

**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 December 31, 2020

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

(State or other jurisdiction of incorporation or organization)

91-1714307

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

801 5th Avenue

Seattle, Washington 98104

(Address of principal executive offices and zip code)

(206) 272-5555

(Registrant's telephone number, including area code)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, no par value	FFIV	NASDAQ Global Select Market

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 has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

(Do not check if a smaller reporting company)

Smaller Reporting Company

Emerging Growth Company

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (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 January 29, 2021 was 61,650,819.

F5 NETWORKS, INC.  
QUARTERLY REPORT ON FORM 10-Q  
For the Quarter Ended December 31, 2020

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****F5 NETWORKS, INC.****CONSOLIDATED BALANCE SHEETS**  
(unaudited, in thousands)

	<u>December 31, 2020</u>	<u>September 30, 2020</u>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 1,026,829	\$ 849,556
Short-term investments	346,515	360,333
Accounts receivable, net of allowances of \$3,356 and \$3,105	346,670	296,183
Inventories	26,455	27,898
Other current assets	283,341	259,506
Total current assets	<u>2,029,810</u>	<u>1,793,476</u>
Property and equipment, net	215,649	229,239
Operating lease right-of-use assets	286,044	300,680
Long-term investments	88,753	102,939
Deferred tax assets	47,236	45,173
Goodwill	1,863,892	1,858,966
Other assets, net	367,955	347,447
Total assets	<u>\$ 4,899,339</u>	<u>\$ 4,677,920</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable	\$ 57,542	\$ 64,472
Accrued liabilities	305,792	321,398
Deferred revenue	936,640	883,134
Current portion of long-term debt	19,275	19,275
Total current liabilities	<u>1,319,249</u>	<u>1,288,279</u>
Deferred tax liabilities	1,965	602
Deferred revenue, long-term	422,185	389,498
Operating lease liabilities, long-term	328,468	338,715
Long-term debt	364,229	369,047
Other long-term liabilities	61,653	59,511
Total long-term liabilities	<u>1,178,500</u>	<u>1,157,373</u>
Commitments and contingencies (Note 9)		
Shareholders' equity		
Preferred stock, no par value; 10,000 shares authorized, no shares outstanding	—	—
Common stock, no par value; 200,000 shares authorized, 61,632 and 61,099 shares issued and outstanding	386,236	305,453
Accumulated other comprehensive loss	(17,855)	(18,716)
Retained earnings	2,033,209	1,945,531
Total shareholders' equity	<u>2,401,590</u>	<u>2,232,268</u>
Total liabilities and shareholders' equity	<u>\$ 4,899,339</u>	<u>\$ 4,677,920</u>

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

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

	<b>Three months ended December 31,</b>	
	<b>2020</b>	<b>2019</b>
Net revenues		
Products	\$ 288,045	\$ 234,536
Services	336,572	334,769
Total	<u>624,617</u>	<u>569,305</u>
Cost of net revenues		
Products	67,038	42,118
Services	47,941	46,524
Total	<u>114,979</u>	<u>88,642</u>
Gross profit	509,638	480,663
Operating expenses		
Sales and marketing	214,546	195,519
Research and development	114,191	96,005
General and administrative	63,153	59,004
Restructuring charges	—	7,800
Total	<u>391,890</u>	<u>358,328</u>
Income from operations	117,748	122,335
Other (loss) income, net	<u>(683)</u>	<u>5,220</u>
Income before income taxes	117,065	127,555
Provision for income taxes	29,387	29,028
Net income	<u>\$ 87,678</u>	<u>\$ 98,527</u>
Net income per share — basic	<u>\$ 1.43</u>	<u>\$ 1.62</u>
Weighted average shares — basic	<u>61,440</u>	<u>60,649</u>
Net income per share — diluted	<u>\$ 1.41</u>	<u>\$ 1.62</u>
Weighted average shares — diluted	<u>62,282</u>	<u>60,815</u>

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

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

	<b>Three months ended December 31,</b>	
	<b>2020</b>	<b>2019</b>
Net income	\$ 87,678	\$ 98,527
Other comprehensive income:		
Foreign currency translation adjustment	1,278	634
Available-for-sale securities:		
Unrealized (losses) gains on securities, net of taxes of \$(50) and \$28 for the three months ended December 31, 2020 and 2019, respectively	(420)	189
Reclassification adjustment for realized gains (losses) included in net income, net of taxes of \$0 and \$2 for the three months ended December 31, 2020 and 2019, respectively	3	(9)
Net change in unrealized (losses) gains on available-for-sale securities, net of tax	(417)	180
Total other comprehensive income	861	814
Comprehensive income	<u>\$ 88,539</u>	<u>\$ 99,341</u>

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

**F5 NETWORKS, INC.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(unaudited, in thousands)

	Common Stock		Accumulated Other Comprehensive Loss	Retained Earnings	Total Shareholders' Equity			
	Shares	Amount						
(In thousands)								
Three months ended December 31, 2019								
<b>Balances, September 30, 2019</b>	<u>60,367</u>	<u>\$ 142,597</u>	<u>\$ (19,190)</u>	<u>\$ 1,638,090</u>	<u>\$ 1,761,497</u>			
Exercise of employee stock options	11	290	—	—	290			
Issuance of stock under employee stock purchase plan	169	20,669	—	—	20,669			
Issuance of restricted stock	256	—	—	—	—			
Stock-based compensation	—	47,661	—	—	47,661			
Net income	—	—	—	98,527	98,527			
Other comprehensive income	—	—	814	—	814			
<b>Balances, December 31, 2019</b>	<u>60,803</u>	<u>\$ 211,217</u>	<u>\$ (18,376)</u>	<u>\$ 1,736,617</u>	<u>\$ 1,929,458</u>			
Three months ended December 31, 2020								
<b>Balances, September 30, 2020</b>	<u>61,099</u>	<u>\$ 305,453</u>	<u>\$ (18,716)</u>	<u>\$ 1,945,531</u>	<u>\$ 2,232,268</u>			
Exercise of employee stock options	39	1,118	—	—	1,118			
Issuance of stock under employee stock purchase plan	231	26,077	—	—	26,077			
Issuance of restricted stock	297	—	—	—	—			
Taxes paid related to net share settlement of equity awards	(34)	(4,481)	—	—	(4,481)			
Stock-based compensation	—	58,069	—	—	58,069			
Net income	—	—	—	87,678	87,678			
Other comprehensive income	—	—	861	—	861			
<b>Balances, December 31, 2020</b>	<u>61,632</u>	<u>\$ 386,236</u>	<u>\$ (17,855)</u>	<u>\$ 2,033,209</u>	<u>\$ 2,401,590</u>			

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

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

	Three months ended December 31,	
	2020	2019
<b>Operating activities</b>		
Net income	\$ 87,678	\$ 98,527
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock-based compensation	58,069	47,661
Depreciation and amortization	27,660	18,979
Non-cash operating lease costs	9,698	8,703
Deferred income taxes	(694)	(1,714)
Impairment of assets	6,873	—
Other	307	(31)
Changes in operating assets and liabilities (excluding effects of the acquisition of businesses):		
Accounts receivable	(54,416)	(32,683)
Inventories	1,443	2,020
Other current assets	(23,250)	(5,494)
Other assets	(26,654)	2,011
Accounts payable and accrued liabilities	(23,925)	(23,606)
Deferred revenue	86,193	39,856
Lease liabilities	(11,619)	(10,217)
Net cash provided by operating activities	<u>137,363</u>	<u>144,012</u>
<b>Investing activities</b>		
Purchases of investments	(42,765)	(180,557)
Maturities of investments	69,352	150,697
Sales of investments	—	22,764
Acquisition of businesses, net of cash acquired	(1,247)	—
Purchases of property and equipment	(4,697)	(22,304)
Net cash provided by (used in) investing activities	<u>20,643</u>	<u>(29,400)</u>
<b>Financing activities</b>		
Proceeds from the exercise of stock options and purchases of stock under employee stock purchase plan	27,196	20,959
Payments on term debt agreement	(5,000)	—
Taxes paid related to net share settlement of equity awards	(4,481)	—
Net cash provided by financing activities	<u>17,715</u>	<u>20,959</u>
Net increase in cash, cash equivalents and restricted cash	175,721	135,571
Effect of exchange rate changes on cash, cash equivalents and restricted cash	1,655	820
Cash, cash equivalents and restricted cash, beginning of period	852,826	602,254
Cash, cash equivalents and restricted cash, end of period	<u>\$ 1,030,202</u>	<u>\$ 738,645</u>
<b>Supplemental disclosures of cash flow information</b>		
Cash paid for amounts included in the measurement of operating lease liabilities	\$ 15,032	\$ 12,707
Cash paid for interest on long-term debt	1,370	—
<b>Supplemental disclosures of non-cash activities</b>		
Right-of-use assets obtained in exchange for lease obligations	\$ 1,614	\$ 394,315

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

## F5 NETWORKS, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

#### 1. Summary of Significant Accounting Policies

##### Description of Business

F5 Networks, Inc. (the "Company") is a leading provider of multi-cloud application services which enable its customers to develop, deploy, operate, secure, and govern applications in any architecture, from on-premises to the public cloud. The Company's cloud, software, and hardware solutions enable its customers to deliver digital experiences to their customers faster, reliably, and at scale. The Company's enterprise-grade application services are available as cloud-based, software-as-a-service, and software-only solutions optimized for multi-cloud environments, with modules that can run independently, or as part of an integrated solution on its high-performance appliances. In connection with its solutions, the Company offers a broad range of professional services, including consulting, training, installation, maintenance, and other technical support services.

