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

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2001

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________

Commission File Number 000-26041

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

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

401 ELLIOTT AVENUE WEST
SEATTLE, WASHINGTON 98119
(Address of principal executive offices and zip code)

(206) 272-5555
(Registrant's telephone number, including area code)

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

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the latest practicable date: 22,173,843 shares of common stock, no par value, as of May 1, 2001.

F5 NETWORKS, INC.

FORM 10-Q

FOR THE QUARTER ENDED MARCH 31, 2001

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PART I

ITEM 1. FINANCIAL STATEMENTS

F5 NETWORKS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	MARCH 31, 2001 (unaudited)	SEPTEMBER 30, 2000
ASSETS		
Current assets:		
Cash and cash equivalents	$ 30,279	$ 53,017
Accounts receivable, net of allowances of $3,801 and $1,666	25,113	38,237
Inventories	8,845	5,231
Other current assets	3,887	2,290
Deferred income taxes	4,282	1,858
Total current assets	72,406	100,633
Restricted cash	6,347	6,182
Property and equipment, net	17,812	13,524
Other assets, net	502	541
Deferred income taxes	3,015	1,540
Total assets	$ 100,082	$ 122,420
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 3,905	$ 10,561
Accrued liabilities	9,915	7,975
Deferred revenue	13,628	16,199
Total current liabilities	27,448	34,735
Commitments and Contingencies:		
Shareholders' equity:		
Common stock, no par value; 100,000,000 shares authorized 21,997,000 and 21,613,000 shares issued and outstanding	87,620	87,419
Note receivable from shareholder	(469)	(469)
Accumulated other comprehensive income (loss)	297	(52)
Unearned compensation	(990)	(3,061)
Retained earnings (deficit)	(13,824)	3,848
Total shareholders' equity	72,634	87,685
Total liabilities and shareholders' equity	$ 100,082	$ 122,420

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

F5 NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited, in thousands except per share data)

	THREE MONTHS ENDED MARCH 31,		SIX MONTHS ENDED MARCH 31,	
	2001	2000	2001	2000
Net revenues:				
Products	$ 19,772	$ 18,532	$ 37,497	$ 34,814
Services	7,295	5,072	14,303	7,963
Total net revenues	27,067	23,604	51,800	42,777
Cost of net revenues:				
Products	7,753	5,053	15,839	9,677
Services	3,238	1,792	6,822	2,851
Provision for excess inventory	4,910	--	4,910	--
Total cost of net revenues	15,901	6,845	27,571	12,528
Gross profit	11,166	16,759	24,229	30,249
Operating expenses:				
Sales and marketing	12,877	8,452	26,405	14,194
Research and development	4,652	2,761	9,596	4,986
General and administrative	4,251	1,748	8,998	3,226
Restructuring charge	(96)	--	975	--
Amortization of unearned compensation	1,595	470	2,171	1,013
Total operating expenses	23,279	13,431	48,145	23,419
Income (loss) from operations	(12,113)	3,328	(23,916)	6,830
Other income, net	1,111	818	1,547	1,559
Income (loss) before income taxes	(11,002)	4,146	(22,369)	8,389
Income tax benefit	2,260	--	4,697	--
Net income (loss)	$ (8,742)	$ 4,146	$(17,672)	$ 8,389
Net income (loss) per share - basic	$ (0.40)	$ 0.20	$ (0.81)	$ 0.40
Weighted average shares - basic	21,917	21,198	21,796	20,811
Net income (loss) per share - diluted	$ (0.40)	$ 0.18	$ (0.81)	$ 0.36
Weighted average shares - diluted	21,917	23,105	21,796	23,092

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

F5 NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, in thousands)

