months ended June 30,	
	2003	2002	2003	2002
Net income (loss)	$1,399	$(4,346)	$2,734	$(8,187)
Unrealized gain (loss) on investments	(462)	52	(586)	247
Foreign currency translation adjustment	(171)	1	(451)	(170)
Comprehensive income (loss)	$ 766	$(4,293)	$1,697	$(8,110)

6. Net Income (Loss) Per Share

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

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

	Three months ended June 30,		Nine months ended June 30,	
	2003	2002	2003	2002
Numerator				
Net income (loss)	$ 1,399	$ (4,346)	$ 2,734	$ (8,187)
Denominator				
Weighted average shares – basic	26,638	25,537	26,227	25,206
Dilutive effect of common shares from stock options	1,829	—	1,298	—
Weighted average shares – diluted	28,467	25,537	27,525	25,206
Net income (loss) per share – basic	$ 0.05	$ (0.17)	$ 0.10	$ (0.32)
Net income (loss) per share – diluted	$ 0.05	$ (0.17)	$ 0.10	$ (0.32)

For the three months ended June 30, 2003, approximately 2.3 million shares attributable to outstanding stock options were excluded from the calculation of diluted earnings per share because the effect was antidilutive. For the three months ended June 30, 2002, in which we incurred a net loss, all common stock equivalent shares are excluded from the calculation as their impact would have been antidilutive. Diluted earnings per share would have been reduced by the calculated effect of approximately 1.6 million outstanding stock options for the three months ended June 30, 2002.

For the nine months ended June 30, 2003, approximately 4.2 million shares attributable to outstanding stock options were excluded from the calculation of diluted earnings per share because the effect was antidilutive. For the nine months ended June 30, 2002, in which we incurred a net loss, all common stock equivalent shares are excluded from the calculation as their impact would have been antidilutive. Diluted earnings per share would have been reduced by the calculated effect of approximately 2.1 million outstanding stock options for the nine months ended June 30,

F5 Networks, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

2002.

7. Stock-Based Compensation

We account for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board Opinion No. 25 (“APB No. 25”), “Accounting for Stock Issued to Employees,” FASB Interpretation No. 44 (“FIN No. 44”) “Accounting for Certain Transactions Involving Stock Compensation,” and related interpretations and comply with the disclosure provisions of Statement of Financial Accounting Standards No. 123 (“SFAS No. 123”), “Accounting for Stock-Based Compensation.” Under APB No. 25, compensation expense is based on the difference, if any, on the date of the grant, between the fair value of our stock and the exercise price of the option. The unearned compensation is being amortized in accordance with Financial Accounting Standards Board Interpretation No. 28 on an accelerated basis over the vesting period of the individual options.

Pro forma information regarding net income (loss) is required by SFAS No. 123, and has been determined as if we had accounted for our stock options under the minimum value method of that statement for all periods prior to us becoming a public entity and fair value method of that statement for all periods subsequent to us becoming a public entity. For purposes of pro forma disclosures, the estimated fair value of the options is amortized over the options’ vesting period. Our net income (loss) and net income (loss) per share would have been adjusted to the pro forma amounts indicated below (in thousands, except per share data):

	Three months ended June 30,		Nine months ended June 30,	
	2003	2002	2003	2002
Net income (loss), as reported	$ 1,399	$ (4,346)	$ 2,734	$ (8,187)
Add : Stock-based employee compensation expense under APB No. 25 included in reported net income (loss)	6	106	77	353
Deduct : Total stock-based employee compensation expense determined under fair value based methods	5,090	7,775	18,171	3,803
Pro forma net loss	$(3,685)	$(12,015)	$(15,360)	$(11,637)
Net income (loss) per share :				
As reported – basic	$ 0.05	$ (0.17)	$ 0.10	$ (0.32)
Pro forma – basic	$ (0.14)	$ (0.47)	$ (0.59)	$ (0.46)
As reported – diluted	$ 0.05	$ (0.17)	$ 0.10	$ (0.32)
Pro forma – diluted	$ (0.14)	$ (0.47)	$ (0.59)	$ (0.46)