##### Basis of Presentation

The year-end consolidated balance sheet data was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America ("GAAP"). In the opinion of management, the unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for their fair statement in conformity with accounting principles generally accepted in the United States of America. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC"). 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, 2020.

In December 2019, a novel strain of coronavirus ("COVID-19") was first identified, and in March 2020, the World Health Organization categorized COVID-19 as a pandemic. The Company assessed the impact that COVID-19 had on its results of operations, including, but not limited to an assessment of its allowance for current expected credit losses, the carrying value of short-term and long-term investments, the carrying value of goodwill and other long-lived assets, and the impact to revenue recognition and cost of revenues. The Company is actively monitoring the impact to the results of its business operations, and may make decisions required by federal, state or local authorities, or that are determined to be in the best interests of its employees, customers, partners, suppliers and stockholders. As of the filing date, the extent to which the COVID-19 pandemic may impact the Company's financial condition or results of operations remains uncertain.

##### Recently Adopted Accounting Standards

In August 2018, the FASB issued ASU 2018-15, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40) (ASU 2018-15), which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software, and hosting arrangements that include an internal-use software license. The accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in this update. The Company adopted this new standard prospectively on October 1, 2020. The adoption of this standard did not have a material impact to the Company's consolidated financial statements or disclosures.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (ASU 2016-13), which modifies the accounting for credit losses for most financial assets and requires the use of an expected loss model, replacing the currently used incurred loss method. Under this model, entities will be required to estimate the lifetime expected credit loss on such instruments and record an allowance to offset the amortized cost basis of the financial asset, resulting in a net presentation of the amount expected to be collected on the financial asset. The Company adopted this new standard on October 1, 2020 using the modified retrospective approach. The adoption of this standard did not have a material impact on the Company's condensed consolidated financial statements. The following accounting policies were updated as a result of the adoption of this standard.

##### **Investments**

The Company classifies its investment securities as available-for-sale. Investment securities, consisting of certificates of deposit, corporate and municipal bonds and notes, the United States government and agency securities and international government securities are reported at fair value with the related unrealized gains and losses included as a component of accumulated other comprehensive income (loss) in shareholders' equity. Realized gains and losses and impairments due to

credit losses, in which the fair value of a security is below its amortized cost and management's intent is to sell the impaired security prior to its recovery, are included in other income (expense). An allowance for credit losses for the excess of amortized cost over the expected cash flows is recorded in other income, net in the Company's consolidated income statements. The cost of investments for purposes of computing realized and unrealized gains and losses is based on the specific identification method. Investments in securities with maturities of less than one year or where management's intent is to use the investments to fund current operations are classified as short-term investments. Investments with maturities of greater than one year are classified as long-term investments.

### **Accounts Receivable**

Trade accounts receivable are recorded at the invoiced amount, net of allowances for credit losses for any potential uncollectible amounts. The allowance for credit losses is based on the assessment of the collectability of accounts. Management regularly reviews the adequacy of the allowance for credit losses on a collective basis by considering the age of each outstanding invoice, each customer's expected ability to pay and collection history, current market conditions, and reasonable and supportable forecasts of future economic conditions to determine whether the allowance is appropriate. Accounts receivable deemed uncollectible are charged against the allowance for credit losses when identified. For the three months ended December 31, 2020 and 2019, the allowance for credit losses activity was not significant.

There have been no additional changes to the Company's significant accounting policies as of and for the three months ended December 31, 2020.

## **2. Revenue from Contracts with Customers**

### *Capitalized Contract Acquisition Costs*

The table below shows significant movements in capitalized contract acquisition costs (current and noncurrent) for the three months ended December 31, 2020 and 2019 (in thousands):

	Three months ended December 31,	
	2020	2019
<b>Balance, beginning of period</b>	\$ 70,396	\$ 59,446
Additional capitalized contract acquisition costs deferred	9,725	7,412
Amortization of capitalized contract acquisition costs	(8,152)	(8,705)
<b>Balance, end of period</b>	<b>\$ 71,969</b>	<b>\$ 58,153</b>

Amortization of capitalized contract acquisition costs was \$8.2 million and \$8.7 million for the three months ended December 31, 2020 and 2019, respectively, and is recorded in Sales and Marketing expense in the accompanying consolidated income statements. There was no impairment of any capitalized contract acquisition costs during any period presented.

### *Contract Balances*

Timing may differ between the satisfaction of performance obligations and the invoicing and collection of amounts related to the Company's contracts with customers. The Company records assets for amounts related to performance obligations that are satisfied but not yet billed and/or collected, in addition to contracts that have started, but not yet been fully billed. These assets are recorded as contract assets rather than receivables when receipt of the consideration is conditional on something other than the passage of time. Liabilities are recorded for amounts that are collected in advance of the satisfaction of performance obligations. These liabilities are classified as current and non-current deferred revenue.

The table below shows significant movements in contract assets (current and noncurrent) for the three months ended December 31, 2020 and 2019 (in thousands):

	Three months ended December 31,	
	2020	2019
<b>Balance, beginning of period</b>	\$ 200,472	\$ 132,492
Revenue recognized during period but not yet billed	18,316	3,407
Contract asset additions	55,834	12,930
Contract assets reclassified to accounts receivable	(28,818)	(13,584)
<b>Balance, end of period</b>	<b>\$ 245,804</b>	<b>\$ 135,245</b>

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As of December 31, 2020, contract assets that are expected to be reclassified to receivables within the next 12 months are included in other current assets, with those expected to be transferred to receivables in more than 12 months included in other assets. There were no impairments of contract assets during the three months ended December 31, 2020 and 2019.

The table below shows significant movements in the deferred revenue balances (current and noncurrent) for the three months ended December 31, 2020 and 2019 (in thousands):

	Three months ended December 31,	
	2020	2019
<b>Balance, beginning of period</b>	\$ 1,272,632	\$ 1,198,116
Amounts billed but not recognized as revenues	421,918	346,132
Revenues recognized related to the opening balance of deferred revenue	(335,725)	(306,275)
<b>Balance, end of period</b>	<u>\$ 1,358,825</u>	<u>\$ 1,237,973</u>

The Company's contract assets and liabilities are reported in a net position on a contract by contract basis at the end of each reporting period.

### *Remaining Performance Obligations*

Remaining performance obligations represent the amount of the transaction price under contracts with customers that are attributable to performance obligations that are unsatisfied or partially satisfied at the reporting date. As of December 31, 2020, the total non-cancellable remaining performance obligations under the Company's contracts with customers was approximately \$1.4 billion and the Company expects to recognize revenues on approximately 68.9% of these remaining performance obligations over the next 12 months, 18.9% in year two, and the remaining balance thereafter.

See Note 12, Segment Information, for disaggregated revenue by significant customer and geographic region, as well as disaggregated product revenue by systems and software.

## **3. Fair Value Measurements**

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

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

The levels of fair value hierarchy are:

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

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

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

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

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

The Company's financial assets measured at fair value on a recurring basis subject to the disclosure requirements at December 31, 2020, were as follows (in thousands):

	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Identical Securities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value at December 31, 2020
Cash equivalents	\$ 286,495	\$ 208,406	\$ —	\$ 494,901
<b>Short-term investments</b>				
Available-for-sale securities — corporate bonds and notes	—	179,694	—	179,694
Available-for-sale securities — municipal bonds and notes	—	2,916	—	2,916
Available-for-sale securities — U.S. government securities	—	116,526	—	116,526
Available-for-sale securities — U.S. government agency securities	—	47,379	—	47,379
<b>Long-term investments</b>				
Available-for-sale securities — corporate bonds and notes	—	72,173	—	72,173
Available-for-sale securities — U.S. government agency securities	—	16,580	—	16,580
Total	<u>\$ 286,495</u>	<u>\$ 643,674</u>	<u>\$ —</u>	<u>\$ 930,169</u>

The Company's financial assets measured at fair value on a recurring basis subject to the disclosure requirements at September 30, 2020, were as follows (in thousands):

	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Identical Securities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value at September 30, 2020
Cash equivalents	\$ 43,553	\$ 207,417	\$ —	\$ 250,970
<b>Short-term investments</b>				
Available-for-sale securities — corporate bonds and notes	—	189,662	—	189,662
Available-for-sale securities — municipal bonds and notes	—	6,146	—	6,146
Available-for-sale securities — U.S. government securities	—	117,374	—	117,374
Available-for-sale securities — U.S. government agency securities	—	47,151	—	47,151
<b>Long-term investments</b>				
Available-for-sale securities — corporate bonds and notes	—	102,939	—	102,939
Total	<u>\$ 43,553</u>	<u>\$ 670,689</u>	<u>\$ —</u>	<u>\$ 714,242</u>

The Company uses the fair value hierarchy for financial assets and liabilities. The carrying amounts of other current financial assets and other current financial liabilities approximate fair value due to their short-term nature.

