

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

FORM 10-Q

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

For the quarterly period ended June 30, 2019
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)

401 Elliott Avenue West
Seattle, Washington 98119
(Former name, former address and former
fiscal year, if changed since last report)

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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	<input checked="" type="checkbox"/>		Accelerated Filer	<input type="checkbox"/>
Non-accelerated Filer	<input type="checkbox"/>	(Do not check if a smaller reporting company)	Smaller Reporting Company	<input type="checkbox"/>

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 July 29, 2019 was 60,130,021 .

F5 NETWORKS, INC.
QUARTERLY REPORT ON FORM 10-Q
For the Quarter Ended June 30, 2019
Table of Contents

	<u>Page</u>
<u>PART I. FINANCIAL INFORMATION</u>	
Item 1. Financial Statements (unaudited)	3
Consolidated Balance Sheets — June 30, 2019 and September 30, 2018	3
Consolidated Income Statements — Three and nine months ended June 30, 2019 and 2018	4
Consolidated Statements of Comprehensive Income — Three and nine months ended June 30, 2019 and 2018	5
Consolidated Statements of Shareholders' Equity — Three and nine months ended June 30, 2019 and 2018	6
Consolidated Statements of Cash Flows — Nine months ended June 30, 2019 and 2018	8
Notes to Consolidated Financial Statements	9
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	26
Item 3. Quantitative and Qualitative Disclosures About Market Risk	32
Item 4. Controls and Procedures	32
<u>PART II. OTHER INFORMATION</u>	
Item 1. Legal Proceedings	33
Item 1A. Risk Factors	33
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	33
Item 4. Mine Safety Disclosures	33
Item 5. Other Information	33
Item 6. Exhibits	34
<u>SIGNATURES</u>	35

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

F5 NETWORKS, INC.

CONSOLIDATED BALANCE SHEETS
(unaudited, in thousands)

	June 30, 2019	September 30, 2018
ASSETS		
Current assets		
Cash and cash equivalents	\$ 688,350	\$ 424,707
Short-term investments	298,137	614,705
Accounts receivable, net of allowances of \$2,562 and \$2,040	320,465	295,352
Inventories	36,009	30,568
Other current assets	161,940	52,326
Total current assets	1,504,901	1,417,658
Property and equipment, net	226,002	145,042
Long-term investments	161,619	411,184
Deferred tax assets	25,079	33,441
Goodwill	1,065,379	555,965
Other assets, net	194,295	42,186
Total assets	\$ 3,177,275	\$ 2,605,476
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 55,630	\$ 57,757
Accrued liabilities	213,195	180,979
Deferred revenue	803,241	715,697
Total current liabilities	1,072,066	954,433
Other long-term liabilities	117,804	65,892
Deferred revenue, long-term	363,271	299,624
Deferred tax liabilities	352	35
Total long-term liabilities	481,427	365,551
Commitments and contingencies (Note 7)		
Shareholders' equity		
Preferred stock, no par value; 10,000 shares authorized, no shares outstanding	—	—
Common stock, no par value; 200,000 shares authorized, 60,129 and 60,215 shares issued and outstanding	98,722	20,427
Accumulated other comprehensive loss	(18,193)	(22,178)
Retained earnings	1,543,253	1,287,243
Total shareholders' equity	1,623,782	1,285,492
Total liabilities and shareholders' equity	\$ 3,177,275	\$ 2,605,476

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)

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018	2019	2018
Net revenues				
Products	\$ 248,929	\$ 238,835	\$ 720,665	\$ 703,696
Services	314,465	303,368	931,394	895,002
Total	563,394	542,203	1,652,059	1,598,698
Cost of net revenues				
Products	44,336	45,164	130,293	132,556
Services	46,431	45,845	135,366	135,485
Total	90,767	91,009	265,659	268,041
Gross profit	472,627	451,194	1,386,400	1,330,657
Operating expenses				
Sales and marketing	195,852	165,806	531,065	503,710
Research and development	116,894	94,061	305,246	271,006
General and administrative	57,141	39,374	146,340	118,634
Total	369,887	299,241	982,651	893,350
Income from operations	102,740	151,953	403,749	437,307
Other income, net	4,722	2,259	19,251	7,194
Income before income taxes	107,462	154,212	423,000	444,501
Provision for income taxes	21,557	31,469	90,103	123,693
Net income	\$ 85,905	\$ 122,743	\$ 332,897	\$ 320,808
Net income per share — basic	\$ 1.43	\$ 2.01	\$ 5.55	\$ 5.21
Weighted average shares — basic	59,981	60,970	59,963	61,531
Net income per share — diluted	\$ 1.43	\$ 1.99	\$ 5.51	\$ 5.16
Weighted average shares — diluted	60,196	61,633	60,372	62,214

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

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

(unaudited, in thousands)

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018	2019	2018
Net income	\$ 85,905	\$ 122,743	\$ 332,897	\$ 320,808
Other comprehensive income (loss):				
Foreign currency translation adjustment	118	(1,441)	61	(896)
Available-for-sale securities:				
Unrealized gains (losses) on securities, net of taxes of \$197 and \$177 for the three months ended June 30, 2019 and 2018, respectively, and \$940 and \$(1,010) for the nine months ended June 30, 2019 and 2018, respectively	918	436	3,811	(3,100)
Reclassification adjustment for realized losses included in net income, net of taxes of \$(35) and \$0 for the three months ended June 30, 2019 and 2018, respectively, and \$(35) and \$(4) for the nine months ended June 30, 2019 and 2018, respectively	112	1	113	10
Net change in unrealized gains (losses) on available-for-sale securities, net of tax	1,030	437	3,924	(3,090)
Total other comprehensive income (loss)	1,148	(1,004)	3,985	(3,986)
Comprehensive income	\$ 87,053	\$ 121,739	\$ 336,882	\$ 316,822

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 June 30, 2018					
Balances, March 31, 2018	61,115	\$ 21,120	\$ (20,980)	\$ 1,226,474	\$ 1,226,614
Issuance of stock under employee stock purchase plan	282	28,900	—	—	28,900
Issuance of restricted stock	324	—	—	—	—
Repurchase of common stock	(903)	(68,751)	—	(81,267)	(150,018)
Stock-based compensation	—	38,739	—	—	38,739
Net income	—	—	—	122,743	122,743
Other comprehensive loss	—	—	(1,003)	—	(1,003)
Balances, June 30, 2018	60,818	\$ 20,008	\$ (21,983)	\$ 1,267,950	\$ 1,265,975
Three months ended June 30, 2019					
Balances, March 31, 2019	59,695	\$ 29,401	\$ (19,341)	\$ 1,457,348	\$ 1,467,408
Exercise of employee stock options	1	16	—	—	16
Issuance of stock under employee stock purchase plan	199	26,539	—	—	26,539
Issuance of restricted stock	234	—	—	—	—
Stock-based compensation	—	42,766	—	—	42,766
Net income	—	—	—	85,905	85,905
Other comprehensive income	—	—	1,148	—	1,148
Balances, June 30, 2019	60,129	\$ 98,722	\$ (18,193)	\$ 1,543,253	\$ 1,623,782

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

	Common Stock		Accumulated Other Comprehensive Loss	Retained Earnings	Total Shareholders' Equity
	Shares	Amount			
(In thousands)					
Nine months ended June 30, 2018					
Balances, September 30, 2017	62,594	\$ 17,627	\$ (17,997)	\$ 1,229,762	\$ 1,229,392
Exercise of employee stock options	1	3	—	—	3
Issuance of stock under employee stock purchase plan	475	48,815	—	—	48,815
Issuance of restricted stock	959	—	—	—	—
Repurchase of common stock	(3,211)	(167,444)	—	(282,620)	(450,064)
Stock-based compensation	—	121,007	—	—	121,007
Net income	—	—	—	320,808	320,808
Other comprehensive loss	—	—	(3,986)	—	(3,986)
Balances, June 30, 2018	60,818	\$ 20,008	\$ (21,983)	\$ 1,267,950	\$ 1,265,975
Nine months ended June 30, 2019					
Balances, September 30, 2018	60,215	\$ 20,427	\$ (22,178)	\$ 1,287,243	\$ 1,285,492
Cumulative effect adjustment from adoption of ASC 606	—	—	—	36,048	36,048
Exercise of employee stock options	1	16	—	—	16
Issuance of stock under employee stock purchase plan	334	45,439	—	—	45,439
Issuance of restricted stock	765	—	—	—	—
Repurchase of common stock	(1,186)	(88,110)	—	(112,935)	(201,045)
Stock-based compensation	—	120,950	—	—	120,950
Net income	—	—	—	332,897	332,897
Other comprehensive income	—	—	3,985	—	3,985
Balances, June 30, 2019	60,129	\$ 98,722	\$ (18,193)	\$ 1,543,253	\$ 1,623,782