F5 Networks, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

8. Restructuring Charge

During the third quarter of fiscal 2002, we recorded restructuring charges of approximately $2.8 million in connection with management's decision to exit the cache appliance business. As a result of discontinuing this line of business and other changes in the overall business, we wrote-down certain assets, consolidated operations, and terminated 47 employees throughout all divisions of the company. An additional charge of $503,000 related to employee separation costs was recorded in July 2002 resulting in total restructuring charges of $3.3 million for the fiscal year 2002. As of September 30, 2002, total cash payments and write-offs of approximately $2.2 million had been recorded. The following summarizes our remaining restructuring charge liabilities (in thousands):

	Balance at September 30, 2002	Additional Charges	Cash Payments and Write-offs	Balance at June 30, 2003
Excess facilities	$1,000	$ —	$(113)	$887
Other	76	—	(2)	74
	$1,076	$ —	$(115)	$961

As part of the restructuring, excess facilities costs were determined to be $1.0 million. These costs are the result of our decision to exit our support facility in Washington DC. The estimated facilities costs were based on current comparable rates for leases in the respective market. In April 2003, the excess facilities were subleased at the then current market value through the term of the lease. The difference between our lease payments and sublease income will be applied against the restructuring liability until expiration of the lease in 2007.

9. Recent Accounting Pronouncements

In July 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities ("SFAS 146"). SFAS 146 requires that a liability for costs associated with exit or disposal activities be recognized and measured at fair value when the liability is incurred. SFAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The adoption of this standard did not have an impact on our financial statements.

In December 2002, the FASB issued SFAS No. 148 "Accounting for Stock-Based Compensation—Transition and Disclosure," which provides guidance for transition to the fair value based method of accounting for stock-based employee compensation and the required financial statement disclosure. The adoption of SFAS No. 148 did not have a material impact on our financial statements and the additional disclosures required are included in the notes to the consolidated financial statements.

10. Subsequent Event

On July 23, 2003, we acquired substantially all of the assets and assumed certain operating liabilities of uRoam, Inc. and its subsidiaries ("uRoam") for cash of $25.0 million. We also incurred $2.3 million of direct transaction costs and assumed liabilities of approximately $0.1 million, for a total purchase price of approximately $27.4 million. uRoam was founded in 1998 and is based in Sunnyvale, California. We have hired substantially all of the 20 employees of uRoam primarily consisting of product development, sales and service support personnel. 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 (SSL) technology. The addition of uRoam is intended to allow us to quickly enter the SSL Virtual Private Network (VPN) market, broaden our customer base, and augment our existing product line.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 19, 2002. Our discussion may contain forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, based upon current expectations. These forward-looking statements include, but are not limited to, statements about our plans, objectives, expectations and intentions and other statements that are not historical facts. Because these forward-looking statements involve risks and uncertainties, our actual results and the timing of certain events could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under "Risk Factors" and "Business" in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2002, and elsewhere in this report.

	Three months ended June 30,		Nine months ended June 30,	
	2003	2002	2003	2002
Net Revenues (unaudited, in thousands)				
Net revenues				
Products	$21,310	$20,750	$61,149	$62,190
Services	7,879	6,315	23,113	19,001
Total	$29,189	$27,065	$84,262	$81,191
Percentage of net revenues				
Products	73.0%	76.7%	72.6%	76.6%
Services	27.0	23.3	27.4	23.4
Total	100.0%	100.0%	100.0%	100.0%

Net revenues. Total net revenues increased by 7.8%, to $29.2 million for the three months ended June 30, 2003 from $27.1 million for the same period in the prior year. The increase for the three months ended June 30, 2003 is primarily due to increased international product revenues and continued growth in service revenues. Total net revenues increased by 3.8% to $84.3 million for the nine months ended June 30, 2003 from $81.2 million for the same period in the prior year. The increase for the nine months ended June 30, 2003 is primarily due to increased service revenues partially offset by lower product revenues.