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

Included in the Company's impairment considerations for non-financial assets and liabilities in the current quarter were the

potential impacts of the COVID-19 pandemic. In the first quarter of fiscal 2021, the Company recorded an impairment of \$6.7 million against the right-of-use asset related to the integration of the former Shape headquarters in Santa Clara, California, which was allocated to various expense line items on the Company's consolidated income statement. No impairment of long-lived assets was noted as of and for the three months ended December 31, 2019.

#### 4. Short-Term and Long-Term Investments

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

December 31, 2020	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds and notes	\$ 179,159	\$ 540	\$ (5)	\$ 179,694
Municipal bonds and notes	2,916	—	—	2,916
U.S. government securities	116,515	15	(4)	116,526
U.S. government agency securities	47,377	3	(1)	47,379
	<u>\$ 345,967</u>	<u>\$ 558</u>	<u>\$ (10)</u>	<u>\$ 346,515</u>

September 30, 2020	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds and notes	\$ 188,932	\$ 736	\$ (6)	\$ 189,662
Municipal bonds and notes	6,143	3	—	6,146
U.S. government securities	117,363	14	(3)	117,374
U.S. government agency securities	47,148	3	—	47,151
	<u>\$ 359,586</u>	<u>\$ 756</u>	<u>\$ (9)</u>	<u>\$ 360,333</u>

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

December 31, 2020	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds and notes	\$ 71,711	\$ 462	\$ —	\$ 72,173
U.S. government agency securities	16,580	—	—	16,580
	<u>\$ 88,291</u>	<u>\$ 462</u>	<u>\$ —</u>	<u>\$ 88,753</u>

September 30, 2020	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds and notes	\$ 102,206	\$ 756	\$ (23)	\$ 102,939
	<u>\$ 102,206</u>	<u>\$ 756</u>	<u>\$ (23)</u>	<u>\$ 102,939</u>

Interest income from investments was \$1.1 million and \$5.6 million for the three months ended December 31, 2020 and 2019, respectively. Interest income is included in other income, net on the Company's consolidated income statements.

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The following table summarizes investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for more than 12 months as of December 31, 2020 (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>December 31, 2020</b>						
Corporate bonds and notes	\$ 26,703	\$ (5)	\$ —	\$ —	\$ 26,703	\$ (5)
U.S. government securities	29,053	(4)	—	—	29,053	(4)
U.S. government agency securities	33,127	(1)	—	—	33,127	(1)
<b>Total</b>	<b>\$ 88,883</b>	<b>\$ (10)</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 88,883</b>	<b>\$ (10)</b>

The following table summarizes investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for more than 12 months as of September 30, 2020 (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>September 30, 2020</b>						
Corporate bonds and notes	\$ 43,492	\$ (28)	\$ 5,006	\$ (1)	\$ 48,498	\$ (29)
U.S. government securities	41,812	(3)	—	—	41,812	(3)
<b>Total</b>	<b>\$ 85,304</b>	<b>\$ (31)</b>	<b>\$ 5,006</b>	<b>\$ (1)</b>	<b>\$ 90,310</b>	<b>\$ (32)</b>

The Company invests in securities that are rated investment grade. Gross unrealized losses were not material for the three months ended December 31, 2020.

The Company reviews the individual securities in its portfolio to determine whether a decline in a security's fair value below the amortized cost basis is other-than-temporary. The Company determined that as of December 31, 2020, there were no investments in its portfolio that were other-than-temporarily impaired.

## 5. Business Combinations

### *Fiscal Year 2020 Acquisition of Shape Security, Inc.*

On December 19, 2019, the Company entered into a Merger Agreement (the "Merger Agreement") with Shape Security, Inc. ("Shape"), a provider of fraud and abuse prevention solutions. The transaction closed on January 24, 2020 with Shape becoming a wholly-owned subsidiary of F5.

Pursuant to the Merger Agreement, at the effective time of the acquisition, the capital stock of Shape and the vested outstanding and unexercised stock options in Shape were cancelled and converted to the right to receive approximately \$1.0 billion in cash, subject to certain adjustments and conditions set forth in the Merger Agreement, and the unvested stock options and restricted stock units in Shape held by continuing employees of Shape were assumed by F5, on the terms and conditions set forth in the Merger Agreement. Included in cash consideration was \$23.2 million of transaction costs paid by F5 on behalf of Shape. In addition, the Company incurred \$15.3 million of transaction costs associated with the acquisition which was included in General and Administrative expenses in fiscal 2020.

As a result of the acquisition, the Company acquired all the assets and assumed all the liabilities of Shape. The goodwill related to the Shape acquisition is comprised primarily of expected synergies from combining operations and the acquired intangible assets that do not qualify for separate recognition. Goodwill related to the Shape acquisition is not expected to be deductible for tax purposes. The results of operations of Shape have been included in the Company's consolidated financial statements from the date of acquisition.

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The allocated purchase consideration to assets acquired and liabilities assumed based on preliminary estimated fair values is presented in the following table (in thousands):

		Estimated Useful Life
<b>Assets acquired</b>		
Cash, cash equivalents, and restricted cash	\$ 53,934	
Fair value of tangible assets:		
Accounts receivable	21,077	
Deferred tax assets	24,619	
Operating lease right-of-use assets	29,644	
Other tangible assets	22,571	
Identifiable intangible assets:		
Developed technologies	120,000	7 years
Customer relationships	21,000	4 years
Trade name	9,500	5 years
Goodwill	<u>804,537</u>	
Total assets acquired	<u>\$ 1,106,882</u>	
<b>Liabilities assumed</b>		
Deferred revenue	\$ (39,000)	
Operating lease liabilities	(30,773)	
Other assumed liabilities	<u>(18,571)</u>	
Total liabilities assumed	<u>\$ (88,344)</u>	
Net assets acquired	<u>\$ 1,018,538</u>	

The measurement period for the Shape acquisition will lapse in the second quarter of fiscal 2021. In the first quarter of fiscal 2021, the Company increased the carrying amount of goodwill by \$4.9 million to reflect an adjustment to consideration exchanged for the purchase of Shape within the post-close measurement period. No other financial statement amounts were affected by this adjustment. The adjustment was not material to the current period or any of the previous period financial statements.

The developed technology intangible asset will be amortized on a straight-line basis over its estimated useful life of seven years and included in cost of net product revenues. The trade names and customer relationships intangible assets will be amortized on a straight-line basis over their estimated useful lives of five years and four years, respectively, and included in sales and marketing expenses. The weighted average life of the amortizable intangible assets recognized from the Shape acquisition was 6.5 years as of January 24, 2020, the date the transaction closed. The estimated useful lives for the acquired intangible assets were based on the expected future cash flows associated with the respective asset.

Since the Shape acquisition was completed on January 24, 2020, the F5 and Shape teams have been executing a plan to integrate ongoing operations. The pro forma financial information, as well as the revenue and earnings generated by Shape, were not considered material to the Company's operations.