	SIX MONTHS ENDED MARCH 31, 2001	SIX MONTHS ENDED MARCH 31, 2000
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$(17,672)	$ 8,389
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Restructuring charges	975	--
Provisions for asset write downs	378	--
Gain/Loss on sale of assets	120	--
Provision for inventory write down	4,910	--
Unrealized gain/loss on investments	186	87
Amortization of unearned compensation	2,171	1,013
Provision for doubtful accounts and sales returns	8,908	702
Depreciation and amortization	2,385	870
Deferred income taxes	(3,891)	--
Changes in operating assets and liabilities:		
Accounts receivable	4,245	(11,506)
Inventories	(6,631)	(950)
Other assets	(2,345)	(889)
Accounts payable and accrued liabilities	(6,700)	2,546
Deferred revenue	(2,537)	5,543
Net cash provided by (used in) operating activities	(15,498)	5,805
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from the sale of property and equipment	90	
Investment in restricted cash	(165)	(66)
Purchases of property and equipment	(7,232)	(3,288)
Net cash used in investing activities	(7,307)	(3,354)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from the secondary offering, net of issuance costs	--	31,475
Proceeds from the exercise of stock options and warrants	1,183	2,322
Proceeds from payments on shareholder loan	--	187
Repurchase of common stock	(1,082)	--
Net cash provided by financing activities	101	33,984
Net increase (decrease) in cash and cash equivalents	(22,704)	36,435
Effect of exchange rate changes on cash and cash equivalents	(34)	(7)
Cash and cash equivalents, at beginning of period	53,017	24,797
Cash and cash equivalents, at end of period	$ 30,279	$ 61,225

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. THE COMPANY AND BASIS OF PRESENTATION:

The accompanying unaudited condensed consolidated financial statements have been prepared by F5 Networks, Inc. ("F5") in accordance with the rules and regulations of the Securities and Exchange Commission for interim financial statements. Accordingly, certain information and footnote disclosures, normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States, have been condensed or omitted pursuant to such rules and regulations. In the opinion of management of the Company, the unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the Company's financial position at March 31, 2001, its operating results for the three and six months ended March 31, 2001 and 2000 and cash flows for the six months ended March 31, 2001 and 2000. The condensed consolidated balance sheet at September 30, 2000 has been derived from audited financial statements as of that date. These consolidated financial statements and the notes should be read in conjunction with the Company's 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 13, 2000.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

PRINCIPLES OF CONSOLIDATION

The financial statements consolidate the accounts of F5 Networks, Inc. and its wholly owned subsidiaries F5 Networks, Ltd., F5 Networks, Singapore Pte. Ltd. and F5 Networks, Japan K.K. and are collectively hereinafter referred to as the "Company". All intercompany transactions have been eliminated.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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. Actual results could differ from those estimates.

REVENUE RECOGNITION

The Company recognizes software revenue under Statement of Position 97-2, "Software Revenue Recognition," and SOP 98-9 "Modification of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions."

The Company sells products through resellers, original equipment manufacturers and other channel partners, as well as to end users, under similar terms. The Company generally combines software license, hardware, installation and customer support elements into a package with a single "bundled" price. The Company allocates a portion of the sales price to each element of the bundled package based on their respective fair values when the individual elements are sold separately. Revenues from the license of software, net of an allowance for estimated returns, are recognized when the product has been shipped and the customer is obligated to pay for the product. Installation revenue is recognized when the product has been installed at the customer's site. Revenues for customer support are recognized on a straight-line basis over the service contract terms. Estimated sales returns are based on historical experience by product and are recorded at the time revenues are recognized.

CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

Cash equivalents are highly liquid investments, consisting of investments in money market funds and marketable securities which are readily convertible to cash without penalty and subject to insignificant risk of changes in value. The Company's cash and cash equivalents balance consists of the following:

	MARCH 31, 2001	SEPTEMBER 30, 2000
	(IN THOUSANDS)	
Cash	$ 6,839	$18,354
Short-term investments	23,440	34,663
	$30,279	$53,017

CONCENTRATION OF CREDIT RISK

The Company places its temporary cash investments with five major financial institutions. As of March 31, 2001, all of the Company's temporary cash investments were placed with five institutions.

The Company's customers are from diverse industries and geographic locations. The majority of net revenues from international customers are denominated in U.S. dollars and were approximately $9.0 million for the three months ended March 31, 2001, and $6.6 million for the three months ended March 31, 2000. For the six months ended March 31, 2001 and 2000, one customer accounted for 9.5% and 19.6% of net revenues, respectively. One customer accounted for 4.8% and 10.6% of the Company's accounts receivable balance at March 31, 2001 and 2000, respectively.