Net product revenues increased by 2.7%, to $21.3 million for the three months ended June 30, 2003 from $20.8 million for the same period in the prior year. The increase in product revenues for the three months ended June 30, 2003 is primarily due to growth in our Asia-Pacific markets. For the nine months ended June 30, 2003 product revenues decreased by 1.7% to $61.2 million from $62.2 million for the same period in the prior year. The decrease in product revenues for the nine months ended June 30, 2003 is primarily due to lower sales in Japan partially offset by increases in EMEA and Asia-Pacific.

Net services revenues increased by 24.8%, to $7.9 million for the three months ended June 30, 2003 from $6.3 million for the same period in the prior year. For the nine months ended June 30, 2003 services revenues increased by 21.6% to $23.1 million from $19.0 million for the same period in the prior year. The increase in service revenues for the three and nine months ended June 30, 2003 is primarily due to growth in the number of customers renewing their original service maintenance contracts. We expect services revenues will continue to represent a significant portion of total net revenues.

International revenues represented 34.7% and 28.3% of total net revenues for the three months ended June 30, 2003 and 2002, respectively and 34.2% and 34.3% of total net revenues for the nine months ended June 30, 2003 and 2002, respectively. The increase in international revenues for the three months ended June 30, 2003 is primarily due to increased sales in Asia compared to the same period in the prior year. For the nine months ended June 30, 2003 lower Japan revenues were offset by increased revenues in Asia and Europe resulting in overall international revenues consistent with the prior nine month period. We expect international revenues will continue to represent a significant portion of net revenues, although we cannot provide assurance that international revenues as a percentage of total net revenues will remain at current levels.

Sales of our BIG-IP products represented 85.3% and 81.3% of product revenues (excluding service revenues) for the three months ended June 30, 2003 and 2002, respectively and 83.6% and 83.8% of product revenues for the nine months ended June 30, 2003 and 2002, respectively. Our BIG-IP products are currently manufactured on two lines of systems: server appliances and IP application switches. Server appliances were our original products and as of the end of fiscal year 2002, accounted for a little more than half of our systems revenues. However, with the introduction of our new IP application switch based products including the BIG-IP 1000, BIG-IP 2400, and the BIG-IP 5100, the percentage of revenues derived from IP application switches has increased to over half of total systems revenue for the three and nine months ended June 30, 2003. We expect to derive a significant portion of our product revenues from sales of BIG-IP in the future and expect the percentage of BIG-IP sales derived from IP application switches to continue to increase as a percentage of total systems sales.

One of our domestic distributors accounted for 12.0% of our total net revenues for the three and nine months ended June 30, 2003. This customer accounted for 18.0% of our accounts receivable as of June 30, 2003. No individual customer represented more than 10% of our total net revenues or accounts receivable for the three or nine month periods ended June 30, 2002.

	Three months ended June 30,		Nine months ended June 30,	
	2003	**2002**	**2003**	**2002**
Gross margin (unaudited, in thousands)				
Cost of net revenues				
Products	$ 4,491	$ 5,081	$12,751	$16,195
Services	2,290	2,504	6,726	7,878
Total	$ 6,781	$ 7,585	$19,477	$24,073
Gross margin	$22,408	$19,480	$64,785	$57,118
Cost of net revenues (as a percentage of related revenue)				
Products	21.1%	24.5%	20.9%	26.0%
Services	29.1	39.7	29.1	41.5
Total	23.2	28.0	23.1	29.6
Gross margin	76.8%	72.0%	76.9%	70.4%

Cost of product revenues . Cost of product revenues decreased by 11.6% to $4.5 million for the three months ended June 30, 2003 from $5.1 million for the same period in the prior year and decreased as a percentage of product revenues to 21.1% from 24.5% for the same periods. For the nine months ended June 30, 2003 cost of product revenues decreased by 21.3% to $12.8 million from $16.2 million for the same period in the prior year and decreased as a percentage of product revenues to 20.9% from 26.0% for the same periods. The decrease in cost of product revenues is primarily due to lower manufacturing and warranty costs, component costs, and overall material costs resulting from engineering improvements in the design of our products. Some of our components are subject to significant price fluctuations based on market supply and demand. In the future component pricing may increase significantly due to limited supply and may have a negative impact on our gross margin.