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

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

	Nine months ended June 30,	
	2019	2018
Operating activities		
Net income	\$ 332,897	\$ 320,808
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized loss on disposition of assets and investments	606	64
Stock-based compensation	119,182	121,007
Provisions for doubtful accounts and sales returns	65	1,494
Depreciation and amortization	46,645	44,081
Deferred income taxes	10,171	19,241
Changes in operating assets and liabilities:		
Accounts receivable	(16,249)	(6,945)
Inventories	(5,441)	(1,488)
Other current assets	(54,381)	11,590
Other assets	(8,785)	(68)
Accounts payable and accrued liabilities	37,932	(16,423)
Deferred revenue	79,113	63,402
Net cash provided by operating activities	541,755	556,763
Investing activities		
Purchases of investments	(210,109)	(499,084)
Maturities of investments	507,804	295,479
Sales of investments	276,278	10,748
Cash provided by sale of fixed asset	—	1,000
Acquisition of businesses, net of cash acquired	(611,550)	—
Purchases of property and equipment	(83,008)	(36,074)
Net cash used in investing activities	(120,585)	(227,931)
Financing activities		
Proceeds from the exercise of stock options and purchases of stock under employee stock purchase plan	45,455	48,818
Repurchase of common stock	(201,045)	(450,064)
Net cash used in financing activities	(155,590)	(401,246)
Net increase (decrease) in cash, cash equivalents and restricted cash	265,580	(72,414)
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(111)	(1,588)
Cash, cash equivalents and restricted cash, beginning of period	425,894	674,452
Cash, cash equivalents and restricted cash, end of period	\$ 691,363	\$ 600,450
Supplemental disclosures of non-cash activities		
Capitalized leasehold improvements paid directly by landlord	\$ 34,487	\$ —

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 the leading developer and provider of application services. The Company's core technology is a full-proxy, programmable, highly-scalable software platform called TMOS, which supports a broad array of features and functions designed to ensure that applications delivered over Internet Protocol (IP) networks are secure, fast and available. The Company's offerings include software products for local and global traffic management, network and application security, identity and access management, web acceleration and a number of other network and application services. F5 offerings are available via software that can run individually or as part of an integrated solution on the Company's high-performance, scalable, purpose-built BIG-IP appliances and VIPRION chassis-based hardware, as software-only Virtual Editions, or as software-based services available through a number of leading cloud marketplaces. The Company also offers distributed denial-of-service (DDoS) protection, application security and other application services by subscription on its cloud-based Silverline managed service platform. In connection with its products, the Company offers a broad range of support and services including consulting, training, installation and maintenance. On May 8, 2019, the Company completed the acquisition of Nginx, Inc. ("Nginx"), the open source leader in application delivery for modern applications. The combined company will enable multi-cloud application services across all environments, providing the ease-of-use and flexibility developers require while also delivering the scale, security, reliability and enterprise readiness network operations teams demand.

Basis of Presentation

The year-end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. In the opinion of management, the unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for their fair statement in conformity with accounting principles generally accepted in the United States of America. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted in accordance with the rules and regulations of the Securities and Exchange Commission. The information included in this Form 10-Q should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2018 .

There have been no material changes to our significant accounting policies as of and for the three and nine months ended June 30, 2019 , except for the accounting policies for revenue recognition and deferred contract costs that were updated as a result of adopting Accounting Standards Update 2014-09, *Revenue from Contracts with Customers (Topic 606)* (ASU 2014-09). For more information, refer to the "Revenue Recognition" and "Recently Adopted Accounting Standards" sections of Note 1 and Note 2 - Revenue from Contracts with Customers.

Revenue Recognition

On October 1, 2018, the Company adopted the new revenue recognition standard by applying the modified retrospective approach to those contracts which were not completed as of October 1, 2018. Results for reporting periods beginning after October 1, 2018 are presented under the new revenue recognition standard, while prior period amounts are not adjusted and continue to be reported under the accounting standards in effect for the prior periods.

The Company sells products through distributors, resellers, and directly to end users. Revenue related to the Company's contracts with customers is recognized by following a five-step process:

- *Identify the contract(s) with a customer.* Evidence of a contract generally consists of a purchase order issued pursuant to the terms and conditions of a distributor, reseller or end user agreement.
- *Identify the performance obligations in the contract.* Performance obligations are explicitly identified in the Company's contracts and include hardware-based software, software-only solutions, cloud-based subscription services as well as a broad range of service performance obligations including consulting, training, installation and maintenance.
- *Determine the transaction price.* The purchase price stated in an agreed upon purchase order is generally representative of the transaction price. The Company offers several programs in which customers are eligible for certain levels of rebates if certain conditions are met. When determining the transaction price, the Company considers the effects of any variable consideration.

- *Allocate the transaction price to the performance obligations in the contract.* The transaction price in a contract is allocated based upon the relative standalone selling price of each distinct performance obligation identified in the contract.
- *Recognize revenue when (or as) the entity satisfies a performance obligation.* The Company satisfies performance obligations either over time or at a point in time as discussed in further detail below. Revenue is recognized at the time the related performance obligation is satisfied by transferring control of promised products and services to a customer.

The following is a description of the principal activities from which the Company generates revenue:

Product

Revenue from the sale of the Company's hardware and perpetual software products is generally recognized at a point in time when the product has been delivered and the customer is obligated to pay for the product. When rights of return are present and the Company cannot estimate returns, revenue is recognized when such rights of return lapse. Payment terms to domestic customers are generally net 30 days to net 45 days. Payment terms to international customers range from net 30 days to net 120 days based on normal and customary trade practices in the individual markets.

Subscription

The Company also offers several products by subscription, either through term-based license agreements or as a service through its cloud-based Silverline platform. Revenue for term-based license agreements is recognized at a point in time, when the Company delivers the software license to the customer and the subscription term has commenced. For the Company's software-as-a-service Silverline offerings, revenue is recognized ratably as the services are provided.

Support and professional services

Revenues for post-contract customer support (PCS) are recognized on a straight-line basis over the service contract term. PCS includes a limited period of telephone support, updates, repair or replacement of any failed product or component that fails during the term of the agreement, bug fixes and rights to upgrades, when and if available. Consulting services are customarily billed at fixed hourly rates, plus out-of-pocket expenses, and revenues are recognized as the consulting is completed. Similarly, training revenue is recognized as the training is completed.

Contract acquisition costs

Sales commissions earned by the Company's sales force are considered incremental and recoverable costs of obtaining a contract with a customer. Sales commissions for initial service contracts and subscription offerings are deferred and then amortized as an expense on a straight-line basis over the period of benefit which management has determined to be 4.5 years and 3 years, respectively.

Significant Judgments

The Company's contracts with customers often include promises to transfer multiple products and services. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment.

Judgment is also required to determine the standalone selling price (SSP) for each distinct performance obligation. The Company sells post-contract customer support (PCS), subscriptions and professional services on a standalone basis and can therefore use a population of historical standalone sales to determine fair value. For distinct performance obligations that the Company does not generally sell on a standalone basis (hardware and perpetual software), a combination of the adjusted market assessment approach and the expected cost plus a margin approach are used to estimate the SSP.

Cash, Cash Equivalents and Restricted Cash

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

Amounts included in restricted cash represent those required to be set aside by a contractual agreement. 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):

	June 30, 2019	June 30, 2018
Cash and cash equivalents	\$ 688,350	\$ 599,268
Restricted cash included in other assets, net	3,013	1,182
Total cash, cash equivalents and restricted cash	\$ 691,363	\$ 600,450

Inventories

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

Goodwill and Acquired Intangible Assets

Goodwill represents the excess purchase price over the estimated fair value of net assets acquired as of the acquisition date. The Company tests goodwill for impairment on an annual basis and between annual tests when impairment indicators are identified, and goodwill is written down when impaired. Goodwill has been recorded in connection with various acquisitions, including the acquisition on Nginx in the third quarter of fiscal 2019. For its annual goodwill impairment test in all periods to date, the Company has operated under one reporting unit and the fair value of its reporting unit has been determined by the Company's enterprise value. The Company performs its annual goodwill impairment test during the second fiscal quarter.

As part of the annual goodwill impairment test, the Company has the option to perform a qualitative assessment to determine whether further impairment testing is necessary. Examples of events and circumstances that might indicate that the reporting unit's fair value is less than its carrying amount include macro-economic conditions such as deterioration in the entity's operating environment or industry or market considerations; entity-specific events such as increasing costs, declining financial performance, or loss of key personnel; or other events such as a sustained decrease in the stock price on either an absolute basis or relative to peers. If, as a result of its qualitative assessment, it is more-likely-than-not (i.e. greater than 50% chance) that the fair value of the Company's reporting unit is less than its carrying amount, the quantitative impairment test will be required. Otherwise, no further testing will be required.

For its annual impairment test performed in the second quarter of fiscal 2019, the Company completed a quantitative assessment and determined that there was no impairment of goodwill.

The Company's intangible assets subject to amortization are amortized using the straight-line method over their estimated useful lives, ranging from two to fifteen years. The Company evaluates the recoverability of intangible assets periodically by taking into account events or circumstances that may warrant revised estimates of useful lives or that indicate the asset may be impaired. The Company considered potential impairment indicators of acquired intangible assets at June 30, 2019 and noted no indicators of impairment.

Software Development Costs

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

Internal Use Software

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

Stock-Based Compensation

The Company accounts for stock-based compensation using the straight-line attribution method for recognizing compensation expense. The Company recognized \$41.0 million and \$38.7 million of stock-based compensation expense for the three months ended June 30, 2019 and 2018, respectively and \$119.2 million and \$121.0 million of stock-based compensation expense for the nine months ended June 30, 2019 and 2018, respectively. As of June 30, 2019, there was \$176.1 million of total unrecognized stock-based compensation cost, the majority of which will be recognized over the next two years. Going forward, stock-based compensation expenses may increase as the Company issues additional equity-based awards to continue to attract and retain key employees.

The Company issues incentive awards to its employees through stock-based compensation consisting of restricted stock units (RSUs). On October 31, 2018, the Company's Board of Directors and Compensation Committee approved 774,313 RSUs to employees and executive officers pursuant to the Company's annual equity awards program. The value of RSUs is determined using the fair value method, which in this case, is based on the number of shares granted and the quoted price of the Company's common stock on the date of grant.