INVENTORIES

Inventories consist of hardware, software and related component parts and are recorded at the lower of cost or market (as determined by the first-in, first-out method).

Inventories are comprised of the following:

	MARCH 31, 2001	SEPTEMBER 30, 2000
	(IN THOUSANDS)	
Finished goods	$ 8,370	$2,045
Raw materials	3,515	3,186
Less: Provision for excess of inventory	(3,040)	--
	$ 8,845	$5,231

Due to changes in current market conditions, and a revision of our sales forecast, a review was made of our inventory needs and an assessment of our future purchase commitments as of March 31, 2001. As a result, we determined a provision for excess inventory and future purchase commitments would be recorded. The provision for excess inventory was charged to cost of revenues in the amount of $3.8 million as of March 31, 2001, which consisted of a $3.0 million inventory valuation allowance and $800,000 of future purchase commitments. An additional $1.1 million was included in the provision for excess inventory in the statement of operations. The charge is associated with changes in the configuration of our EDGE-FX Cache product, which will increase the functionality of the product. These costs are associated with updating both existing inventory and product previously sold to customers, as well as costs to fulfill existing purchase commitments, have been included in cost of revenues at March 31, 2001.

COMPREHENSIVE INCOME (LOSS)

The following table sets forth a reconciliation of net income (loss) to comprehensive income (loss), net of tax:

	THREE MONTHS ENDED MARCH 31,		SIX MONTHS ENDED MARCH 31,	
	2001	2000	2001	2000
	(IN THOUSANDS)		(IN THOUSANDS)	
Net income (loss)	$(8,742)	$4,146	$(17,672)	$8,389
Unrealized gain (loss) on investments	564	31	(186)	87
Foreign currency translation adjustment	(48)	(6)	(162)	(7)
Comprehensive income (loss)	$(8,226)	$4,171	$(18,020)	$8,469

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 per share is computed by dividing net income by the weighted average number of common and dilutive common stock equivalent shares outstanding during the period. The Company excluded the impact of dilutive common stock equivalent shares from the calculation of diluted net loss per share as the inclusion of such elements would be antidilutive.

The following table sets forth the computation of basic and diluted net income (loss) per share for the three and six months ended March 31, 2001 and 2000 (in thousands, except per share data):

	THREE MONTH ENDED MARCH 31,		SIX MONTH ENDED MARCH 31,	
	2001	2000	2001	2000
NUMERATOR:				
Net income (loss)	$ (8,742)	$ 4,146	$(17,672)	$ 8,389
DENOMINATOR:				
Weighted average shares outstanding - basic	21,917	21,198	21,796	20,811
Dilutive effect of common shares from stock options	--	1,896	--	2,034
Dilutive effect of common shares from warrants	--	11	--	247
Weighted average shares outstanding - diluted	21,917	23,105	21,796	23,092
Basic net income (loss) per share	$ (0.40)	$ 0.20	$ (0.81)	$ 0.40
Diluted net income (loss) per share	$ (0.40)	$ 0.18	$ (0.81)	$ 0.36

RESTRUCTURING CHARGE

During the first fiscal quarter of 2001, F5 recorded a restructuring charge of $1.1 million in connection with management's decision to bring operating expenses in line with the business revenue growth model. As a result of changes in the business revenue growth model, the Company terminated 96 employees throughout all divisions of the Company. In January 2001, all identified employees had been terminated. During the quarter ended March 31, 2001, the Company reversed $96,000 of the original accrual due to a revision of previous estimates. As of March 31, 2001, substantially all of the restructuring charge accrued during the first fiscal quarter of 2001 has been paid.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." This statement requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. In July 1999, the FASB issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities Deferral of the Effective Date of FASB Statement No. 133." SFAS No. 137 deferred the effective date of SFAS No. 133 until fiscal years beginning after June 15, 2000. The Company does not use derivative instruments, therefore the adoption of this statement will not have any effect on the Company's results of operations or its financial position.