Cost of service revenues . Cost of service revenues decreased by 8.5% to $2.3 million for the three months ended June 30, 2003 from $2.5 million for the same period in the prior year. Cost of service revenues decreased as a percentage of service revenues to 29.1% from 39.7% for the same periods. For the nine months ended June 30, 2003 cost of service revenues decreased by 14.6% to $6.7 million from $7.9 million for the same period in the prior year. Cost of service revenues decreased as a percentage of service revenues to 29.1% from 41.5% for the same periods. The decrease in cost of service revenues is primarily the result of improved operational efficiencies and a reduction in personnel and related costs.

	Three months ended June 30,		Nine months ended June 30,	
	2003	2002	2003	2002
Operating expenses (unaudited, in thousands)				
Sales and marketing	$13,593	$13,256	$39,413	$37,519
Research and development	4,810	4,785	14,091	13,673
General and administrative	2,800	3,049	9,050	11,618
Restructuring charges	—	2,771	—	2,771
Amortization of unearned compensation	6	106	77	353
Total operating expenses	$21,209	$23,967	$62,631	$65,934
Operating expenses (as a percentage of revenue)				
Sales and marketing	46.6%	49.0%	46.8%	46.3%
Research and development	16.5	17.7	16.7	16.8
General and administrative	9.6	11.3	10.7	14.3
Restructuring charges	—	10.2	—	3.4
Amortization of unearned compensation	—	0.4	0.1	0.4
Total operating expenses	72.7%	88.6%	74.3%	81.2%

Sales and marketing. Sales and marketing expenses consist primarily of salaries, commissions and related benefits of our sales and marketing staff, costs of our marketing programs, including public relations, advertising and trade shows and an allocation of our facilities and depreciation expenses. Sales and marketing expenses increased by 2.5% to $13.6 million for the three months ended June 30, 2003, from $13.3 million for the same period in the prior year. For the nine months ended June 30, 2003, sales and marketing expenses increased by 5.0% to $39.4 million from $37.5 million for the same period in the prior year. The increase in sales and marketing expenses is primarily due to higher payroll and related personnel costs.

Research and development . Research and development expenses consist primarily of salaries and related benefits for our product development personnel and an allocation of our facilities and depreciation expenses. Research and development expenses for the three months ended June 30, 2003 was $4.8 million, consistent with the same period in the prior year. For the nine months ended June 30, 2003 research and development expenses increased by 3.1% to $14.1 million from $13.7 million for the same period in the prior year. The increase in research and development expenses is primarily due to an increase in payroll and related costs and expenses related to the development of new products. We expect to continue to increase research and development expenses as our future success is dependent on the continued enhancement of our current products and our ability to develop new, technologically advanced products that meet the changing needs of our customers.

General and administrative . General and administrative expenses consist primarily of salaries, benefits and related costs of our executive, finance, information technology, human resource and legal personnel, third-party professional service fees, bad debt charges, and an allocation of our facilities and depreciation expenses. General and administrative expenses decreased by 8.2% to $2.8 million for the three months ended June 30, 2003 from $3.0 million for the same period in the prior year. For the nine months ended June 30, 2003 general and administrative expenses decreased by 22.1% to $9.1 million from $11.6 million for the same period in the prior year. The decrease in general and administrative expenses is primarily due to reductions in professional service fees and bad debt expenses partially offset by increased personnel related expenses.

Restructuring charges . During the third quarter of fiscal 2002, we recorded restructuring charges of $2.8 million in connection with management’s decision to exit the cache appliance business. As a result of changes in the business, we wrote-down certain assets, consolidated operations and terminated 47 employees throughout all divisions of the Company.