The Company recognizes compensation expense for only the portion of restricted stock units that are expected to vest. Therefore, the Company applies estimated forfeiture rates that are derived from historical employee termination behavior. Based on historical differences with forfeitures of stock-based awards granted to the Company's executive officers and Board of Directors versus grants awarded to all other employees, the Company has developed separate forfeiture expectations for these two groups. In determining the fair value of shares issued under the Employee Stock Purchase Plan (ESPP), the Company uses the Black-Scholes option pricing model. Compensation expense related to the shares issued pursuant to the ESPP is recognized on a straight-line basis over the offering period.

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

For performance stock awards granted prior to fiscal 2018, attainment is based on the Company achieving specific quarterly revenue and EBITDA targets. In each case, 70% of the quarterly performance stock grant is based on achieving at least 80% of the quarterly revenue goal set by the Company's Board of Directors, and the other 30% is based on achieving at least 80% of the quarterly EBITDA goal set by the Company's Board of Directors. The quarterly performance stock grant is paid linearly over 80% of the targeted goals. At least 100% of both goals must be attained in order for the quarterly performance stock grant to be awarded over 100%. Each goal is evaluated individually and subject to the 80% achievement threshold and the 100% over-achievement threshold. Each goal is also capped at achievement of 200% above target.

For the fiscal 2018 and 2019 performance stock awards, the Company's Compensation Committee adopted a new set of metrics that are differentiated from the quarterly revenue and EBITDA measures, including (1) 50% of the annual performance stock grant is based on achieving 80% of the annual revenue goal set by the Company's Board of Directors; (2) 25% of the annual performance stock grant is based on achieving at least a 18% increase in annual software revenue compared to the prior year; and (3) 25% of the annual performance stock grant is based on relative total shareholder return benchmarked to the S&P 500 index. In each case, no vesting or payment with respect to a performance goal shall occur unless a minimum threshold is met for the applicable goal. Vesting and payment with respect to the performance goal is linear above the threshold of the applicable goal and is capped at achievement of 200% above target.

As of June 30, 2019, the following annual equity grants for executive officers or a portion thereof are outstanding:

<u>Grant Date</u>	<u>RSUs Granted</u>	<u>Vesting Schedule</u>	<u>Vesting Period</u>	<u>Date Fully Vested</u>
November 1, 2018	144,066	Quarterly, Annually ¹	3 years	November 1, 2021
November 1, 2017	140,135	Quarterly, Annually ¹	4 years	November 1, 2021
November 1, 2016	115,347	Quarterly	4 years	November 1, 2020
November 2, 2015	145,508	Quarterly	4 years	November 1, 2019

(1) 50% of the annual equity grant vests in equal quarterly increments and 50% is subject to the Company achieving specified annual performance goals.

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

Common Stock Repurchase

On 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 new 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 or open market purchases as permitted by securities laws and other legal requirements. For the nine months ended June 30, 2019, the Company repurchased and retired 1,185,881 shares at an average price of \$169.53 per share and the Company had \$1.4 billion remaining authorized to purchase shares at June 30, 2019.

In the second quarter of fiscal 2019, the Company announced that, in connection with its acquisition of Nginx, it was suspending the automatic component of its common stock share repurchase program. Management will continue to evaluate market conditions and other factors including the Company's capital requirements in determining when and whether to repurchase shares and when and whether to re-implement an automatic component of its repurchase program. The program does not require the purchase of any minimum number of shares and the program may be modified, suspended or discontinued at any time.

Earnings Per Share

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

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

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018	2019	2018
Numerator				
Net income	\$ 85,905	\$ 122,743	\$ 332,897	\$ 320,808
Denominator				
Weighted average shares outstanding — basic	59,981	60,970	59,963	61,531
Dilutive effect of common shares from stock options and restricted stock units	215	663	409	683
Weighted average shares outstanding — diluted	60,196	61,633	60,372	62,214
Basic net income per share	\$ 1.43	\$ 2.01	\$ 5.55	\$ 5.21
Diluted net income per share	\$ 1.43	\$ 1.99	\$ 5.51	\$ 5.16

Anti-dilutive stock-based awards excluded from the calculations of diluted earnings per share were immaterial for the three and nine months ended June 30, 2019 and 2018.

Comprehensive Income

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

Recently Adopted Accounting Standards

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* (ASU 2014-09). ASU 2014-09 and the related amendments outline a new, single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The new model requires revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration a company expects to receive in exchange for those goods or services. The Company adopted this new accounting standard and the related amendments on October 1, 2018 using the modified retrospective method. See Note 2 - Revenue from Contracts with Customers for further details.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments* (ASU 2016-15), which clarifies how companies present and classify certain cash receipts and cash payments in the statement of cash flows. The Company adopted this new accounting standard on October 1, 2018. The adoption did not have an impact on the Company's consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* (ASU 2016-18), which requires a company's cash flow statement to explain the changes during a reporting period of the totals for cash, cash equivalents, restricted cash and restricted cash equivalents. Additionally, amounts for restricted cash and restricted cash equivalents are to be included with cash and cash equivalents if the cash flow statement includes a reconciliation of the total cash balances for a reporting period. The Company adopted this new accounting standard on October 1, 2018, which resulted in an immaterial reclassification of beginning and ending cash, cash equivalents and restricted cash for the periods presented within the statement of cash flows. Upon adoption of this new standard, restricted cash activity is no longer separately presented within the investing activities in the statement of cash flows. The overall adoption of the standard did not have a material impact to the consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business* (ASU 2017-01), which provides a more robust framework to use in determining when a set of assets and activities is considered a business. The Company adopted this new accounting standard on October 1, 2018. The adoption did not have an impact on the Company's consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, *Compensation-Stock Compensation* (ASU 2017-09), which provides clarification on when modification accounting should be used for changes to the terms or conditions of a share-based payment award. This ASU does not change the accounting for modifications but clarifies that modification accounting guidance should only be applied if there is a change to the value, vesting conditions or award classification and would not be required if the changes are considered non-substantive. The Company adopted this new accounting standard on October 1, 2018. The adoption did not have an impact on the Company's consolidated financial statements.

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* (ASU 2016-02), which requires lessees to recognize on the balance sheet a right-of-use asset, representing its right to use the underlying asset for the lease term, and a corresponding lease liability for all leases with terms greater than twelve months. The Company's leases consist of operating leases for its offices and lab spaces. The guidance also requires qualitative and quantitative disclosures designed to assess the amount, timing and uncertainty of cash flows arising from leases. Adoption of the new lease standard requires measurement of leases at the beginning of the earliest period presented on a modified retrospective basis. The new standard will be effective for the Company beginning October 1, 2019. The Company anticipates that its long-term leases for office space will be recognized as lease liabilities and corresponding right-of-use assets, and will have a material impact on its consolidated balance sheets upon adoption.

In July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842)* (ASU 2018-11), which provides an optional transition method to adopt ASU 2016-02, *Leases (Topic 842)* by allowing lessees to apply the new standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Comparative periods will still be presented under current GAAP (ASC 840), along with the applicable Topic 840 disclosures for those comparative periods. The new standard is effective at the same time as adoption of ASU 2016-02, *Leases (Topic 842)*, which the Company is planning to adopt in the first quarter of fiscal year 2020. The Company plans to adopt the transitional provisions allowed under ASU 2018-11.

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 replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted. The Company does not anticipate that the adoption of this standard will have a material impact on its consolidated financial statements.

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 new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted.

The Company does not anticipate that the adoption of this standard will have a material impact on its consolidated financial statements.

2. Revenue from Contracts with Customers

The following table summarizes the impact of adopting ASC 606 on the Company's consolidated balance sheet as of the date of adoption, October 1, 2018. This table does not represent the full consolidated balance sheet as it only reflects the accounts impacted by the adoption of ASC 606.

	Ending Balance as of September 30, 2018 (ASC 605)	ASC 606 Adjustments	Beginning Balance as of October 1, 2018 (ASC 606)
Assets			
Other current assets ¹	\$ 52,326	\$ 50,558	\$ 102,884
Other assets, net ¹	\$ 42,186	\$ 59,676	\$ 101,862
Deferred tax assets	\$ 33,441	\$ (7,902)	\$ 25,539
Liabilities and Shareholders' Equity			
Deferred revenue	\$ 715,697	\$ 35,464	\$ 751,161
Deferred revenue, long-term	\$ 299,624	\$ 32,614	\$ 332,238
Retained earnings ²	\$ 1,287,243	\$ 36,048	\$ 1,323,291

- (1) Upon the adoption of ASC 606, capitalized contract acquisition costs and unbilled accounts receivable are reported as part of other current assets and other assets, net.
- (2) The net increase to retained earnings of \$36.0 million was primarily related to the capitalization of contract acquisition costs of \$54.6 million, partially offset by a decrease of \$8.8 million due to changes in deferred revenue and a decrease of \$7.9 million from the impact on deferred income taxes.

As a result of an increase in sales of the Company's software solutions sold as Enterprise License Agreements and annual subscriptions, the adoption of ASC 606 had a material impact to the Company's consolidated balance sheet as of June 30, 2019 and consolidated income statements for the three and nine months ended June 30, 2019.