In December 1999, SEC Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements," was issued. This pronouncement summarizes certain of the SEC staff's views in applying generally accepted accounting principles to revenue recognition. SAB 101 is required to be adopted by the Company for the year ended September 30, 2001. The Company implemented SAB 101 in the first quarter of the fiscal year 2001 and there was no material impact on the Company's financial statements.

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 Financial Statements and Notes. Our discussion contains forward-looking statements 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 Form 10-K for the fiscal year ended September 30, 2000, and elsewhere in this report.

OVERVIEW

F5 Networks, Inc. ("F5") is a leading provider of integrated Internet traffic and content management solutions designed to improve the availability and performance of Internet-based servers and applications. Our products monitor and manage local and geographically dispersed servers and intelligently direct traffic to the server best able to handle a user's request. Our content management products enable network managers to increase access to content by capturing and storing it at points between production servers and end-users and ensure that newly published or updated files and applications are replicated uniformly across all target servers. When combined with our network management tools, these products help organizations optimize their network server availability and performance and cost-effectively manage their Internet infrastructure.

Currently, we derive approximately 57% of our net revenues from sales of BIG-IP, and we expect to derive a significant portion of our net revenues from sales of BIG-IP in the future. For the three months ended March 31, 2001, no individual customer represented more than 10% of our total revenues.

Net revenues derived from customers located outside of the United States were $9.0 million and $4.4 million for the three months ended March 31, 2001 and 2000, respectively. We plan to continue expanding our international operations, primarily in the European and the Asia Pacific markets, because we believe international markets represent significant growth opportunity.

Customers who purchase our products have the option to receive installation services and an initial customer support contract, typically covering a 12-month period. We generally combine the software license, installation, and customer support elements of our products into a package with a single price. We allocate a portion of the sales price to each element of the bundled package based on their respective fair values as determined when the individual elements are sold separately. Customers may also purchase consulting services and renew their initial customer support contract.

Revenues from the sale of our products and software licenses are recognized, net of allowances for estimated returns, when the product has been shipped and the reseller or end user is obligated to pay for the product. Estimated sales returns are based on historical experience by product and are recorded at the time revenues are recognized. Services revenue for installation is recognized when the product has been installed at the customer's site. Revenues for customer support are recognized on a straight-line basis over the service contract term. Consulting services are customarily billed at fixed rates, plus out-of-pocket expenses, and revenues from consulting services are recognized when completed.

Our ordinary payment terms to our domestic customers are net 30 days, but we have extended payment terms beyond net 30 days to some customers. For these arrangements, revenue is recognized ratably over the terms of the arrangement. Our ordinary payment terms to our international customers are net 60 days.

In view of the rapidly changing nature of our business, our limited operating history and the current economic conditions, we believe that period-to-period comparisons of net revenues and operating results are not necessarily meaningful and should not be relied upon as indicators of future performance. To achieve profitability we will need to increase our net revenues and manage operating expenses.

We have recorded a total of $8.3 million of stock compensation costs since our inception through March 31, 2001. These charges represent the difference between the exercise price and the deemed fair value of certain stock options granted to our employees and outside directors. These options generally vest ratably over a four-year period. We are amortizing these costs using an accelerated method as prescribed by FASB interpretation No. 28 ("FIN No. 28") and have recorded stock compensation charges of $2.1 million, $2.5 million and $420,000 for the years ended September 30, 2000, 1999 and 1998, respectively and $1.6 million and $470,000 for the three months ended March 31, 2001 and 2000.

We expect to recognize amortization expense related to unearned compensation of approximately $2.6 million, $400,000, $60,000 and $0 during the years ended September 30, 2001, 2002, 2003 and 2004, respectively. We cannot guarantee, however, that we will not accrue additional stock compensation costs in the future or that our current estimate of these costs will prove accurate.

RESULTS OF OPERATIONS

The following table sets forth financial data as a percentage of total net revenues for the periods indicated.