## 6. Balance Sheet Details

### ***Cash, Cash Equivalents and Restricted Cash***

The following table provides a reconciliation of the Company's cash and cash equivalents and restricted cash reported within the consolidated balance sheets that sum to the total cash, cash equivalents and restricted cash shown in the Company's consolidated statements of cash flows for the periods presented (in thousands):

	December 31, 2020	September 30, 2020
Cash and cash equivalents	\$ 1,026,829	\$ 849,556
Restricted cash included in other assets, net	3,373	3,270
<b>Total cash, cash equivalents and restricted cash</b>	<b>\$ 1,030,202</b>	<b>\$ 852,826</b>

### ***Inventories***

Inventories consist of the following (in thousands):

	December 31, 2020	September 30, 2020
Finished goods	\$ 15,839	\$ 17,096
Raw materials	10,616	10,802
<b>Total</b>	<b>\$ 26,455</b>	<b>\$ 27,898</b>

### ***Other Current Assets***

Other current assets consist of the following (in thousands):

	December 31, 2020	September 30, 2020
Contract assets	\$ 163,546	\$ 138,096
Prepaid expenses	59,232	47,197
Capitalized contract acquisition costs	30,687	29,650
Other	29,876	44,563
<b>Total</b>	<b>\$ 283,341</b>	<b>\$ 259,506</b>

### ***Other Assets***

Other assets, net consist of the following (in thousands):

	December 31, 2020	September 30, 2020
Intangible assets	\$ 223,371	\$ 225,900
Contract assets	82,258	62,377
Capitalized contract acquisition costs	41,282	40,746
Other	21,044	18,424
<b>Total</b>	<b>\$ 367,955</b>	<b>\$ 347,447</b>

### ***Accrued Liabilities***

Accrued liabilities consist of the following (in thousands):

	December 31, 2020	September 30, 2020
Payroll and benefits	\$ 141,378	\$ 169,708
Operating lease liabilities, current	46,763	46,010
Income and other tax accruals	39,760	33,048
Other	77,891	72,632
<b>Total</b>	<b>\$ 305,792</b>	<b>\$ 321,398</b>

**Other Long-term Liabilities**

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

	December 31, 2020	September 30, 2020
Income taxes payable	\$ 52,523	\$ 49,846
Other	9,130	9,665
	<u><u>\$ 61,653</u></u>	<u><u>\$ 59,511</u></u>

**7. Debt Facilities*****Term Credit Agreement***

In connection with the acquisition of Shape, on January 24, 2020, the Company entered into a Term Credit Agreement ("Term Credit Agreement") with certain institutional lenders that provides for a senior unsecured term loan facility in an aggregate principal amount of \$400.0 million (the "Term Loan Facility"). The proceeds from the Term Loan Facility were primarily used to finance the acquisition of Shape and related expenses. In connection with the Term Loan Facility, the Company incurred \$2.2 million in debt issuance costs, which are recorded as a reduction to the carrying value of the principal amount of the debt.

Borrowings under the Term Loan Facility bear interest at a rate equal to, at the Company's option, (a) LIBOR, adjusted for customary statutory reserves, plus an applicable margin of 1.125% to 1.75% depending on the Company's leverage ratio, or (b) an alternate base rate determined in accordance with the Term Credit Agreement, plus an applicable margin of 0.125% to 0.750% depending on the Company's leverage ratio. Interest on the outstanding principal of borrowings is currently due quarterly in arrears. As of December 31, 2020, the margin for LIBOR-based loans was 1.125% and the margin for alternate base rate loans was 0.125%.

The Term Loan Facility matures on January 24, 2023 with quarterly installments (commencing with the first full fiscal quarter ended after January 24, 2020) equal to 1.25% of the original principal amount of the Term Loan Facility. The remaining outstanding principal of borrowings under the Term Loan Facility is due upon maturity on January 24, 2023. Borrowings under the Term Loan Facility may be voluntarily prepaid, in whole or in part, without penalty or premium. Borrowings repaid or prepaid under the Term Loan Facility may not be reborrowed.

Among certain affirmative and negative covenants provided in the Term Credit Agreement, there is a financial covenant that requires the Company to maintain a leverage ratio, calculated as of the last day of each fiscal quarter, of consolidated total indebtedness to consolidated EBITDA. This covenant may result in a higher interest rate on its outstanding principal borrowings on the Term Loan Facility in future periods, depending on the Company's performance. As of December 31, 2020, the Company was in compliance with all covenants.

As of December 31, 2020, \$385.0 million of principal amount under the Term Loan Facility was outstanding, excluding unamortized debt issuance costs of \$1.5 million. The weighted average interest rate on the principal amount under the Term Loan Facility outstanding balance was 2.106% for the period ending December 31, 2020. The following table presents the scheduled principal maturities as of December 31, 2020 (in thousands):

<b>Fiscal Years Ending September 30:</b>	<b>Amount</b>
2021 (remainder)	\$ 15,000
2022	20,000
2023	350,000
<b>Total</b>	<b><u><u>\$ 385,000</u></u></b>

### **Revolving Credit Agreement**

On January 31, 2020, the Company entered into a Revolving Credit Agreement (the "Revolving Credit Agreement") that provides for a senior unsecured revolving credit facility in an aggregate principal amount of \$350.0 million (the "Revolving Credit Facility"). The Company has the option to increase commitments under the Revolving Credit Facility from time to time, subject to certain conditions, by up to \$150.0 million. Borrowings under the Revolving Credit Facility bear interest at a rate equal to, at the Company's option, (a) LIBOR, adjusted for customary statutory reserves, plus an applicable margin of 1.125% to 1.75% depending on the Company's leverage ratio, or (b) an alternate base rate determined in accordance with the Revolving Credit Agreement, plus an applicable margin of 0.125% to 0.750% depending on the Company's leverage ratio. The Revolving Credit Agreement also requires payment of a commitment fee calculated at a rate per annum of 0.125% to 0.300% depending on the Company's leverage ratio on the undrawn portion of the Revolving Credit Facility. Commitment fees incurred during the three months ended December 31, 2020 were not material.

The Revolving Credit Facility matures on January 31, 2025, at which time any remaining outstanding principal of borrowings under the Revolving Credit Facility is due. The Company has the option to request up to two extensions of the maturity date in each case for an additional period of one year. Among certain affirmative and negative covenants provided in the Revolving Credit Agreement, there is a financial covenant that requires the Company to maintain a leverage ratio, calculated as of the last day of each fiscal quarter, of consolidated total indebtedness to consolidated EBITDA. As of December 31, 2020, the Company was in compliance with all covenants. As of December 31, 2020, there were no outstanding borrowings under the Revolving Credit Facility, and the Company had available borrowing capacity of \$350.0 million.

### **8. Leases**

During the first quarter of fiscal 2020, the Company adopted ASU 2016-02, *Leases (Topic 842)* (the "Leasing Standard") using the transition method provided in ASU 2018-11, *Leases (Topic 842): Targeted Improvements*. The impact of adopting the Leasing Standard resulted in the recognition of right-of-use assets and lease liabilities of \$304.8 million and \$386.4 million, respectively, on October 1, 2019, the date of adoption.

The majority of the Company's operating lease payments relate to its corporate headquarters in Seattle, Washington, which includes approximately 515,000 square feet of office space. The lease commenced in April 2019 and expires in 2033 with an option for renewal. The Company has concluded that the renewal option is not yet likely to be exercised. The Company also leases additional office and lab space for product development and sales and support personnel in the United States and internationally. The Company's lease agreements do not contain any material residual value guarantees or material restrictive covenants.

The components of the Company's operating lease expenses for the three months ended December 31, 2020 and 2019 were as follows (in thousands):

	<b>Three months ended December 31,</b>	
	<b>2020</b>	<b>2019</b>
Operating lease expense	\$ 12,181	\$ 11,318
Short-term lease expense	986	814
Variable lease expense	7,026	5,839
<b>Total lease expense</b>	<b>\$ 20,193</b>	<b>\$ 17,971</b>

Variable lease expense primarily consists of common area maintenance and parking expenses. The Company executed two sublease contracts that commenced during the first quarter of fiscal year 2020.

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Supplemental balance sheet information related to the Company's operating leases was as follows (in thousands, except lease term and discount rate):

	December 31, 2020	September 30, 2020
Operating lease right-of-use assets, net	\$ 286,044	\$ 300,680
Operating lease liabilities, current <sup>1</sup>	46,763	46,010
Operating lease liabilities, long-term	328,468	338,715
<b>Total operating lease liabilities</b>	<b><u>\$ 375,231</u></b>	<b><u>\$ 384,725</u></b>
Weighted average remaining lease term (in years)	10.1	10.2
Weighted average discount rate	2.59 %	2.58 %
(1) Current portion of operating lease liabilities is included in accrued liabilities on the Company's consolidated balance sheets.		
As of December 31, 2020, the future operating lease payments for each of the next five years and thereafter is as follows (in thousands):		
<b>Fiscal Years Ending September 30:</b>		<b>Operating Lease Payments</b>
2021 (remainder)		\$ 41,075
2022		57,598
2023		44,656
2024		39,995
2025		33,588
2026		26,705
Thereafter		<u>191,236</u>
Total lease payments		434,853
Less: imputed interest		(59,622)
<b>Total lease liabilities</b>	<b><u>\$ 375,231</u></b>	

Operating lease liabilities above do not include sublease income. As of December 31, 2020, the Company expects to receive sublease income of approximately \$9.1 million, which consists of \$3.3 million to be received for the remainder of fiscal 2021 and \$5.8 million to be received over the two fiscal years thereafter. In the first quarter of fiscal 2021, the Company recorded an impairment of \$6.7 million against the right-of-use asset related to the integration of the former Shape headquarters in Santa Clara, California.