The following table summarizes the impact of adopting ASC 606 on the Company's consolidated balance sheet as of June 30, 2019 (in thousands):

	June 30, 2019			
	As Reported (ASC 606)	Impacts Subsequent to the Date of Adoption	Impacts on the Date of Adoption (October 1, 2018)	Without Adoption (ASC 605)
Assets				
Other current assets	\$ 161,940	\$ 23,480	\$ 50,558	\$ 87,902
Other assets, net	\$ 194,295	\$ 11,714	\$ 59,676	\$ 122,905
Deferred tax assets	\$ 25,079	\$ (1,961)	\$ (7,902)	\$ 34,942
Total assets	\$ 3,177,275	\$ 33,233	\$ 102,332	\$ 3,041,710
Liabilities and Shareholders' Equity				
Accrued liabilities	\$ 213,195	\$ 4,916	\$ —	\$ 208,279
Deferred revenue	\$ 803,241	\$ 11,589	\$ 35,464	\$ 756,188
Deferred revenue, long-term	\$ 363,271	\$ (10,472)	\$ 32,614	\$ 341,129
Total liabilities	\$ 1,553,493	\$ 6,033	\$ 68,078	\$ 1,479,382
Retained earnings	\$ 1,543,253	\$ 25,406	\$ 36,048	\$ 1,481,799
Total liabilities and shareholders' equity	\$ 3,177,275	\$ 31,439	\$ 104,126	\$ 3,041,710

[Table of Contents](#)

The following table summarizes the impact of adopting ASC 606 on the Company's consolidated income statement for the three months ended June 30, 2019 (in thousands):

	Three Months Ended June 30, 2019		
	As Reported (ASC 606)	Effect of Adoption of ASC 606	Without Adoption (ASC 605)
Total net revenues	\$ 563,394	\$ 29,338	\$ 534,056
Total cost of net revenues	\$ 90,767	\$ 626	\$ 90,141
Gross profit	\$ 472,627	\$ 28,712	\$ 443,915
Total operating expenses	\$ 369,887	\$ (1,352)	\$ 371,239
Income before income taxes	\$ 107,462	\$ 30,064	\$ 77,398
Provision for income taxes	\$ 21,557	\$ 6,031	\$ 15,526
Net income	\$ 85,905	\$ 24,033	\$ 61,872
Net income per share — basic	\$ 1.43	\$ 0.40	\$ 1.03
Net income per share — diluted	\$ 1.43	\$ 0.40	\$ 1.03

The following table summarizes the impact of adopting ASC 606 on the Company's consolidated income statement for the nine months ended June 30, 2019 (in thousands):

	Nine Months Ended June 30, 2019		
	As Reported (ASC 606)	Effect of Adoption of ASC 606	Without Adoption (ASC 605)
Total net revenues	\$ 1,652,059	\$ 36,528	\$ 1,615,531
Total cost of net revenues	\$ 265,659	\$ 2,440	\$ 263,219
Gross profit	\$ 1,386,400	\$ 34,088	\$ 1,352,312
Total operating expenses	\$ 982,651	\$ 1,805	\$ 980,846
Income before income taxes	\$ 423,000	\$ 32,283	\$ 390,717
Provision for income taxes	\$ 90,103	\$ 6,877	\$ 83,226
Net income	\$ 332,897	\$ 25,406	\$ 307,491
Net income per share — basic	\$ 5.55	\$ 0.42	\$ 5.13
Net income per share — diluted	\$ 5.51	\$ 0.42	\$ 5.09

The adoption of ASC 606 did not have a material impact to cash from or used in operating, financing, or investing activities on the Company's consolidated statement of cash flows for the nine months ended June 30, 2019.

Capitalized Contract Acquisition Costs

The table below shows significant movements in capitalized contract acquisition costs (current and noncurrent) for the nine months ended June 30, 2019 (in thousands):

Balance, September 30, 2018	\$ —
Impacts from adoption of ASC 606	\$ 54,608
Additional capitalized contract acquisition costs deferred	\$ 22,460
Amortization of capitalized contract acquisition costs	\$ (21,380)
Balance, June 30, 2019	\$ 55,688

Amortization of capitalized contract acquisition costs is recorded in Sales and Marketing expense in the accompanying consolidated income statements for the three and nine months ended June 30, 2019. There was no impairment of any capitalized contract acquisition costs.

Contract Balances

Timing may differ between the satisfaction of performance obligations and the invoicing and collection of amounts related to our contracts with customers. We record 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 nine months ended June 30, 2019 (in thousands):

Balance, September 30, 2018	\$	—
Impacts from adoption of ASC 606	\$	57,499
Revenue recognized during period but not yet billed	\$	15,240
Contract asset net additions	\$	50,159
Contract assets reclassified to accounts receivable	\$	(29,386)
Balance, June 30, 2019	\$	93,512

As of June 30, 2019, 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 nine months ended June 30, 2019.

The impacts to deferred revenue from the adoption of ASC 606 are primarily related to unbilled accounts receivable now being capitalized and included as contract assets on the balance sheet. The table below shows significant movements in the deferred revenue balances (current and noncurrent) for the nine months ended June 30, 2019 (in thousands):

Balance, September 30, 2018	\$	1,015,321
Impacts from adoption of ASC 606	\$	68,078
Amounts billed but not recognized as revenues	\$	731,306
Revenues recognized related to the opening balance of deferred revenue	\$	(648,193)
Balance, June 30, 2019	\$	1,166,512

Our 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. The Company expects to recognize this amount as revenue over the following time periods (in thousands):

	<u>2,019</u>	<u>2,020</u>	<u>Thereafter</u>	<u>Total</u>
Revenue expected to be recognized on remaining performance obligations	\$ 278,529	\$ 574,901	\$ 313,082	\$ 1,166,512

See Note 9, Geographic Sales and Significant Customers, for disaggregated revenue by significant customer and geographic region.

3. Business Combinations

The Company's business combinations are accounted for under the acquisition method. The total purchase price is allocated to the tangible and intangible assets acquired and the liabilities assumed based on their estimated fair values. The excess of the purchase price over those fair values is recorded as goodwill. The fair value assigned to the tangible and intangible assets acquired and liabilities assumed are based on estimates and assumptions provided by management. Goodwill is not amortized but instead is tested for impairment at least annually, as described in Note 1.

Fiscal Year 2019 Acquisition of Nginx, Inc.

On March 9, 2019, the Company entered into a Merger Agreement (the “Merger Agreement”) with Nginx, Inc. (“Nginx”), a provider of open source web server software and application delivery solutions. The transaction closed on May 8, 2019 with Nginx becoming a wholly-owned subsidiary of F5.

Pursuant to the Merger Agreement, at the effective time of the Merger, the capital stock of Nginx and the vested outstanding and unexercised stock options in Nginx were cancelled and converted to the right to receive approximately \$643.2 million in cash, subject to certain adjustments and conditions set forth in the Merger Agreement, and the unvested stock options and restricted stock units in Nginx held by continuing employees of Nginx were assumed by F5, on the terms and conditions set forth in the Merger Agreement. Included in cash consideration was \$19.0 million of transaction costs paid by F5 on behalf of Nginx. In addition, the Company incurred an additional \$1.0 million of transaction costs associated with the acquisition which was included in General and Administrative expenses for the third quarter of fiscal 2019.

Nginx is an open source leader in application delivery. The combined company will enable multi-cloud application services across all environments, providing the ease-of-use and flexibility developers require while also delivering the scale, security, reliability and enterprise readiness network operations teams demand. As a result of the acquisition, the Company acquired all the assets and assumed all the liabilities of Nginx. The goodwill related to the Nginx acquisition is comprised primarily of expected synergies from combining operations and the acquired intangible assets that do not qualify for separate recognition. The results of operations of Nginx have been included in the Company’s consolidated financial statements from the date of acquisition.

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

Assets acquired	
Cash and cash equivalents	\$ 29,911
Fair value of tangible assets:	
Accounts receivable	7,306
Other current assets	4,214
Property and equipment, net	1,822
Deferred tax assets	10,357
Intangible assets	89,300
Goodwill	509,414
Total assets acquired	<u>\$ 652,324</u>
Liabilities assumed	
Accounts payable	\$ (1,081)
Deferred revenue	(4,000)
Other liabilities	(4,035)
Total liabilities assumed	<u>\$ (9,116)</u>
Net assets acquired	<u>\$ 643,208</u>

The allocation of the purchase price and the estimated useful lives associated with certain assets is as follows (in thousands):

	Amount	Estimated Useful Life
Net tangible assets	\$ 44,494	—
Identifiable intangible assets:		
Developed technologies	62,500	7 years
Customer relationships	12,000	15 years
Trade name	14,500	7 years
Non-competition agreements	300	2 years
Goodwill	509,414	—
Total purchase price	<u>\$ 643,208</u>	

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 seven years and fifteen years, respectively, and included in sales and marketing expenses. The weighted average life of the amortizable intangible assets recognized from the Nginx merger was 8.1 years. The estimated useful lives for the acquired intangible assets were based on the expected future cash flows associated with the respective asset. Tax deductible goodwill based on the Company's preliminary calculation is \$437.4 million.

The unaudited pro forma financial information shown below summarizes the combined results of operations for F5 and Nginx as if the closing of the acquisition had occurred on October 1, 2017, the first day of F5's fiscal year 2018. The unaudited pro forma financial information includes adjustments that are directly attributable to the business combination and are factually supportable. The adjustments primarily reflect the amortization of acquired intangible assets, share-based compensation expense for replacement awards, as well as the pro forma tax impact for such adjustments at the statutory rate. The unaudited pro forma results for the nine months ended June 30, 2018 also includes \$21.8 million in non-recurring retention costs for Nginx employees and \$1.0 million in transaction costs associated with the acquisition. The unaudited pro forma results do not reflect any cost saving synergies from operating efficiencies or the effect of the incremental costs incurred from integrating these companies. Accordingly, these unaudited pro forma results are presented for informational purposes only and are not necessarily indicative of what the actual results of operations of the combined company would have been if the acquisitions had occurred at the beginning of the periods presented, nor are they indicative of future results of operations (in thousands, except per share amounts):

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018	2019	2018
Net revenue	\$ 568,272	\$ 546,324	\$ 1,671,875	\$ 1,609,341
Net income	\$ 100,329	\$ 110,800	\$ 324,074	\$ 267,742

For the three and nine months ended June 30, 2019, Nginx contributed \$5.1 million to F5's consolidated net revenues and \$5.9 million in losses to F5's consolidated net income.