	THREE MONTHS ENDED MARCH 31,		SIX MONTHS ENDED MARCH 31,	
	2001	2000	2001	2000
	(UNAUDITED)		(UNAUDITED)	
STATEMENT OF OPERATIONS DATA:				
Net revenues:				
Products	73.0%	78.5%	72.4%	81.4%
Services	27.0	21.5	27.6	18.6
Total net revenues	100.0	100.0	100.0	100.0
Cost of net revenues:				
Products	28.6	21.4	30.6	22.6
Services	12.0	7.6	13.2	6.7
Provision for excess inventory	18.1	--	9.4	--
Total cost of net revenues	58.7	29.0	53.2	29.3
Gross margin	41.3	71.0	46.8	70.7
Operating expenses:				
Sales and marketing	47.6	35.8	51.0	33.2
Research and development	17.2	11.7	18.5	11.7
General and administrative	15.7	7.4	17.4	7.5
Restructuring charges	(.4)	--	1.9	--
Amortization of unearned compensation	5.9	2.0	4.2	2.3
Total operating expenses	86.0	56.9	93.0	54.7
Income (loss) from operations	(44.7)	14.1	(46.2)	16.0
Other income, net	1.6	3.5	0.1	3.6
Interest income (expense), net	2.5	--	2.6	--
Income (loss) before income taxes	(40.6)	17.6	(43.2)	19.6
Income tax provision	(8.4)	--	(9.1)	--
Net income (loss)	(32.2)%	17.6%	34.1%	19.6%

NET REVENUES:

Net revenues consist of sales of our products and services, which include software licenses and services. Services include revenue from service and support agreements provided as part of the initial product sale, sales of extended service and support contracts and consulting services.

Product revenues. Product revenues increased by 6.7% from $18.5 million for the three months ended March 31, 2000 to $19.8 million for the three months ended March 31, 2001. Product revenues increased 7.7% from $34.8 million for the six months ended March 31, 2000 to $37.5 million for the six months ended March 31, 2001. The increase in product revenues were due primarily to an increase in the quantity of our products sold through our international indirect sales channels. This increase also reflects the addition of new customers, as well as repeat sales to existing customers.

Service revenues. Service revenues increased by 43.8% from $5.1 million for the three months ended March 31, 2000 to $7.3 million for the three months ended March 31, 2001. Service revenues increased 79.6% from $8.0 million for the six months ended March 31, 2000 to $14.3 million for the six months ended March 31, 2001. The increase was due primarily to an increase in the installed base of our products and the renewal of service and support contracts.

International revenues represented 32.6% and 18.48% of net revenues for the three months ended March 31, 2001 and 2000, respectively. International revenues represented 31.7% and 15.5% for the six months ended March 31, 2001 and 2000. We expect international sales will continue to represent a significant portion of net revenues, although we cannot assure you that international sales as a percentage of net revenues will remain at current levels.

We anticipate our average selling prices to decrease primarily as a result of a shift in our channel mix and, to a lesser extent, increased competition. This decrease may have a negative impact on our gross margin. In order to maintain our gross margin, we must continually manage our cost of revenues to offset the decrease in our average sales price.

COST OF NET REVENUES:

Cost of net revenues consists primarily of out-sourced hardware components and manufacturing, fees for third-party software products integrated into our products, service and support personnel, an allocation of our facilities and depreciation expenses.

Cost of product revenues. Cost of product revenues increased by 53.4%, from $5.0 million for the three months ended March 31, 2000 to $7.8 million for the three months ended March 31, 2001 and increased as a percentage of product revenues from 27.3% to 39.2% for the same periods. Cost of product revenues increased by 63.7% from $9.7 million for the six months ended March 31, 2000 to $15.8 million for the six months ended March 31, 2001 and increased as a percentage of product revenues from 27.8% to 42.2% for the same periods. The increases as a percentage of product revenues was due to component enhancements of our products and a decrease in our average selling price as a result of a change in our channel mix.

Due to changes in current market conditions, and a revision of our sales forecast, a review was made of our inventory needs and an assessment of our future purchase commitments as of March 31, 2001. As a result, we determined a provision for excess inventory and future purchase commitments would be recorded. The provision for excess inventory was charged to cost of revenues in the amount of $3.8 million as of March 31, 2001, which consisted of a $3.0 million inventory valuation allowance and $800,000 of future purchase commitments. An additional $1.1 million was included in the provision for excess inventory in the statement of operations. The charge is associated with changes in the configuration of our EDGE-FX Cache product, which will increase the functionality of the product. These costs are associated with updating both existing inventory and product previously sold to customers, as well as costs to fulfill existing purchase commitments, have been included in cost of revenues at March 31, 2001.