As of December 31, 2020, the Company had no significant operating leases that were executed but not yet commenced.

## 9. Commitments and Contingencies

### Guarantees and Product Warranties

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

The Company generally offers warranties of one year for hardware for those customers without service contracts, with the option of purchasing additional warranty coverage in yearly increments. The Company accrues for warranty costs as part of

its cost of sales based on associated material product costs and technical support labor costs. Accrued warranty costs as of December 31, 2020 and September 30, 2020 were not material.

## **Commitments**

As of December 31, 2020, the Company's principal commitments consisted of borrowings under the Term Loan Facility and obligations outstanding under operating leases. Refer to Note 7 for the scheduled principal maturities of the Term Loan Facility as of December 31, 2020.

The Company leases its facilities under operating leases that expire at various dates through 2033. There have been no material changes in the Company's lease obligations compared to those discussed in Note 8 to its annual consolidated financial statements.

The Company currently has arrangements with contract manufacturers and other suppliers for the manufacturing of its products. The arrangement with the primary contract manufacturer allows them to procure component inventory on the Company's behalf based on a rolling production forecast provided by the Company. The Company is obligated to the purchase of component inventory that the contract manufacturer procures in accordance with the forecast, unless it gives notice of order cancellation in advance of applicable lead times. There have been no material changes in the Company's inventory purchase obligations compared to those discussed in Note 13 to its annual consolidated financial statements.

## **Legal Proceedings**

On June 8, 2020, Lynwood Investment CY Limited ("Lynwood") filed a lawsuit in the United States District Court for the Northern District of California against the Company and certain affiliates, along with other defendants. In its complaint, Lynwood claims to be the assignee of all rights and interests of Rambler Internet Holding LLC ("Rambler"), and alleges that the intellectual property in the NGINX software originally released by the co-founder of NGINX in 2004 belongs to Rambler (and therefore Lynwood, by assignment) because the software was created and developed while the co-founder was employed by Rambler. Lynwood asserts 26 causes of action against the various defendants, including copyright infringement, violation of trademark law, tortious interference, conspiracy, and fraud. The complaint seeks damages, disgorgement of profits, fees and costs, declarations of copyright and trademark ownership, trademark cancellations, and injunctive relief. Lynwood also initiated several trademark opposition and cancellation proceedings before the Trademark Trial and Appeal Board of the United States Patent and Trademark Office, which have all since been suspended. The Company and the other defendants have filed motions to dismiss all claims asserted against them in the lawsuit.

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

The Company records an accrual for loss contingencies for legal proceedings when it believes that an unfavorable outcome is both (a) probable and (b) the amount or range of any possible loss is reasonably estimable. The Company has not recorded any accrual for loss contingencies associated with such legal proceedings or the investigations discussed above.

## **10. Income Taxes**

The Company's tax provision for interim periods is determined using an estimated annual effective tax rate, adjusted for discrete items in the related period.

The effective tax rate was 25.1% and 22.8% for the three months ended December 31, 2020 and 2019, respectively. The increase in the effective tax rate for the three months ended December 31, 2020 as compared to the three months ended December 31, 2019 is primarily due to the tax impact from stock-based compensation and other non-deductible expenses.

At December 31, 2020, the Company had \$54.3 million of unrecognized tax benefits that, if recognized, would affect the effective tax rate. It is anticipated that the Company's existing liabilities for unrecognized tax benefits will change within the next twelve months due to audit settlements or the expiration of statutes of limitations. The Company does not expect these changes to be material to the consolidated financial statements. The Company recognizes interest and, if applicable, penalties for any uncertain tax positions as a component of income tax expense.

The Company and its subsidiaries are subject to U.S. federal income tax as well as the income tax of multiple state and foreign jurisdictions. The Company has concluded all U.S. federal income tax matters for fiscal years through September 30, 2016. Major jurisdictions where there are wholly owned subsidiaries of F5 Networks, Inc. which require income tax filings include the United Kingdom, Singapore, and Israel. The earliest periods open for review by local taxing authorities are fiscal years 2019 for the United Kingdom, 2016 for Singapore, and 2013 for Israel. The Company is currently under audit by various states for fiscal years 2015 through 2018, by Israel for fiscal years 2013 to 2017, by Saudi Arabia for fiscal years 2014 to 2019, and by Singapore for fiscal year 2018. Within the next four fiscal quarters, the statute of limitations will begin to close on the fiscal year 2017 federal income tax return, fiscal years 2016 and 2017 state income tax returns, and fiscal years 2014 to 2019 foreign income tax returns.

## 11. Net Income Per Share

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

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

	Three months ended December 31,	
	2020	2019
<b>Numerator</b>		
Net income	\$ 87,678	\$ 98,527
<b>Denominator</b>		
Weighted average shares outstanding — basic	61,440	60,649
Dilutive effect of common shares from stock options and restricted stock units	842	166
Weighted average shares outstanding — diluted	<u>62,282</u>	<u>60,815</u>
Basic net income per share	<u>\$ 1.43</u>	<u>\$ 1.62</u>
Diluted net income per share	<u>\$ 1.41</u>	<u>\$ 1.62</u>

Anti-dilutive stock-based awards excluded from the calculations of diluted earnings per share were not material for the three months ended December 31, 2020 and 2019.

## 12. Segment Information

Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Management has determined that the Company is organized as, and operates in, one reportable operating segment: the development, marketing and sale of application services that optimize the security, performance and availability of network applications, servers and storage systems.

### *Revenues by Geographic Location and Other Information*

The Company does business in three main geographic regions: the Americas (primarily the United States); Europe, the Middle East, and Africa (EMEA); and the Asia Pacific region (APAC). The Company's chief operating decision-maker reviews financial information presented on a consolidated basis accompanied by information about revenues by geographic region. The Company's foreign offices conduct sales, marketing and support activities. Revenues are attributed by geographic location based on the location of the customer.

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

	Three months ended December 31,	
	2020	2019
<b>Americas:</b>		
United States	\$ 320,343	\$ 275,499
Other	22,793	26,063
Total Americas	<u>343,136</u>	<u>301,562</u>
<b>EMEA</b>	<u>162,084</u>	<u>155,952</u>
<b>Asia Pacific</b>	<u>119,397</u>	<u>111,791</u>
	<u><u>\$ 624,617</u></u>	<u><u>\$ 569,305</u></u>

The Company generates revenues from the sale of products and services. The Company continues to offer its products through a range of consumption models, from physical systems to software solutions and managed services. The following presents net product revenues by systems and software (in thousands):

	Three months ended December 31,	
	2020	2019
<b>Net product revenues</b>		
Systems revenue	\$ 178,571	\$ 169,601
Software revenue	<u>109,474</u>	<u>64,935</u>
Total net product revenue	<u><u>\$ 288,045</u></u>	<u><u>\$ 234,536</u></u>

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

	Three months ended December 31,	
	2020	2019
Ingram Micro, Inc.	18.1 %	16.5 %
Westcon Group, Inc.	—	11.0 %
Arrow ECS	—	10.1 %
Synnex Corporation	10.0 %	—

The Company tracks assets by physical location. Long-lived assets consist of property and equipment, net, and are shown below (in thousands):

	December 31, 2020	September 30, 2020
United States	\$ 178,638	\$ 190,509
EMEA	19,405	20,361
Other countries	17,606	18,369
	<u><u>\$ 215,649</u></u>	<u><u>\$ 229,239</u></u>

### 13. Restructuring Charges

In December 2019, the Company initiated a restructuring plan to match strategic and financial objectives and optimize resources for long term growth, including a reduction in force program affecting approximately 75 employees. The Company recorded a restructuring charge of \$7.8 million in the first quarter of fiscal 2020. The Company does not expect to record any significant future charges related to the restructuring plan.

During the three months ended December 31, 2019, the following activity was recorded (in thousands):

	<u>Employee Severance, Benefits and Related Costs</u>
Accrued expenses, October 1, 2019	\$ —
Restructuring charges	7,800
Cash payments	(5,282)
Non-cash items	—
Accrued expenses, December 31, 2019	<u><u>\$ 2,518</u></u>

#### 14. Subsequent Events

##### *Acquisition of Volterra, Inc.*

On January 5, 2021, the Company entered into a Merger Agreement (the “Merger Agreement”) with Volterra, Inc. (“Volterra”), creator of the first universal edge-as-a-service platform.

Pursuant to the Merger Agreement, at the effective time of the Merger, the capital stock of Volterra and the vested outstanding and unexercised stock options in Volterra will be cancelled and converted to the right to receive approximately \$440 million in cash and \$60 million in deferred consideration, subject to certain adjustments and conditions set forth in the Merger Agreement. The unvested stock options and restricted stock units in Volterra held by continuing employees of Volterra will be assumed by F5, on the terms and conditions set forth in the Merger Agreement.