4. 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 June 30, 2019 , were as follows (in thousands):

	Fair Value Measurements at Reporting Date Using			Fair Value at June 30, 2019
	Quoted Prices in Active Markets for Identical Securities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash equivalents	\$ 48,807	\$ 228,127	\$ —	\$ 276,934
Short-term investments				
Available-for-sale securities — certificates of deposits	—	734	—	734
Available-for-sale securities — corporate bonds and notes	—	256,422	—	256,422
Available-for-sale securities — municipal bonds and notes	—	13,054	—	13,054
Available-for-sale securities — U.S. government securities	—	25,929	—	25,929
Available-for-sale securities — U.S. government agency securities	—	1,998	—	1,998
Long-term investments				
Available-for-sale securities — corporate bonds and notes	—	155,348	—	155,348
Available-for-sale securities — municipal bonds and notes	—	3,776	—	3,776
Available-for-sale securities — U.S. government agency securities	—	2,495	—	2,495
Total	\$ 48,807	\$ 687,883	\$ —	\$ 736,690

[Table of Contents](#)

The Company's financial assets measured at fair value on a recurring basis subject to the disclosure requirements at September 30, 2018, were as follows (in thousands):

	Fair Value Measurements at Reporting Date Using			Fair Value at September 30, 2018
	Quoted Prices in Active Markets for Identical Securities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash equivalents	\$ 41,468	\$ 13,118	\$ —	\$ 54,586
Short-term investments				
Available-for-sale securities — certificates of deposits	—	2,970	—	2,970
Available-for-sale securities — corporate bonds and notes	—	393,750	—	393,750
Available-for-sale securities — municipal bonds and notes	—	22,524	—	22,524
Available-for-sale securities — U.S. government securities	—	120,078	—	120,078
Available-for-sale securities — U.S. government agency securities	—	75,383	—	75,383
Long-term investments				
Available-for-sale securities — corporate bonds and notes	—	367,710	—	367,710
Available-for-sale securities — municipal bonds and notes	—	24,286	—	24,286
Available-for-sale securities — U.S. government securities	—	12,771	—	12,771
Available-for-sale securities — U.S. government agency securities	—	6,417	—	6,417
Total	\$ 41,468	\$ 1,039,007	\$ —	\$ 1,080,475

The Company uses the fair value hierarchy for financial assets and liabilities. The Company's non-financial assets and liabilities, which include goodwill, intangible assets, and long-lived assets, are not required to be carried at fair value on a recurring basis. These non-financial assets and liabilities are measured at fair value on a non-recurring basis when there is an indicator of impairment, and they are recorded at fair value only when impairment is recognized. The Company reviews goodwill and intangible assets for impairment annually, during the second quarter of each fiscal year, or as circumstances indicate the possibility of impairment. The Company monitors the carrying value of long-lived assets for impairment whenever events or changes in circumstances indicate its carrying amount may not be recoverable. During the three and nine months ended June 30, 2019 and 2018, the Company did not recognize any impairment charges related to goodwill, intangible assets, or long-lived assets.

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

5. Short-Term and Long-Term Investments

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

June 30, 2019	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Certificates of deposits	\$ 734	\$ —	\$ —	\$ 734
Corporate bonds and notes	256,471	238	(287)	256,422
Municipal bonds and notes	13,066	3	(15)	13,054
U.S. government securities	25,942	10	(23)	25,929
U.S. government agency securities	2,000	—	(2)	1,998
	\$ 298,213	\$ 251	\$ (327)	\$ 298,137

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2018				
Certificates of deposits	\$ 2,970	\$ —	\$ —	\$ 2,970
Corporate bonds and notes	394,684	9	(943)	393,750
Municipal bonds and notes	22,588	1	(65)	22,524
U.S. government securities	120,283	—	(205)	120,078
U.S. government agency securities	75,587	—	(204)	75,383
	<u>\$ 616,112</u>	<u>\$ 10</u>	<u>\$ (1,417)</u>	<u>\$ 614,705</u>

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

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2019				
Corporate bonds and notes	\$ 154,893	\$ 590	\$ (135)	\$ 155,348
Municipal bonds and notes	3,776	8	(8)	3,776
U.S. government agency securities	2,500	—	(5)	2,495
	<u>\$ 161,169</u>	<u>\$ 598</u>	<u>\$ (148)</u>	<u>\$ 161,619</u>

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2018				
Corporate bonds and notes	\$ 370,377	\$ 25	\$ (2,692)	\$ 367,710
Municipal bonds and notes	24,468	—	(182)	24,286
U.S. government securities	12,956	—	(185)	12,771
U.S. government agency securities	6,500	—	(83)	6,417
	<u>\$ 414,301</u>	<u>\$ 25</u>	<u>\$ (3,142)</u>	<u>\$ 411,184</u>

The following table summarizes investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for more than 12 months as of June 30, 2019 (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
June 30, 2019						
Corporate bonds and notes	\$ 66,064	\$ (70)	\$ 165,970	\$ (352)	\$ 232,034	\$ (422)
Municipal bonds and notes	1,105	—	10,786	(23)	11,891	(23)
U.S. government securities	—	—	12,964	(23)	12,964	(23)
U.S. government agency securities	—	—	4,492	(7)	4,492	(7)
Total	<u>\$ 67,169</u>	<u>\$ (70)</u>	<u>\$ 194,212</u>	<u>\$ (405)</u>	<u>\$ 261,381</u>	<u>\$ (475)</u>

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, 2018 (in thousands):

September 30, 2018	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds and notes	\$ 543,729	\$ (1,800)	\$ 152,097	\$ (1,835)	\$ 695,826	\$ (3,635)
Municipal bonds and notes	26,846	(123)	14,363	(124)	41,209	(247)
U.S. government securities	103,470	(281)	29,379	(109)	132,849	(390)
U.S. government agency securities	44,812	(110)	36,987	(177)	81,799	(287)
Total	\$ 718,857	\$ (2,314)	\$ 232,826	\$ (2,245)	\$ 951,683	\$ (4,559)

The Company invests in securities that are rated investment grade or better. The Company reviews the individual securities in its portfolio to determine whether a decline in a security's fair value below the amortized cost basis is other-than-temporary. The Company determined that as of June 30, 2019, there were no investments in its portfolio that were other-than-temporarily impaired.

6. Balance Sheet Details

Inventories consist of the following (in thousands):

	June 30, 2019	September 30, 2018
Finished goods	\$ 23,103	\$ 21,339
Raw materials	12,906	9,229
	\$ 36,009	\$ 30,568

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

	June 30, 2019	September 30, 2018
Prepaid expenses	\$ 82,794	\$ 39,531
Unbilled accounts receivable	51,798	—
Other	27,348	12,795
	\$ 161,940	\$ 52,326

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

	June 30, 2019	September 30, 2018
Intangible assets	\$ 113,389	\$ 31,259
Other	80,906	10,927
	\$ 194,295	\$ 42,186

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

	June 30, 2019	September 30, 2018
Deferred rent	\$ 65,526	\$ 31,151
Income taxes payable	35,655	30,864
Other	16,623	3,877
	\$ 117,804	\$ 65,892

7. Commitments and Contingencies

Guarantees and Product Warranties

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

The Company generally offers warranties of one year for hardware for those customers without service contracts, with the option of purchasing additional warranty coverage in yearly increments. The Company accrues for warranty costs as part of its cost of sales based on associated material product costs and technical support labor costs. Accrued warranty costs as of June 30, 2019 and September 30, 2018 were not considered material.

Commitments

As of June 30, 2019, the Company's principal commitments consisted of obligations outstanding under operating leases. The Company leases its facilities under operating leases that expire at various dates through 2033. There have been no material changes in the Company's lease obligations compared to those discussed in Note 7 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 7 to its annual consolidated financial statements.

Legal Proceedings

On April 4, 2016, the Company sued Radware, Inc. in the United States District Court for the Western District of Washington (the case was subsequently moved to the Northern District of California) accusing Radware of infringing three Company patents. The Company's complaint sought a jury trial and an unspecified amount of monetary damages, as well as interest, costs, and injunctive relief. Radware moved to dismiss the allegations of one patent, but the motion was denied. Radware filed inter partes review (IPR) petitions on all of the asserted Company patents, but the US Patent Office dismissed all of the petitions. Radware also filed a counterclaim asserting that the Company infringed one of its now-expired patents. The Company filed an IPR petition against Radware's counterclaim patent that resulted in cancellation of all but four of the patent's claims by the Patent Office. The Court then held that F5 does not infringe the four remaining claims. F5's claims against Radware were later dismissed pursuant to a settlement agreement, the terms of which are confidential. The settlement did not have a material impact to the Company's consolidated financial statements.

In addition to the above referenced matters, the Company is subject to other legal proceedings, claims, and litigation arising in the ordinary course of business. 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 an accrual for loss contingencies associated with the legal proceedings or the investigations discussed above.