Cost of service revenues. Cost of service revenues increased by 80.7%, from $1.8 million for the three months ended March 31, 2000 to $3.2 million for the three months ended March 31, 2001 and increased as a percentage of service revenues from 35.3% to 44.4% for the same periods. Cost of service revenues increased by 139.3% from $2.9 million for the six months ended March 31, 2000 to 6.8 million for the six months ended March 31, 2001 and increased as a percentage of service revenues from 35.8% to 47.7% for the same periods. The increases as a percentage of cost of service revenues was due to increased personnel costs related to hiring. The personnel associated with cost of service revenues increased from 43 as of March 31, 2000 to 95 as of March 31, 2001.

Sales and marketing. Our 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 52.3%, from $8.5 million for the three months ended March 31, 2000 to $12.9 million for the three months ended March 31, 2001. Sales and marketing expenses increased by 86% from $14.2 million for the six months ended March 31, 2000 to $26.4 million for the six months ended March 31, 2001. These increases were due to an increase in sales and marketing and professional services personnel from 170 to 212, increased commissions, and increased advertising and promotional activities. We expect to continue increasing the number of commissioned sales staff in order to grow our revenues.

Research and development. Our 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 increased by 68.5%, from $2.8 million for the three months ended March 31, 2000 to $4.7 million for the three months ended March 31, 2001. Research and development expenses increased by 92.5% from $5.0 million for the six months ended March 31, 2000 to $9.6 million for the six months ended March 31, 2001. These increases were due primarily to an increase in product development personnel from 89 to 115. Our future success is dependent in a large part on the continued enhancement of our current products and our ability to develop new, technologically advanced products that meet the sophisticated needs of our customers. We expect research and development expenses to increase in future periods.

General and administrative. Our 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, and an allocation of our facilities and depreciation expenses. General and administrative expenses increased by 143.2% from $1.8 million for the three months ended March 31, 2000 to $4.3 million for the three months ended March 31, 2001. General and administrative expenses increased by 178.9% from $3.2 million for the six months ended March 31, 2000 to $9.0 million for the six months ended March 31, 2001. These increases were due primarily to an increase in general and administrative personnel from 48 to 67.

Restructuring charge. During the first fiscal quarter of 2001, F5 recorded a restructuring charge of $1.1 million in connection with management's decision to bring operating expenses in line with the business revenue growth model. As a result of change in the business revenue growth model, the Company terminated 96 employees throughout all divisions of the Company. In January 2001, all identified employees had been terminated. During the quarter ended March 31, 2001, the Company reversed $96,000 of the original accrual due to a revision of previous estimates. As of March 31, 2001, substantially all of the restructuring charge accrued during the first fiscal quarter of 2001, has been paid.

Stock compensation. We recorded stock compensation charges of $470,000 for the three months ended March 31, 2000 and $1.6 million for the three months ended March 31, 2001. The increase was the result of stock granted below fair market value to an executive officer. For the six months ended March 31, 2000 and 2001, stock compensation was $1.0 million and $2.2 million, respectively.

Other income, net. Other income consists primarily of earnings on our cash and cash equivalent balances. Other income, net was $818,000 for the three months ended March 31, 2000 and $1.1 million for the three months ended March 31, 2001. The decrease in other income is due to a decline in our cash and cash equivalent balances which were used for investment in the building of our corporate facilities and our global business. For the six months ended March 31, 2000 and 2001, other income, net, was $1.6 million and $1.5 million, respectively.

Income taxes. At March 31, 2001 the Company had net operating loss carryforwards of approximately $10.9 million, which begin to expire in 2011. Until June 30, 2000, the Company had provided a full valuation allowance against deferred tax assets. Based upon available evidence, which included a review of historical operating performance, the Company determined that certain of these deferred tax assets were more likely than not realized and therefore reduced the valuation allowance related to those deferred tax assets.