The transaction closed on January 22, 2021 with Volterra becoming a wholly-owned subsidiary of F5.

During the first quarter of 2021, the Company incurred approximately \$2.7 million of acquisition related expenses associated with the Volterra acquisition, which is included within General and Administrative operating expenses in the Company’s Consolidated Income Statement.

As a result of limited access to Volterra information required to prepare initial accounting, together with the limited time since the acquisition date and the effort required to conform the financial statements to the Company’s practices and policies, the initial accounting for the business combination is incomplete at the time of this filing. As a result, the Company is unable to provide the amounts recognized as of the acquisition date for the major classes of assets acquired and liabilities assumed, pre-acquisition contingencies and goodwill.

##### *Share Repurchase Activities*

On February 3, 2021, the Company entered into Accelerated Share Repurchase (ASR) agreements with two financial institutions under which the Company paid an aggregate of \$500 million and received an initial delivery of shares, which approximates 80 percent of the total number of shares to be repurchased under the ASR agreements. The shares received by the Company were immediately retired. In accordance with the terms of the ASR agreements, the final number of shares to be repurchased and the average price paid per share will be determined upon settlement of the agreements by the end of the third quarter of fiscal 2021. The final number of shares to be repurchased will be based on the volume-weighted average price of the Company’s common stock over the duration of the ASR agreements, less applicable discounts. Upon settlement, the financial institutions may be required to deliver additional shares of common stock to the Company, or under certain conditions, the Company may be required to make a cash payment or deliver shares of common stock, at its election, to the financial institutions. Prior to entering into the ASR agreements, the Company had \$1.3 billion remaining authorized under its share repurchase program.

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

The following discussion of our financial condition and results of operations contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933. These statements include, but are not limited to, statements about our plans, objectives, expectations, strategies, intentions or other characterizations of future events or circumstances and are generally identified by the words "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," and similar expressions. These forward-looking statements are based on current information and expectations and are subject to a number of risks and uncertainties. Our actual results could differ materially from those expressed or implied by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in Part II, Item 1A. "Risk Factors" herein and in other documents we file from time to time with the Securities and Exchange Commission. We assume no obligation to revise or update any such forward-looking statements.

### Overview

F5 is a leading provider of multi-cloud application services which enable our customers to develop, deploy, operate, secure, and govern applications in any architecture, from on-premises to the public cloud. Our enterprise-grade application services are available as cloud-based, software-as-a-service, and software-only solutions optimized for multi-cloud environments, with modules that can run independently, or as part of an integrated solution on our high-performance appliances. We market and sell our products primarily through multiple indirect sales channels in the Americas (primarily the United States); Europe, the Middle East, and Africa (EMEA); and the Asia Pacific region (APAC). Enterprise customers (Fortune 1000 or Business Week Global 1000 companies) in the technology, telecommunications, financial services, transportation, education, manufacturing and health care industries, along with government customers, continue to make up the largest percentage of our customer base.

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

- *Revenues.* The majority of our revenues are derived from sales of our application delivery controller (ADC) products including our BIG-IP appliances and VIPRION chassis and related software modules and our software-only Virtual Editions; Local Traffic Manager (LTM), DNS Services (formerly Global Traffic Manager); Advanced Firewall Manager (AFM) and Policy Enforcement Manager (PEM), that leverage the unique performance characteristics of our hardware and software architecture; and products that incorporate acquired technology, including Application Security Manager (ASM) and Access Policy Manager (APM); NGINX Plus and NGINX Controller; Shape Defense and Enterprise Defense; and the Secure Web Gateway and Silverline DDoS and Application security offerings which are sold to customers on a subscription basis. We also derive revenues from the sales of services including annual maintenance contracts, training and consulting services. We carefully monitor the sales mix of our revenues within each reporting period. We believe customer acceptance rates of our new products and feature enhancements are indicators of future trends. We also consider overall revenue concentration by customer and by geographic region as additional indicators of current and future trends. We are also monitoring the uncertainty related to the impacts that the COVID-19 pandemic has on the global economy and our customer base.
- *Cost of revenues and gross margins.* We strive to control our cost of revenues and thereby maintain our gross margins. Significant items impacting cost of revenues are hardware costs paid to our contract manufacturers, third-party software license fees, software-as-a-service infrastructure costs, amortization of developed technology and personnel and overhead expenses. Our margins have remained relatively stable; however, factors such as sales price, product and services mix, inventory obsolescence, returns, component price increases, warranty costs, and the uncertainty surrounding the COVID-19 pandemic and its potential impacts to our supply chain could significantly impact our gross margins from quarter to quarter and represent significant indicators we monitor on a regular basis.
- *Operating expenses.* Operating expenses are substantially driven by personnel and related overhead expenses. Existing headcount and future hiring plans are the predominant factors in analyzing and forecasting future operating expense trends. Other significant operating expenses that we monitor include marketing and promotions, travel, professional fees, computer costs related to the development of new products and provision of services, facilities and depreciation expenses.
- *Liquidity and cash flows.* Our financial condition remains strong with significant cash and investments. The increase in cash and investments for the first three months of fiscal year 2021 was primarily due to cash provided by operating activities of \$137.4 million. Going forward, we believe the primary driver of cash flows will be net income from operations. Capital expenditures of \$4.7 million for the first three months of fiscal year 2021 were primarily related to the expansion of our facilities to support our operations worldwide as well as investments in information technology infrastructure and equipment purchases to support our core business activities. We will continue to evaluate possible

acquisitions of, or investments in businesses, products, or technologies that we believe are strategic, which may require the use of cash. Additionally, on January 31, 2020, we entered into a Revolving Credit Agreement (the "Revolving Credit Agreement") that provides for a senior unsecured revolving credit facility in an aggregate principal amount of \$350.0 million (the "Revolving Credit Facility"). We have the option to increase commitments under the Revolving Credit Facility from time to time, subject to certain conditions, by up to \$150.0 million. As of December 31, 2020, there were no outstanding borrowings under the Revolving Credit Facility, and we had available borrowing capacity of \$350.0 million.

- *Balance sheet.* We view cash, short-term and long-term investments, deferred revenue, accounts receivable balances and days sales outstanding as important indicators of our financial health. Deferred revenues continued to increase in the first quarter of fiscal year 2021 due to the growth of our subscriptions business, including the acquired deferred revenue associated with the Shape acquisition. Our days sales outstanding for the first quarter of fiscal year 2021 was 50. Days sales outstanding is calculated by dividing ending accounts receivable by revenue per day for a given quarter.

### Summary of Critical Accounting Policies and Estimates

The preparation of our financial condition and results of operations requires us to make judgments and estimates that may have a significant impact upon our financial results. We believe that, of our significant accounting policies, the following require estimates and assumptions that require complex, subjective judgments by management, which can materially impact reported results: revenue recognition, accounting for business combinations and accounting for leases. Actual results may differ from these estimates under different assumptions or conditions.

There were no material changes to our critical accounting policies and estimates compared to the critical accounting policies and estimates described in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Form 10-K for the fiscal year ended September 30, 2020. Refer to the "Recently Adopted Accounting Standards" section of Note 1 in this Quarterly Report on Form 10-Q for a summary of the new accounting policies.

### COVID-19 Update

Management has prioritized a human-first approach to the COVID-19 pandemic. For F5, this means ensuring the health and safety of employees, their families and our communities. Further, this approach extends to our customers as we look for ways that we can support their operations during this crisis.

While our analysis shows COVID-19 did not have a significant impact on our results of operations for the quarter ended December 31, 2020, the impacts of the global pandemic on our business and financial outlook are currently unknown. We are conducting business with substantial modifications to employee travel, employee work locations, and virtualization or cancellation of certain sales and marketing events, among other modifications. We will continue to actively monitor the situation and may take further actions that alter our business operations as may be required by federal, state or local authorities, or that we determine are in the best interests of our employees, customers, partners, suppliers and stockholders. It is not clear what the potential effects any such alterations or modifications may have on our business, including the effects on our customers and prospects, or on our financial results.

### Results of Operations

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

	Three months ended December 31,	
	2020	2019
	(in thousands, except percentages)	
<b>Net revenues</b>		
Products	\$ 288,045	\$ 234,536
Services	336,572	334,769
Total	<u>\$ 624,617</u>	<u>\$ 569,305</u>
<b>Percentage of net revenues</b>		
Products	46.1 %	41.2 %
Services	53.9	58.8
Total	<u>100.0 %</u>	<u>100.0 %</u>

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*Net Revenues.* Total net revenues increased 9.7% for the three months ended December 31, 2020, from the comparable period in the prior year. Overall revenue growth for the three months ended December 31, 2020, was primarily due to the addition of the software-as-a-service product offerings through the Shape acquisition and our subscription-based offerings, which include our enterprise license agreement product offerings. Revenues outside of the United States represented 48.7% of total net revenues for the three months ended December 31, 2020, compared to 51.6% for the same period in the prior year.