Amortization of unearned compensation. We have recorded $8.3 million of stock compensation costs since our inception through June 30, 2003. These compensation costs represent the difference between the exercise price and the deemed fair value of certain stock options granted to our employees and outside directors. These stock options generally vest ratably over a four-year period. We are amortizing these compensation costs using an accelerated method as prescribed by FASB interpretation No. 28 ("FIN No. 28"). As of June 30, 2003, the remaining balance of unearned compensation totaled approximately $16,000.

	Three months ended June 30,		Nine months ended June 30,	
	2003	2002	2003	2002
Other income and income taxes (unaudited, in thousands)				
Income (loss) from operations	$1,199	$(4,487)	$2,154	$(8,816)
Other income, net	352	287	1,126	1,065
Income (loss) before income taxes	1,551	(4,200)	3,280	(7,751)
Provision for income taxes	152	146	546	436
Net income (loss)	$1,399	$(4,346)	$2,734	$(8,187)
Other income and income taxes (as a percentage of revenue)				
Income (loss) from operations	4.1%	(16.6)%	2.6%	(10.9)%
Other income, net	1.2	1.1	1.3	1.3
Income (loss) before income taxes	5.3	(15.5)	3.9	(9.6)
Provision for income taxes	0.5	0.5	0.7	0.5
Net income (loss)	4.8%	(16.0)%	3.2%	(10.1)%

Other income, net. Other income, net, consists primarily of interest income and foreign currency transaction gains and losses. Other income, net, increased 22.6% to $352,000 for the three months ended June 30, 2003 from $287,000 for the same period in the prior year. This increase is primarily due to lower foreign currency losses realized in the current quarter compared to the same period in the prior year. For the nine months ended June 30, 2003 other income, net, was $1.1 million consistent with same period in the prior year.

Income taxes . The provision for income tax for the three and nine months ended June 30, 2003 and 2002, primarily relates to foreign income taxes associated with our international operations. We have a valuation allowance to offset U.S. deferred tax assets in accordance with the provisions of FAS 109. We reported net income during the first half of fiscal 2003. In the event we maintain profitability in future reporting periods management will continue to evaluate the realizability of our U.S. deferred tax assets. If it is determined that it is more likely than not that the U.S. deferred tax assets are recoverable, the valuation allowance will be reversed in a future reporting period.

Financial Condition

Cash and cash equivalents, short-term investments and long-term investments increased 18.6% to $96.8 million as of June 30, 2003 from $81.7 million at the end of the fiscal year. Working capital was $55.5 million as of June 30, 2003, compared to $74.5 million as of September 30, 2002. The decrease in working capital was primarily the result of a reclassification of cash and short-term investments to long-term investments. During the nine months ended June 30, 2003 we invested approximately $31.3 million in securities with maturities greater than one year, which are classified as long-term investments. Consistent with our investment policy, the average maturity of our investments is less than one year with no individual security having a maturity exceeding two years.

Cash flow from operations was $9.0 million for the nine months ended June 30, 2003 compared to $8.0 million for the same period in the prior year. Cash flow from operations in the nine months ended June 30, 2003 resulted primarily from net income from operations combined with changes in operating assets and liabilities, as adjusted for various non-cash items including a provision for doubtful accounts, and depreciation and amortization charges. Cash used in investing activities was $19.4 million for the nine months ended June 30, 2003 compared to $12.7 million for the same period in the prior year. Cash used in investing activities was primarily due to the purchase of investments and capital equipment partially offset by the sale of investments. Cash provided by financing activities for the nine months ended June 30, 2003 was $8.8 million compared to $4.8 million for the same period in the prior year. Our financing activities relate to cash received from the exercise of employee stock options and purchases under our employee stock purchase plan. We believe that our existing cash and investment balances together with cash generated from operations should be sufficient to meet our operating requirements.