8. Income Taxes

The effective tax rate was 20.1% and 21.3% for the three and nine months ended June 30, 2019, respectively, compared to 20.4% and 27.8% for the three and nine months ended June 30, 2018, respectively. The effective tax rate for the three and nine months ended June 30, 2019 and June 30, 2018 includes various impacts from the Tax Cuts and Jobs Act enacted on December 22, 2017. Significant impacts for the three and nine months ended June 30, 2019 include a further reduction in the U.S. federal income tax rate to 21%, a deduction for foreign derived intangible income, a tax on global intangible low taxed income, and repeal of the deduction for income attributable to domestic production activities. The nine months ended June 30, 2018 included one-time charges for the deemed repatriation of undistributed foreign earnings, and for the remeasurement of the Company's net deferred tax assets to reflect the change in the U.S. federal income tax rate when temporary differences are expected to reverse.

At June 30, 2019, the Company had \$35.8 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, 2015. Major jurisdictions where there are wholly owned subsidiaries of F5 Networks, Inc. which require income tax filings include the United Kingdom, Japan, Singapore, Australia, and Israel. The earliest periods open for review by local taxing authorities are fiscal years 2017 for the United Kingdom, 2013 for Japan, 2014 for Singapore, 2015 for Australia, and 2013 for Israel. The Company is currently under audit by the IRS for fiscal year 2016, by various states for fiscal years 2014 through 2017, and by Israel for fiscal years 2013 to 2017. Within the next four fiscal quarters, the statute of limitations will begin to close on the fiscal year 2016 federal income tax return, fiscal years 2014, 2015 and 2016 state income tax returns, and fiscal years 2013 to 2017 foreign income tax returns.

9. Geographic Sales and Significant Customers

Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources and in assessing performance. 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.

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.

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

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018	2019	2018
Americas:				
United States	\$ 273,273	\$ 275,011	\$ 820,061	\$ 805,594
Other	27,429	30,453	79,697	87,359
Total Americas	300,702	305,464	899,758	892,953
EMEA	132,806	130,821	418,339	406,712
Asia Pacific ¹	129,886	105,918	333,962	299,033
	\$ 563,394	\$ 542,203	\$ 1,652,059	\$ 1,598,698

- (1) Beginning with the first quarter of fiscal 2019, revenue from Japan is now included with the APAC region. This change has been applied to all periods presented for comparability purposes.

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

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018	2019	2018
Ingram Micro, Inc.	17.8%	16.9%	18.2%	16.3%
Tech Data	10.8%	11.0%	10.2%	11.8%
Arrow ECS ¹	—	10.5%	10.3%	10.9%
Synnex Corporation ¹	—	11.4%	—	11.2%
Westcon Group, Inc.	10.0%	10.1%	10.3%	10.4%

- (1) Arrow ECS accounted for under 10% of total net revenue for the three months ended June 30, 2019. Synnex Corporation accounted for under 10% of total net revenue for the three and nine months ended June 30, 2019.

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

	June 30, 2019	September 30, 2018
United States	\$ 198,902	\$ 126,790
EMEA	12,405	12,538
Other countries	14,695	5,714
	\$ 226,002	\$ 145,042

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 global provider of application services designed to ensure the fast, secure and reliable delivery of applications and data in multi-cloud environments and data centers. Our products include hardware-based software, software-only solutions, cloud-based services and managed service offerings that accelerate, optimize, secure and improve application performance for all types of deployment scenarios. 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.

On May 8, 2019, the Company completed the acquisition of Nginx, the open source leader in application delivery for modern applications. The combined company will enable multi-cloud application services across all environments, providing the ease-of-use and flexibility developers require while also delivering the scale, security, reliability and enterprise readiness network operations teams demand.

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); and the WebSafe, MobileSafe, Secure Web Gateway and Silverline DDoS and Application security offerings which are sold to customers on a subscription basis. We also derive revenues from the sales of services including annual maintenance contracts, training and consulting services. We carefully monitor the sales mix of our revenues within each reporting period. We believe customer acceptance rates of our new products and feature enhancements are indicators of future trends. We also consider overall revenue concentration by customer and by geographic region as additional indicators of current and future trends.
- *Cost of revenues and gross margins.* We strive to control our cost of revenues and thereby maintain our gross margins. Significant items impacting cost of revenues are hardware costs paid to our contract manufacturers, third-party software license fees, Silverline infrastructure, amortization of developed technology and personnel and overhead expenses. Our margins have remained relatively stable; however, factors such as sales price, product and services mix, inventory obsolescence, returns, component price increases and warranty costs could significantly impact our gross margins from quarter to quarter and represent significant indicators we monitor on a regular basis.
- *Operating expenses.* Operating expenses are substantially driven by personnel and related overhead expenses. Existing headcount and future hiring plans are the predominant factors in analyzing and forecasting future operating expense trends. Other significant operating expenses that we monitor include marketing and promotions, travel, professional fees, computer costs related to the development of new products and provision of services, facilities and depreciation expenses.
- *Liquidity and cash flows.* Our financial condition remains strong with significant cash and investments and no long term debt. The decrease in cash and investments for the first nine months of fiscal year 2019 was primarily due to \$611.6 million in cash paid for the acquisition of Nginx in the third quarter of fiscal 2019, partially offset by cash provided by operating activities of \$541.8 million. Going forward, we believe the primary driver of cash flows will be net income from operations. Capital expenditures of \$83.0 million for the first nine months of fiscal year 2019 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.
- *Balance sheet.* We view cash, short-term and long-term investments, deferred revenue, accounts receivable balances and days sales outstanding as important indicators of our financial health. Deferred revenues increased in the third quarter of fiscal year 2019 primarily due to growth in the amount of annual maintenance contracts purchased on new products and maintenance renewal contracts related to our existing product installation base. Our days sales outstanding for the third quarter of fiscal year 2019 was 51.

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 and accounting for income taxes.

We adopted the new revenue recognition accounting standard (ASC 606) effective October 1, 2018 on a modified retrospective basis. For more information, refer to the "Revenue Recognition" and "Recently Adopted Accounting Standards" sections of Note 1 and Note 2 - Revenue from Contracts with Customers. There were no other 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, 2018. Actual results may differ from these estimates under different assumptions or conditions.

Results of Operations

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

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018	2019	2018
(in thousands, except percentages)				
Net Revenues				
Products	\$ 248,929	\$ 238,835	\$ 720,665	\$ 703,696
Services	314,465	303,368	931,394	895,002
Total	\$ 563,394	\$ 542,203	\$ 1,652,059	\$ 1,598,698
Percentage of net revenues				
Products	44.2%	44.0%	43.6%	44.0%
Services	55.8	56.0	56.4	56.0
Total	100.0%	100.0%	100.0%	100.0%

Net revenues. Total net revenues increased 3.9% and 3.3% for the three and nine months ended June 30, 2019, respectively, from the comparable periods in the prior year. Overall revenue growth for the three and nine months ended June 30, 2019, was primarily due to increased software revenue including our subscription based products and increased service revenues as a result of our increased installed base of products. International revenues represented 51.5% and 50.4% of total net revenues for the three and nine months ended June 30, 2019, respectively, compared to 49.3% and 49.6% for the same periods in the prior year, respectively.

Net product revenues increased 4.2% and 2.4% for the three and nine months ended June 30, 2019, respectively, from the comparable periods in the prior year. The increase in net product revenues for the nine months ended June 30, 2019 was primarily due to an increase in software sales compared to the same period in the prior year.

Net service revenues increased 3.7% and 4.1% for the three and nine months ended June 30, 2019, respectively, from the comparable periods in the prior year. The increase in net service revenues was primarily due to increases in the purchase or renewal of maintenance contracts driven by additions to our installed base of products.

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

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018	2019	2018
Ingram Micro, Inc.	17.8%	16.9%	18.2%	16.3%
Tech Data	10.8%	11.0%	10.2%	11.8%
Arrow ECS ¹	—	10.5%	10.3%	10.9%
Synnex Corporation ¹	—	11.4%	—	11.2%
Westcon Group, Inc.	10.0%	10.1%	10.3%	10.4%

(1) Arrow ECS accounted for under 10% of total net revenue for the three months ended June 30, 2019. Synnex Corporation accounted for under 10% of total net revenue for the three and nine months ended June 30, 2019.

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

	June 30, 2019	September 30, 2018
Ingram Micro, Inc.	15.5%	16.6%
Westcon Group, Inc.	10.0%	—
Arrow ECS	—	—
Synnex Corporation	—	10.3%

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

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018	2019	2018
(in thousands, except percentages)				
Cost of net revenues and Gross Margin				
Products	\$ 44,336	\$ 45,164	\$ 130,293	\$ 132,556
Services	46,431	45,845	135,366	135,485
Total	90,767	91,009	265,659	268,041
Gross profit	\$ 472,627	\$ 451,194	\$ 1,386,400	\$ 1,330,657
Percentage of net revenues and Gross Margin (as a percentage of related net revenue)				
Products	17.8%	18.9%	18.1%	18.8%
Services	14.8	15.1	14.5	15.1
Total	16.1	16.8	16.1	16.8
Gross profit	83.9%	83.2%	83.9%	83.2%

Cost of net product revenues . Cost of net product revenues consist of finished products purchased from our contract manufacturers, manufacturing overhead, freight, warranty, provisions for excess and obsolete inventory and amortization expenses in connection with developed technology from acquisitions. Cost of net product revenues decreased 1.8% and 1.7% for the three and nine months ended June 30, 2019 , respectively, from the comparable periods in the prior year. The decrease in cost of net product revenues for the three months ended June 30, 2019 is primarily due to a change in product mix.