*Net Product Revenues.* Net product revenues increased 22.8% for the three months ended December 31, 2020, from the comparable period in the prior year. The increase of \$53.5 million in net product revenues for the three months ended December 31, 2020 was primarily due to an increase in software sales compared to the same period in the prior year.

The following presents net product revenues by systems and software (in thousands):

	Three months ended December 31,	
	2020	2019
<b>Net product revenues</b>		
Systems revenue	\$ 178,571	\$ 169,601
Software revenue	109,474	64,935
Total net product revenue	<u>\$ 288,045</u>	<u>\$ 234,536</u>
<b>Percentage of net product revenues</b>		
Systems revenue	62.0 %	72.3 %
Software revenue	38.0	27.7
Total net product revenue	<u>100.0 %</u>	<u>100.0 %</u>

*Net Service Revenues.* Net service revenues of \$336.6 million remained relatively flat for the three months ended December 31, 2020, from the comparable period in the prior year.

The following distributors of our products accounted for more than 10% of total net revenue:

	Three months ended December 31,	
	2020	2019
Ingram Micro, Inc.	18.1 %	16.5 %
Westcon Group, Inc.	—	11.0 %
Arrow ECS	—	10.1 %
Synnex Corporation	10.0 %	—

The following distributors of our products accounted for more than 10% of total receivables:

	December 31, 2020	September 30, 2020
	2020	2020
Ingram Micro, Inc.	14.6 %	14.1 %
Arrow ECS	15.6 %	—
Synnex Corporation	13.6 %	11.4 %

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

	Three months ended December 31,	
	2020	2019
	(in thousands, except percentages)	
<b>Cost of net revenues and gross profit</b>		
Products	\$ 67,038	\$ 42,118
Services	47,941	46,524
Total	<u>114,979</u>	<u>88,642</u>
Gross profit	<u>\$ 509,638</u>	<u>\$ 480,663</u>
<b>Percentage of net revenues and gross margin (as a percentage of related net revenue)</b>		
Products	23.3 %	18.0 %
Services	14.2	13.9
Total	<u>18.4</u>	<u>15.6</u>
Gross margin	<u>81.6 %</u>	<u>84.4 %</u>

*Cost of Net Product Revenues.* Cost of net product revenues consist of finished products purchased from our contract manufacturers, manufacturing overhead, freight, warranty, provisions for excess and obsolete inventory, software-as-a-service infrastructure costs and amortization expenses in connection with developed technology from acquisitions. Cost of net product revenues increased \$24.9 million, or 59.2% for the three months ended December 31, 2020, from the comparable period in the prior year. The increase in cost of net product revenues was primarily due to an increase in revenue and related managed service costs from the Shape acquisition.

*Cost of Net Service Revenues.* Cost of net service revenues consist of the salaries and related benefits of our professional services staff, travel, facilities and depreciation expenses. For the three months ended December 31, 2020, cost of net service revenues as a percentage of net service revenues was 14.2%, compared to 13.9% for the comparable period in the prior year. Professional services headcount at the end of December 2020 increased to 967 from 921 at the end of December 2019.

	Three months ended December 31,	
	2020	2019
	(in thousands, except percentages)	
<b>Operating expenses</b>		
Sales and marketing	\$ 214,546	\$ 195,519
Research and development	114,191	96,005
General and administrative	63,153	59,004
Restructuring charges	—	7,800
Total	<u>\$ 391,890</u>	<u>\$ 358,328</u>
<b>Operating expenses (as a percentage of net revenue)</b>		
Sales and marketing	34.3 %	34.3 %
Research and development	18.3	16.9
General and administrative	10.1	10.4
Restructuring charges	—	1.4
Total	<u>62.7 %</u>	<u>63.0 %</u>

*Sales and Marketing.* Sales and marketing expenses consist of salaries, commissions and related benefits of our sales and marketing staff, the costs of our marketing programs, including public relations, advertising and trade shows, travel, facilities, and depreciation expenses. Sales and marketing expenses increased \$19.0 million, or 9.7% for the three months ended December 31, 2020, from the comparable period in the prior year. The increase in sales and marketing expense was primarily due to an increase of \$15.9 million in personnel costs for the three months ended December 31, 2020, from the comparable period in the prior year. Sales and marketing expenses for the three months ended December 31, 2020 also included an increase in commissions of \$5.4 million from the comparable period in the prior year. The increase in sales and marketing expenses for the three months ended December 31, 2020 was partially offset by a decrease in travel and entertainment expenses primarily due to company-wide travel restrictions as a result of the COVID-19 pandemic. Sales and marketing headcount at the end of December 2020 increased to 2,398 from 2,123 at the end of December 2019. Sales and marketing expenses included stock-based compensation expense of \$25.2 million for the three months ended December 31, 2020, compared to \$21.8 million for the same period in the prior year.

*Research and Development.* Research and development expenses consist of the salaries and related benefits of our product development personnel, prototype materials and other expenses related to the development of new and improved products, facilities and depreciation expenses. Research and development expenses increased \$18.2 million, or 18.9% for the three months ended December 31, 2020, from the comparable period in the prior year. The increase in research and development expense was primarily due to an increase of \$9.9 million in personnel costs for the three months ended December 31, 2020, from the comparable period in the prior year. Research and development headcount at the end of December 2020 increased to 1,801 from 1,534 at the end of December 2019. Research and development expenses included stock-based compensation expense of \$15.0 million for the three months ended December 31, 2020, compared to \$11.2 million for the same period in the prior year.

*General and Administrative.* General and administrative expenses consist of the salaries, benefits and related costs of our executive, finance, information technology, human resource and legal personnel, third-party professional service fees, facilities and depreciation expenses. General and administrative expenses increased \$4.1 million, or 7.0% for the three months ended December 31, 2020, from the comparable period in the prior year. For the three months ended December 31, 2020, personnel costs increased \$2.7 million, from the comparable period in the prior year due to growth in general and administrative headcount, including employees from the acquisition of Shape. General and administrative headcount at the end of December 2020 increased to 735 from 616 at the end of December 2019. General and administrative expenses included stock-based compensation expense of \$10.5 million for the three months ended December 31, 2020, compared to \$9.2 million for the same period in the prior year.

*Restructuring Charges.* In the first fiscal quarter of 2020, we completed a restructuring plan to align strategic and financial objectives and optimize resources for long term growth. As a result of these initiatives, we recorded a restructuring charge of \$7.8 million related to a reduction in workforce that is reflected in our results for the three months ended December 2019. There were no restructuring expenses recorded for the three months ended December 31, 2020.

	Three months ended December 31,	
	2020	2019
	(in thousands, except percentages)	
<b>Other income and income taxes</b>		
Income from operations	\$ 117,748	\$ 122,335
Other (loss) income, net	(683)	5,220
Income before income taxes	117,065	127,555
Provision for income taxes	29,387	29,028
Net income	<u>\$ 87,678</u>	<u>\$ 98,527</u>
<b>Other income and income taxes (as percentage of net revenue)</b>		
Income from operations	18.9 %	21.5 %
Other (loss) income, net	(0.1)	0.9
Income before income taxes	18.7	22.4
Provision for income taxes	4.7	5.1
Net income	<u>14.0 %</u>	<u>17.3 %</u>

*Other (Loss) Income, Net.* Other (loss) income, net consists primarily of interest income and expense and foreign currency transaction gains and losses. The decrease in other (loss) income, net for the three months ended December 31, 2020 was primarily due to a decrease in interest income of \$4.4 million, from our investments compared to the same period in the prior year. In addition, interest expense increased \$1.7 million for the three months ended December 31, 2020 compared to the same period in the prior year due to interest paid for outstanding amounts under our Term Loan Facility.

*Provision for income taxes.* The effective tax rate was 25.1% and 22.8% for the three months ended December 31, 2020 and 2019, respectively. The increase in the effective tax rate for the three months ended December 31, 2020 as compared to the three months ended December 31, 2019 is primarily due to the tax impact from stock-based compensation and other non-deductible expenses.

We record a valuation allowance to reduce our deferred tax assets to the amount we believe is more likely than not to be realized. In making these determinations we consider historical and projected taxable income, and ongoing prudent and feasible tax planning strategies in assessing the appropriateness of a valuation allowance. Our net deferred tax assets at December 31, 2020 and September 30, 2020 were \$45.3 million and \$44.6 million, respectively. The net deferred tax assets include valuation allowances of \$32.9 million and \$32.6 million as of December 31, 2020 and September 30, 2020, respectively, which are primarily related to certain state and foreign net operating losses and tax credit carryforwards.