As of June 30, 2003, our principal commitments consisted of obligations outstanding under operating leases. In 2000, we entered into lease agreements on two buildings for our corporate headquarters. The lease agreements expire in 2012 with an option for renewal. The lease for the second building has been fully subleased through 2012. We established a restricted escrow account in connection with this lease agreement. Under the terms of this lease, a $6.0 million letter of credit is required through November 2012, unless the lease is terminated before then. The letter of credit is fully collateralized by a $6.0 million certificate of deposit that has been included on our balance sheet as a component of restricted cash.

We outsource the manufacturing of our pre-configured hardware platforms to a contract manufacturer who assembles each product to our specifications. Our agreement with the 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 outside of applicable lead times. As of June 30, 2003, we were committed to purchase approximately $2.4 million of such inventory.

Critical Accounting Policies and Estimates

The following critical accounting policies relate to the more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition. We recognize revenue in accordance with the guidance provided under Statement of Financial Accounting Standards (SFAS) No. 48, “Revenue Recognition When Right of Return Exists,” SEC Staff Accounting Bulleting (SAB) No. 101, “Revenue Recognition in Financial Statements,” 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.”

We sell products through resellers, original equipment manufacturers (“OEM”) and other channel partners, as well as directly to end users, under similar terms. We recognize product revenue upon shipment, net of estimated returns, provided that collection is determined to be probable and no significant obligations remain. Product revenues from OEM agreements are recognized based on reporting of sales from the OEM partner. Whenever a software license, hardware, installation and post-contract customer support (“PCS”) elements are combined into a package with a single “bundled” price, a portion of the sales price is allocated to each element of the bundled package based on their respective fair values as determined when the individual elements are sold separately. Revenues from the license of software are recognized when the software has been shipped and the customer is obligated to pay for the software. When rights of return are present and we cannot estimate returns, we recognize revenue when such rights 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.

Our ordinary payment terms to our domestic customers are net 30 days. Our ordinary payment terms to our international customers are net 30 to 90 days based on normal and customary trade practices in the individual markets. We have offered extended payment terms beyond ordinary terms to some customers. For these arrangements, revenue is generally recognized when payments become due.

Reserve for Doubtful Accounts. Estimates are used in determining our allowance for bad debts and are based on our historical collection experience, current trends, credit policy, specific identification and a percentage of our accounts receivable by aging category. In determining these percentages, we evaluate historical write-offs of our receivables, current trends in the credit quality of our customer base, as well as changes in the credit policies. We perform ongoing credit evaluations of our customers' financial condition and generally do not require any collateral. If there is a deterioration of a major customer's credit worthiness or actual defaults are higher than our historical experience, the recoverability of amounts due could be adversely affected.

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

Reserve for Obsolete/Excess Inventory. We currently reduce the carrying value of inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

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

Business Combination

On July 23, 2003, we acquired substantially all of the assets of uRoam, Inc. for cash of $25.0 million. We also incurred $2.3 million of direct transaction costs and assumed liabilities of approximately $0.1 million, for a total purchase price of approximately $27.4 million. uRoam's FirePass™ SSL VPN product is a comprehensive remote access solution that enables users to access applications in a secure fashion using industry standard SSL technology. The addition of uRoam is intended to allow us to quickly enter the SSL VPN market, broaden our customer base, and augment our existing product line. We have hired substantially all of the 20 employees of uRoam primarily consisting of product development, sales and service support personnel.

With the acquisition of the FirePass technology from uRoam, we have added a new security dimension to our integrated solution, giving corporations and other large enterprises the ability to provide secure, cost-effective remote access to their IP networks that is easy to deploy, manage and maintain. In addition, the FirePass technology has components that allow remote users to access any application or resource connected to the network, including legacy hosts, desktops and client-server applications.

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

Webifyers — Webifyers provide access to a wide variety of network applications and resources, from shared files to legacy mainframe applications. Each Webifyer represents a separate function that adapts the application being served to the language of Web browsers. The Webifyer's particular tasks are dictated by the application being accessed and the protocol being supported. Webifyers offer Web-based remote access to email servers, file servers, Intranet servers and individual desktops.