Cost of net service revenues . Cost of net service revenues consist of the salaries and related benefits of our professional services staff, travel, facilities and depreciation expenses. For the three and nine months ended June 30, 2019 , cost of net service revenues as a percentage of net service revenues was 14.8% and 14.5% , respectively, compared to 15.1% and 15.1% for the comparable periods in the prior year, respectively. The decrease in cost of net service revenues as a percentage of net service revenues is primarily due to the scalability of our existing customer support infrastructure and increased revenue from maintenance contracts. Professional services headcount at the end of June 2019 increased to 926 from 906 at the end of June 2018 . In addition, cost of net service revenues included stock-based compensation expense of \$4.6 million and \$13.6 million for the three and nine months ended June 30, 2019 , respectively, compared to \$4.4 million and \$14.2 million for the same periods in the prior year, respectively.

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018	2019	2018
(in thousands, except percentages)				
Operating expenses				
Sales and marketing	\$ 195,852	\$ 165,806	\$ 531,065	\$ 503,710
Research and development	116,894	94,061	305,246	271,006
General and administrative	57,141	39,374	146,340	118,634
Total	<u>\$ 369,887</u>	<u>\$ 299,241</u>	<u>\$ 982,651</u>	<u>\$ 893,350</u>
Operating expenses (as a percentage of net revenue)				
Sales and marketing	34.8%	30.6%	32.1%	31.5%
Research and development	20.7	17.3	18.5	17.0
General and administrative	10.2	7.3	8.9	7.4
Total	<u>65.7%</u>	<u>55.2%</u>	<u>59.5%</u>	<u>55.9%</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 18.1% and 5.4% for the three and nine months ended June 30, 2019, respectively, from the comparable periods in the prior year. The increase in sales and marketing expense was primarily due to an increase of \$15.8 million and \$15.7 million in personnel costs for the three and nine months ended June 30, 2019, respectively, from the comparable periods in the prior year. In addition, facilities costs for our Sales and Marketing organization increased \$2.9 million and \$3.7 million for the three and nine months ended June 30, 2019, respectively, from the comparable periods in the prior year, primarily due to the move of our corporate headquarters which began in April 2019. Sales and marketing headcount at the end of June 2019 increased to 2,092 from 1,721 at the end of June 2018. Sales and marketing expense included stock-based compensation expense of \$17.8 million and \$49.6 million for the three and nine months ended June 30, 2019, respectively, compared to \$16.2 million and \$47.2 million for the same periods in the prior year, respectively.

Research and development. Research and development expenses consist of the salaries and related benefits of our product development personnel, prototype materials and other expenses related to the development of new and improved products, facilities and depreciation expenses. Research and development expenses increased 24.3% and 12.6% for the three and nine months ended June 30, 2019, respectively, from the comparable periods in the prior year. The increase in research and development expense was primarily due to an increase of \$17.9 million and \$19.7 million in personnel costs for the three and nine months ended June 30, 2019, respectively, from the comparable periods in the prior year. In addition, facilities costs increased \$4.5 million and \$6.6 million for the three and nine months ended June 30, 2019, respectively, from the comparable periods in the prior year, primarily due to the move of our corporate headquarters which began in April 2019. Research and development headcount at the end of June 2019 increased to 1,492 from 1,284 at the end of June 2018. Research and development expense included stock-based compensation expense of \$10.0 million and \$30.6 million for the three and nine months ended June 30, 2019, respectively, compared to \$11.5 million and \$36.4 million for the same periods in the prior year, respectively.

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 45.1% and 23.4% for the three and nine months ended June 30, 2019, respectively, from the comparable periods in the prior year. The increase in general and administrative expense was primarily due to an increase of \$7.8 million and \$13.6 million in fees paid to outside consultants for legal, accounting and tax services for the three and nine months ended June 30, 2019, respectively, from the comparable periods in the prior year. Fees paid to outside consultants for the three and nine months ended June 30, 2019 were primarily related to the acquisition of Nginx. General and administrative headcount at the end of June 2019 increased to 581 from 467 at the end of June 2018. General and administrative expense included stock-based compensation expense of \$8.1 million and \$23.8 million for the three and nine months ended June 30, 2019, compared to \$6.1 million and \$21.4 million for the same periods in the prior year, respectively.

	Three months ended June 30,		Nine months ended June 30,	
	2019	2018	2019	2018
(in thousands, except percentages)				
Other income and income taxes				
Income from operations	\$ 102,740	\$ 151,953	\$ 403,749	\$ 437,307
Other income, net	4,722	2,259	19,251	7,194
Income before income taxes	107,462	154,212	423,000	444,501
Provision for income taxes	21,557	31,469	90,103	123,693
Net income	\$ 85,905	\$ 122,743	\$ 332,897	\$ 320,808
Other income and income taxes (as percentage of net revenue)				
Income from operations	18.2%	28.0%	24.4%	27.4%
Other income, net	0.8	0.4	1.2	0.4
Income before income taxes	19.0	28.4	25.6	27.8
Provision for income taxes	3.8	5.8	5.5	7.7
Net income	15.2%	22.6%	20.1%	20.1%

Other income, net. Other income, net consists primarily of interest income and foreign currency transaction gains and losses. The increase in other income, net for the three and nine months ended June 30, 2019 was primarily due to increased interest income from our investments, as well as foreign currency gains, compared to the same periods in the prior year.

Provision for income taxes. The effective tax rate was 20.1% and 21.3% for the three and nine months ended June 30, 2019, respectively, compared to 20.4% and 27.8% for the three and nine months ended June 30, 2018, respectively. The decrease in the effective tax rate for the three and nine months ended June 30, 2019 is primarily due to the impact of a further reduction in the U.S. federal income tax rate to 21% and the initial effective date of other U.S. tax reform provisions, partially offset by a decrease in excess tax benefit related to stock compensation, as compared to the three and nine months ended June 30, 2018. The effective tax rate for the nine months ended June 30, 2018 included one-time charges for the deemed repatriation of undistributed foreign earnings, and a remeasurement of the Company's net deferred tax assets.

We record a valuation allowance to reduce our deferred tax assets to the amount we believe is more likely than not to be realized. In making these determinations we consider historical and projected taxable income, and ongoing prudent and feasible tax planning strategies in assessing the appropriateness of a valuation allowance. Our net deferred tax assets at June 30, 2019 and September 30, 2018 were \$24.7 million and \$33.4 million, respectively. The net deferred tax assets include valuation allowances of \$23.4 million and \$22.8 million as of June 30, 2019 and September 30, 2018, respectively, which are primarily related to tax net operating losses incurred in certain foreign jurisdictions, and state tax carryforwards.

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

Liquidity and Capital Resources

Cash and cash equivalents, short-term investments and long-term investments totaled \$1,148.1 million as of June 30, 2019, compared to \$1,450.6 million as of September 30, 2018, representing a decrease of \$302.5 million. The decrease was primarily due to \$611.6 million in cash paid for the acquisition of Nginx in the third quarter of fiscal 2019, partially offset by cash provided by operating activities of \$541.8 million for the nine months ended June 30, 2019. Cash provided by operating activities for the first nine months of fiscal year 2019 resulted from net income of \$332.9 million combined with changes in operating assets and liabilities, as adjusted for various non-cash items including stock-based compensation, deferred revenue, depreciation and amortization charges. Based on our current operating and capital expenditure forecasts, we believe that our existing cash and investment balances, together with cash generated from operations should be sufficient to meet our operating requirements for at least the next twelve months.

Cash used in investing activities was \$120.6 million for the nine months ended June 30, 2019, compared to cash used in investing activities of \$227.9 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 used in investing activities for the nine months ended June 30, 2019 was primarily the result of \$611.6 million in cash paid for the acquisition of Nginx, along with capital expenditures related to the build-out of our new corporate headquarters and the purchase of investments, partially offset by the maturity and sale of investments.

Cash used in financing activities was \$155.6 million for the nine months ended June 30, 2019, compared to cash used in financing activities of \$401.2 million for the same period in the prior year. Our financing activities for the nine months ended June 30, 2019 consisted of cash required for the repurchase of outstanding common stock under our stock repurchase program of \$201.0 million, partially offset by cash received from the exercise of employee stock options and stock purchases under our employee stock purchase plan of \$45.5 million.

Obligations and Commitments

As of June 30, 2019, our principal commitments consisted of obligations outstanding under operating leases. 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, 2018.

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 June 30, 2019. We monitor our interest rate and credit risks, including our credit exposures to specific rating categories and to individual issuers. As of June 30, 2019, 6.6% 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.

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 nine month period ended June 30, 2019, compared to those discussed in our Annual Report on Form 10-K for the year ended September 30, 2018.

Item 4. Controls and Procedures

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

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2019. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of June 30, 2019.

Changes in Internal Control over Financial Reporting

On May 8, 2019, we completed the acquisition of Nginx. We are in the process of integrating Nginx into our systems and control environment. We believe that we have taken the necessary steps to monitor and maintain appropriate internal control over financial reporting during this integration.

There were no changes in our internal control over financial reporting during the three months ended June 30, 2019, which were identified in connection with management's evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

PART II — OTHER INFORMATION**Item 1. Legal Proceedings**

See Note 7 - 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, 2018, which was filed with the Securities and Exchange Commission on November 21, 2018.