An increase from $4.9 million to $10.9 million in the valuation allowance was recorded against the deferred tax assets as a result of the operating losses incurred during the six months ended March 31, 2001.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents, short-term investments, and restricted cash decreased from $53.0 million at September 30, 2000 to $30.3 million at March 31, 2001, a decrease of $22.7 million. This decrease is primarily due to increases in inventory and working capital requirements necessary to fund our operations. Inventory levels increased 69% from September 30, 2000 to March 31, 2001. Inventory management remains an area of focus as we balance the need to maintain strategic inventory levels to ensure competitive lead times. Any such increases in inventory can be expected to reduce cash and cash equivalents, and short-term investments.

Cash used in investing activities was $7.3 million for the six months ended March 31, 2001, and $3.4 million for the six months ended March 31, 2000. The increase in investing activities was primarily the result of capital expenditures associated with the completion of the new corporate facilities.

As of March 31, 2001, our principal commitments consisted of obligations outstanding under operating leases. In April 2000, we entered into a lease agreement on two buildings for a new corporate headquarters. The lease commenced in July 2000 on the first building; and the lease on the second building commenced in October 2000. The lease for both buildings expires in 2012 with an option for renewal. In April 2001, we signed an agreement to sublease the second building. The sublease will substantially cover our monthly costs as the primary tenant. The company established a restricted escrow account in connection with this lease agreement. Under the term of the lease, a $6 million irrevocable standby letter of credit is required through November 2012, unless the lease is terminated before then. This amount has been included on the Company's balance sheet as of March 31, 2001 as a component of restricted cash. In the future we may also require a larger inventory of products in order to provide better availability to customers and achieve purchasing efficiencies. Any such increase can be expected to reduce cash, cash equivalents and short-term investments. We expect that our existing cash balances and cash from operations will be sufficient to meet our anticipated working capital and capital expenditures for the foreseeable future.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.

Interest Rate Risk. We do not hold derivative financial instruments or equity securities in our investment portfolio. Our cash equivalents consist of high-quality securities, as specified in our investment policy guidelines. The policy limits the amount of credit exposure to any one issue or issuer to a maximum of 20% of the total portfolio with the exception of treasury securities, commercial paper and money market funds, which are exempt from size limitation. The policy limits all short-term investments to mature in two years or less, with the average maturity being one year or less. These securities are subject to interest rate risk and will decrease in value if interest rates increase.

	MATURING IN				
MARCH 31, 2001:	THREE MONTHS OR LESS	THREE MONTHS TO ONE YEAR	GREATER THAN ONE YEAR	TOTAL	FAIR VALUE
	(IN THOUSANDS)				
Included in cash and cash equivalents.....................	$ 1,728	--	--	$ 1,728	$ 1,728
Weighted average interest rate	6.04%	--	--	--	--
Included in short-term investments.....................	--	$24,006	--	$ 24,006	$ 24,006
Weighted average interest rates...........................	--	5.96%	--	--	--

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 exchange gains and losses to date. While we have conducted some transactions in foreign currencies during the fiscal year ended September 30, 2000 and the six months ended March 31, 2001 and expect to continue to do so, we do not anticipate that foreign exchange gains and losses will be significant. We have not engaged in foreign currency hedging to date, however we may do so in the future.

PART II

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company held its Annual Meeting of Shareholders on April 20, 2001 to elect two class II directors and amend the Company's 1998 Equity Incentive Plan to increase the number of shares issuable by an additional 2,000,000 shares. At the Annual Meeting, the following nominees were elected as follows:

	VOTES	
	FOR	AGAINST
John McAdam	18,037,258	177,821
Alan J. Higginson	18,036,658	178,421

The shareholders voted in favor of amending the Company's 1998 Equity Incentive Plan to increase the number of shares issuable by an additional 2,000,000 shares, with voting as follows: 6,595,764 for, 1,242,679 against, and 45,134 abstain.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

None

(b) Reports on Form 8-K:

No reports on Form 8-K were filed by the Company during the period ended March 31, 2001.

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 10th day of May, 2001.

F5 Networks, Inc.
(Registrant)

By /s/ Robert J. Chamberlain

Robert J. Chamberlain
Chief Financial Officer

(Duly Authorized Officer and Principal Financial and Accounting Officer)