Client-Server Connector — The Client-Server Connector supports access from remote-point clients to application servers of TCP applications. These include MS Outlook, PeopleSoft, SAP, and Oracle. The Client-Server Connector enables a native client- side application to communicate back to the corporate application server via a secure tunnel between the Browser and the FirePass server. It also allows connected users to map LAN drives to the remote system.

VPN Connector — Like a traditional VPN, it provides access to the entire network, with no client or server-side application changes required. Unlike an IPSec VPN, the FirePass VPN Connector does not require any software installation or configuration on the remote device. The VPN Connector uses the standard HTTPS protocol, works through all firewalls and HTTP proxies, and leverages all of the setup, security, availability, and management features of FirePass as a whole.

Combined with the sophisticated inspection and control capabilities of our application traffic management technology, the FirePass technology is an ideal platform for the development of advanced application security gateways to control access to individual applications and the data and resources they use. Through further development and integration of both these technologies, our goal is to deliver a robust application security gateway solution within the next two years.

The FirePass line of SSL VPN servers currently includes the FirePass 1000 and the FirePass 4000, which support 100 and 1,000 concurrent users respectively. Both support the complete range of FirePass software features and offer a comprehensive solution for Web-based remote access to corporate applications and desktops.

FirePass devices can be clustered to support up to 10,000 concurrent connections on a single logical URL, without performance degradation. In addition, they can be configured for hot, stateful failover between yoked pairs of servers to preserve all session data in the unlikely event of a server failure.

The market for SSL VPN technology is new and relatively small. The current market leaders in SSL VPN are Neoteris and Aventail, small private companies who dominate a field of smaller vendors. Recently, Nokia and Nortel Networks have also introduced SSL VPN products. While we believe our FirePass products are superior to their offerings, Nokia and Nortel have resources and distribution channels that are much larger than ours and could give them a significant competitive advantage in the SSL VPN market. We currently compete with Nortel in the Layer 4/7 traffic management market, and Nokia resells our Layer 4/7 products. In the near term, we do not anticipate that our entry into the SSL VPN market will affect Nokia’s resale of our Layer 4/7 products. SSL VPNs are also a potential replacement for IP-Sec VPNs, the most widely deployed solution for secure remote access today. The current leaders in the IP-Sec VPN market are Check Point Systems and Netscreen, both of them larger and better known than F5.

Risk Factors

Acquisitions present many risks and we may not realize the financial and strategic goals that were contemplated at the time of the transaction. The acquisition of uRoam creates additional risk factors as follows.

- We may find that the acquired assets do not further our business strategy, or that we paid more than what the assets are later worth, or economic conditions change, all of which may generate future impairment charge;

- We may have difficulty integrating the operations and personnel of the acquired business, and may have difficulty retaining the key personnel of the acquired business;

- We may have difficulty in incorporating the acquired technologies or products with our existing product lines;

- Our ongoing business and management’s attention may be disrupted or diverted by transition or integration issues and the complexity of managing geographically and culturally diverse locations;

- We may have difficulty maintaining uniform standards, controls, procedures and policies across locations;

- We may experience significant problems or liabilities associated with the product quality, technology and other matters.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk. The primary objective of our investment activities is to preserve principal, while at the same time maximize the income we receive from our investments without significantly increasing risk. Some of the securities that we have invested in may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing interest rate later rises, the principal amount of our

investment will probably decline. To minimize this risk, we maintain our portfolio of cash equivalents and investments in a variety of securities, including commercial paper, government securities and money market funds.

The following table presents the amounts of our cash equivalents, short-term investments and long-term investments that are subject to market risk by range of expected maturity and weighted-average interest rates as of June 30, 2003.