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

## **Liquidity and Capital Resources**

Cash and cash equivalents, short-term investments and long-term investments totaled \$1,462.1 million as of December 31, 2020, compared to \$1,312.8 million as of September 30, 2020, representing an increase of \$149.3 million. The increase was primarily due to cash provided by operating activities of \$137.4 million for the three months ended December 31, 2020. Cash provided by operating activities for the first three months of fiscal year 2021 resulted from net income of \$87.7 million combined with changes in operating assets and liabilities, as adjusted for various non-cash items including stock-based compensation, deferred revenue, depreciation and amortization charges. Additionally, the increase is due to \$27.2 million of cash received from the exercise of employee stock options and stock purchases under our employee stock purchase plan for the three months ended December 31, 2020.

Cash from operations could be affected by various risks and uncertainties, including, but not limited to, the effects of the COVID-19 pandemic and other risks detailed in Part II, Item 1A titled "Risk Factors". However, we anticipate our current cash, cash equivalents and investment balances, anticipated cash flows generated from operations, and available borrowing capacity on the Revolver Credit Facility will be sufficient to meet our liquidity needs.

Cash provided by investing activities was \$20.6 million for the three months ended December 31, 2020, compared to cash used in investing activities of \$29.4 million for the same period in the prior year. Investing activities include purchases, sales and maturities of available-for-sale securities, business acquisitions and capital expenditures. The amount of cash provided by investing activities for the three months ended December 31, 2020 was primarily the result of \$69.4 million in maturities of investments, partially offset by \$42.8 million of purchases of investments and \$4.7 million of capital expenditures.

Cash provided by financing activities was \$17.7 million for the three months ended December 31, 2020, compared to \$21.0 million for the same period in the prior year. Our financing activities for the three months ended December 31, 2020 primarily consisted of \$27.2 million of cash received from the exercise of employee stock options and stock purchases under our employee stock purchase plan, partially offset by \$5.0 million in cash used to make a principal payment on our term loan and \$4.5 million in cash used for taxes related to net share settlement of equity awards.

On January 31, 2020, we entered into a Revolving Credit Agreement (the "Revolving Credit Agreement") that provides for a senior unsecured revolving credit facility in an aggregate principal amount of \$350.0 million (the "Revolving Credit Facility"). We have the option to increase commitments under the Revolving Credit Facility from time to time, subject to certain conditions, by up to \$150.0 million. As of December 31, 2020, there were no outstanding borrowings under the Revolving Credit Facility, and we had available borrowing capacity of \$350.0 million.

On February 3, 2021, we entered into Accelerated Share Repurchase ("ASR") agreements with two financial institutions under which we paid an aggregate of \$500 million. See Note 14, Subsequent Events, for additional information on the ASR program.

## **Obligations and Commitments**

As of December 31, 2020, our principal commitments consisted of borrowings under the Term Loan Facility and obligations outstanding under operating leases.

In connection with the acquisition of Shape, on January 24, 2020, we entered into a Term Credit Agreement ("Term Credit Agreement") with certain institutional lenders that provides for a senior unsecured term loan facility in an aggregate principal amount of \$400.0 million (the "Term Loan Facility"). The proceeds from the Term Loan Facility were primarily used to finance the acquisition of Shape and related expenses. As of December 31, 2020, \$385.0 million of principal amount under the Term Loan Facility was outstanding. There is a financial covenant that requires us to maintain a leverage ratio, calculated as of the last day of each fiscal quarter, of consolidated total indebtedness to consolidated EBITDA. This covenant may result in a higher interest rate on our outstanding principal borrowings on the Term Loan Facility in future periods, depending on the Company's performance. We will monitor the effect that the COVID-19 pandemic may have on our leverage ratio calculation

but do not believe there will be a material impact to the interest payable on our borrowings under the Term Loan Facility. Refer to Note 7 for the scheduled principal maturities of the Term Loan Facility as of December 31, 2020.

We lease our facilities under operating leases that expire at various dates through 2033. There have been no material changes in our principal lease commitments compared to those discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2020.

We outsource the manufacturing of our pre-configured hardware platforms to contract manufacturers who assemble each product to our specifications. Our agreement with our largest contract manufacturer allows them to procure component inventory on our behalf based upon a rolling production forecast. We are contractually obligated to purchase the component inventory in accordance with the forecast, unless we give notice of order cancellation in advance of applicable lead times.

## **Recent Accounting Pronouncements**

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

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

*Interest Rate Risk.* We maintain an investment portfolio of various holdings, types, and maturities. Our primary objective for holding fixed income securities is to achieve an appropriate investment return consistent with preserving principal and managing risk. At any time, a sharp rise in market interest rates could have a material adverse impact on the fair value of our fixed income investment portfolio. Conversely, declines in interest rates, including the impact from lower credit spreads, could have a material adverse impact on interest income for our investment portfolio. Our fixed income investments are held for purposes other than trading. Our fixed income investments were not leveraged as of December 31, 2020. We monitor our interest rate and credit risks, including our credit exposures to specific rating categories and to individual issuers. As of December 31, 2020, 41.5% of our fixed income securities balance consisted of U.S. government and U.S. government agency securities. We believe the overall credit quality of our portfolio is strong.

Refer to Note 7 for information on our recent borrowings under the Term Loan Facility. Borrowings under the Term Loan Facility bear interest at a rate equal to, at our option, (a) LIBOR, adjusted for customary statutory reserves, plus an applicable margin of 1.125% to 1.75% depending on our leverage ratio, or (b) an alternate base rate determined in accordance with the Term Credit Agreement, plus an applicable margin of 0.125% to 0.750% depending on our leverage ratio.

The Term Loan Facility requires us to maintain a leverage ratio financial covenant, calculated as of the last day of each fiscal quarter, of consolidated total indebtedness to consolidated EBITDA. This covenant may result in a higher interest rate on our outstanding principal borrowings on the Term Loan Facility in future periods, depending on the Company's performance. At any time, a sharp rise in market interest rates could have a material adverse impact on the interest payable on outstanding principal borrowings on our Term Loan Facility. We monitor our interest rate and credit risks, which include the effect that the COVID-19 pandemic may have on interest rates on principal borrowings under the Term Loan Facility. As of December 31, 2020, we have not noted any adverse impacts to interest rates that would have a material impact to interest owed on principal borrowings.

*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.

Management believes there have been no material changes to our quantitative and qualitative disclosures about market risk during the three month period ended December 31, 2020, compared to those discussed in our Annual Report on Form 10-K for the year ended September 30, 2020.

### **Item 4. Controls and Procedures**

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

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2020 and, based on this evaluation, our Chief

Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of December 31, 2020.

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

During the first fiscal quarter, there were no changes to our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Although the entire global F5 workforce is working remotely as a result of the COVID-19 pandemic, there were no material changes to our existing internal controls over financial reporting as a result of this.

**PART II — OTHER INFORMATION**

**Item 1. Legal Proceedings**

See Note 9 - Commitments and Contingencies of the Notes to Financial Statements (Part I, Item 1 of this Form 10-Q) for information regarding legal proceedings in which we are involved.

**Item 1A. Risk Factors**

There have been no material changes to our risk factors from those described in Part 1, Item 1A, "Risk Factors" of our Annual Report on Form 10-K for the fiscal year ended September 30, 2020, which was filed with the Securities and Exchange Commission on November 19, 2020.

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

On October 31, 2018, the Company announced that its Board of Directors authorized an additional \$1.0 billion for its common stock share repurchase program. This authorization is incremental to the existing \$4.4 billion program, initially approved in October 2010 and expanded in each fiscal year. Acquisitions for the share repurchase programs will be made from time to time in private transactions, accelerated share repurchase programs, or open market purchases as permitted by securities laws and other legal requirements. The Company did not repurchase and retire any shares during the three months ended December 31, 2020.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

<u>Exhibit Number</u>	<u>Exhibit Description</u>
31.1* —	<a href="#">Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>
31.2* —	<a href="#">Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>
32.1* —	<a href="#">Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>
101.INS* —	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document
101.SCH* —	Inline XBRL Taxonomy Extension Schema Document
101.CAL* —	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF* —	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB* —	Inline XBRL Taxonomy Extension Label Linkbase Document
101.PRE* —	Inline XBRL Taxonomy Extension Presentation Linkbase Document
104* —	Cover Page Interactive Data File (embedded within the Inline XBRL document)

\* Filed herewith.

## 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 5th day of February, 2021.

F5 NETWORKS, INC.

By: /s/ FRANCIS J. PELZER

Francis J. Pelzer  
Executive Vice President,  
Chief Financial Officer  
(principal financial officer and principal accounting officer)