	Maturing in (in thousands)				
	Three months or less	Three months to one year	Greater than one year	Total	Fair value
Included in cash and cash equivalents	$12,342	—	—	$12,342	$12,342
Weighted average interest rate	1.06%	—	—	—	—
Included in short-term investments	$29,807	$15,359	—	$45,166	$45,166
Weighted average interest rates	1.57%	1.66%	—	—	—
Included in long-term investments	—	—	$31,932	$31,932	$31,932
Weighted average interest rates	—	—	2.04%	—	—

Our investment in Artel is subject to market fluctuations. A future decline in the market value could have an adverse impact on our financial results. The following sensitivity analysis presents changes in our investment in Artel arising from selected hypothetical changes in the stock price of Artel (in thousands).

		Valuation Given Percentage Increase in Price			Valuation Given Percentage Decrease in Price		
Investment	Fair Value at June 30, 2003	15%	35%	50%	15%	35%	50%
Artel	$748	$860	$1,010	$1,122	$636	$486	$374

Foreign Currency Risk. The majority of our sales and expenses are denominated in U.S. dollars and as a result, we have not experienced significant foreign currency transaction gains and losses to date. While we have conducted some transactions in foreign currencies during the fiscal year ended September 30, 2002 and the three and nine months ended June 30, 2003 and expect to continue to do so, we do not anticipate that foreign currency transaction gains or losses will be significant. We have not engaged in foreign currency hedging to date, however we may do so in the future.

Item 4. Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-14(c) within 90 days of the filing date of this report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective. There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

We are subject to legal proceedings, claims, and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on our financial statements.

Reference is made to Item 3, Legal Proceedings in our Annual Report on Form 10-K for the year ended September 30, 2002, filed December 19, 2002, for descriptions of our legal proceedings. We continue to believe that the resolution of these legal proceedings will not have a material adverse effect on us and there have been no material developments since our 10-K filing.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit Number		Exhibit Description
3.1	—	Second Amended and Restated Articles of Incorporation of the Registration (1)
3.2	—	Amended and Restated Bylaws of the Registrant (1)
4.1	—	Specimen Common Stock Certificate (1)
31.1*	—	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	—	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	—	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed herewith.

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

(b) Reports on Form 8-K:

On July 23, 2003, we filed our earnings release for the three months ended June 30, 2003, on Form 8-K, reporting under Item 9. Regulation FD Disclosure.

On July 23, 2003, we filed a press release on Form 8-K reporting under Item 2. Acquisition or Disposition of Assets, announcing our purchase of substantially all the assets of uRoam, Inc.

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 12th day of August, 2003.

F5 NETWORKS, INC.

By: /s/ STEVEN B. COBURN

Steven B. Coburn
Chief Financial Officer
(Duly Authorized Officer and
Principal Financial and Accounting Officer)

EXHIBIT INDEX

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Exhibit 31.1

CERTIFICATIONS

I, John McAdam, certify that:

1) I have reviewed this quarterly report on Form 10-Q of F5 Networks, Inc.

2) Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3) Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal controls over financial reporting that occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal controls over financial reporting; and

5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial data; and any fraud, whether or not material, that involves management or other employee who have a significant role in the registrant's internal controls over financial reporting.

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Date: August 12, 2003


/s/ JOHN MCADAM
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John McAdam
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Chief Executive Officer and President

Exhibit 31.2

CERTIFICATIONS

I, Steven B. Coburn, certify that:

1) I have reviewed this quarterly report on Form 10-Q of F5 Networks, Inc.

2) Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3) Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c. disclosed in this report any change in the registrant's internal controls over financial reporting that occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal controls over financial reporting; and

5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a. all significant deficiencies in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial data; and any fraud, whether or not material, that involves management or other employee who have a significant role in the registrant's internal controls over financial reporting.

Date: August 12, 2003

/s/ STEVEN B. COBURN

Steven B. Coburn
Senior Vice President, Chief Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of F5 Networks, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, John McAdam, President and Chief Executive Officer and Steven Coburn, Senior Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C.
Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: August 12, 2003

/s/ JOHN MCADAM

John McAdam

/s/ STEVEN B. COBURN

Steven B. Coburn

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to F5 Networks, Inc., and will be retained by F5 Networks, Inc., and furnished to the Securities and Exchange Commission or its staff upon request.