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 new 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 or open market purchases as permitted by securities laws and other legal requirements. For the nine months ended June 30, 2019, the Company repurchased and retired 1,185,881 shares at an average price of \$169.53 per share and the Company had \$1.4 billion remaining authorized to purchase shares at June 30, 2019.

In the second quarter of fiscal 2019, the Company announced that, in connection with its acquisition of Nginx, it was suspending the automatic component of its common stock share repurchase program. Management will continue to evaluate market conditions and other factors including the Company's capital requirements in determining when and whether to repurchase shares and when and whether to re-implement an automatic component to its repurchase program. The program does not require the purchase of any minimum number of shares and the program may be modified, suspended or discontinued at any time.

Shares repurchased and retired as of June 30, 2019 are as follows (in thousands, except shares and per share data):

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased per the Publicly Announced Plan	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plan
October 1, 2018 — October 31, 2018	—	\$ —	—	\$ 1,573,571
November 1, 2018 — November 30, 2018	561,951	\$ 177.97	561,951	\$ 1,473,560
December 1, 2018 — December 31, 2018	6,807	\$ 150.01	6,807	\$ 1,472,539
January 1, 2019 — January 31, 2019	617,123	\$ 162.06	617,123	\$ 1,372,527
February 1, 2019 — February 28, 2019	—	\$ —	—	\$ 1,372,527
March 1, 2019 — March 31, 2019	—	\$ —	—	\$ 1,372,527
April 1, 2019 — April 30, 2019	—	\$ —	—	\$ 1,372,527
May 1, 2019 — May 31, 2019	—	\$ —	—	\$ 1,372,527
June 1, 2019 — June 30, 2019	—	\$ —	—	\$ 1,372,527

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

<u>Exhibit Number</u>	<u>Exhibit Description</u>
10.1* —	F5 Networks, Inc. Nginx Acquisition Equity Incentive Plan Award Agreement (Accelerated Vesting)
31.1* —	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2* —	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1* —	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS* —	XBRL Instance Document - 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

* 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 2nd day of August, 2019 .

F5 NETWORKS, INC.

By: /s/ FRANCIS J. PELZER

Francis J. Pelzer

Executive Vice President,

Chief Financial Officer

(principal financial officer and principal accounting officer)

F5 NETWORKS, INC.
NGINX ACQUISITION EQUITY INCENTIVE PLAN
AWARD AGREEMENT
(Accelerated Vesting)

Pursuant to the terms of its Nginx Acquisition Equity Incentive Plan (the “Plan”), F5 Networks, Inc., a Washington corporation (the “Company”), has granted you an award (the “Award”) (either a non-statutory stock option to purchase shares of the Company’s Common Stock (an “Option”) or stock units representing the right to receive shares of the Company’s Common Stock (“Stock Units”) as set forth in the Notice of Grant of Stock Options or Stock Units (the “Grant Notice”)) on the terms and conditions as set forth in this Nginx Acquisition Equity Incentive Plan Award Agreement (this “Agreement”), the Grant Notice (which is incorporated herein by reference) and the Plan (which is incorporated herein by reference). Capitalized terms used but not defined in this Agreement shall have the meanings specified in the Plan.

IN CONSIDERATION OF THE MUTUAL PROMISES SET FORTH BELOW, THE PARTIES AGREE AS FOLLOWS:

1. **Grant of Award; Grant Date** . The Company has granted you an Award to purchase (in the case of an Option) or to be issued (in the case of Stock Units) the total number of shares of Common Stock of the Company as set forth in the Grant Notice (the “Award Shares”) on the terms and conditions set forth in this Agreement, the Grant Notice and the Plan, including in the case of an Option at the exercise price per share of Common Stock set forth in the Grant Notice (the “Award Price”). The number and kind of Award Shares and the Award Price may be adjusted in certain circumstances in accordance with Section 11 of the Plan.

2. **Vesting and Exercise or Settlement of Stock** .

2.1. Options .

(a) The Option will vest and become exercisable during its term in accordance with the vesting schedule set forth in the Grant Notice and with the applicable provisions of the Plan and this Agreement. Vesting will cease upon the termination of your Continuous Service except as otherwise set forth in the Plan or this Agreement.

(b) The vested and exercisable portion of the Option may be exercised during its term (as set forth in Section 6) electronically as directed by the Company or by delivering a Notice of Exercise (in a form designated by the Company), together with the Award Price (payable in the manner set forth in Section 3) to the Secretary of the Company, or to such other person as the Company may designate, during regular business hours, together with such additional documents as the Company may then require.

(c) By exercising the Option, you agree that, as a condition to any exercise of the Option, the Company may require you to enter into an arrangement providing for the payment by you to the Company of any tax withholding obligation of the Company arising by reason of (1) the exercise of the Option or (2) the disposition of shares acquired upon such exercise.

2.2. Stock Units . The Stock Units will be settled as to the number of shares vesting on each date that Stock Units vest (a “Vesting Date”) as soon as practicable after such Vesting Date, meaning that the Company will (subject to your obligations to satisfy the requirements of Sections 5 and 9) issue to you as soon as practicable after such Vesting Date the number of shares vesting on such Vesting Date and the Award will thereafter remain in effect only as to the number of unvested shares of Common Stock remaining subject thereto.

2.3. Accelerated Vesting . Notwithstanding the vesting provisions set forth in the Grant Notice and in lieu of Section 11(c) of the Plan, in the event of a “Change of Control” as defined in the Change of Control Agreement form filed with the Securities and Exchange Commission by the Company on May 4, 2009 as an exhibit to the Company’s Form 8-K (“Change of Control”), the vesting of 100% of the shares of Common Stock subject to the Award (and if applicable, the time during which the Award may be exercised or settled) shall be accelerated in full, and to the extent the Award is not continued in connection with the Change of Control because it is either not assumed or not substituted for similar awards of a surviving or acquiring entity, the Award shall terminate if not exercised at or prior to the closing of the Change of Control provided an opportunity to exercise the Award (or a cashout of the Award for the excess of the fair market value reflecting the Change of Control over the exercise price) has been provided.

3. **Method of Payment of the Option Award Price** . Payment of the Award Price is due in full upon exercise of all or any part of the Option. You may elect to make payment of the Award Price by any of the methods, or combination thereof, described in the Plan, provided that the Board may, in its sole discretion, refuse to accept a particular form of consideration at the time of exercise of any Option, or agree to accept any other form of legal consideration.

4. **Whole Shares** . The Award may only be exercised or settled for whole shares.

5. **Compliance with Law** . Notwithstanding anything to the contrary contained herein, the Award may not be exercised or settled unless the shares issuable upon exercise or settlement of the Award are then registered under the Securities Act or, if such shares are not then so registered, the Company has determined that such exercise and issuance would be exempt from the registration requirements of the Securities Act. The exercise or settlement of the Award must also comply with other applicable laws and regulations governing the Award. In addition, unless there is an exemption from any registration, qualification or other legal requirement applicable to the shares of Common Stock, the Company shall not be required to deliver any shares issuable upon exercise or settlement of the Award prior to the completion of any registration, qualification or approval of the shares with any governmental regulatory body, or any non-U.S. or U.S. local, state or federal governmental agency, which registration, qualification or approval the Company shall, in its absolute discretion, deem necessary or advisable. The Award may not be exercised or settled, and the Company will have no liability for failure to issue shares of Common Stock upon exercise or settlement of the Award, if the Company determines that the exercise or settlement would not be in material compliance with such laws and regulations.

6. **Term and Termination of Award** .

6.1. **Options** . Subject to earlier termination as required under Section 10 or 11 of the Plan, the term of the Option commences on the Grant Date and expires upon the *earliest* of the following:

(a) three (3) months after the termination of your Continuous Service for any reason other than death or Disability, provided that if during any part of such three-month period the Option is not exercisable solely because of the condition set forth in Section 5, the Option shall not expire until the earlier of the Expiration Date or until it shall have been exercisable for an aggregate period of three (3) months after the termination of your Continuous Service;

(b) twelve (12) months after the termination of your Continuous Service due to Disability;

(c) eighteen (18) months after your death if you die either during your Continuous Service or within three (3) months after your Continuous Service terminates for reason other than Cause;

(d) the Expiration Date indicated in the Grant Notice; or

(e) the tenth (10th) anniversary of the Grant Date.

6.2. **Stock Units** . In the event your Continuous Service terminates, any Stock Units and the shares of Common Stock subject thereto (that have not vested on or before the termination of your Continuous Service) shall be forfeited.

6.3. **Continuous Service** . For purposes of the Award, your Continuous Service will be considered terminated as of the date you are no longer actively providing services to the Company or one of its Affiliates (regardless of the reason for such termination and whether or not later found to be invalid or in breach of employment laws in the jurisdiction where you are providing services or the terms of your employment agreement, if any), and your right to vest in the Award under the Plan, if any, will terminate as of such date and will not be extended by any notice period (e.g., your Continuous Service would not include any contractual notice period or any period of “garden leave” or similar period mandated under employment laws in the jurisdiction where you are providing services or the terms of your employment agreement, if any); the Board shall have the exclusive discretion to determine when you are no longer actively providing services for purposes of your Award (including whether you may still be considered to be providing services while on a leave of absence).

7. **Transferability** . The Award is not transferable, except by will or by the laws of descent and distribution. Options are exercisable during your life only by you. Shares of Common Stock issued upon vesting of a Stock Unit are issuable during your life only to you.

8. **Not a Service Contract** . This Agreement is not an employment or service contract, and nothing in this Agreement shall be deemed to create in any way whatsoever any obligation on your part to continue in the employ of the Company or an Affiliate, or of the Company or an Affiliate to continue your employment. In addition, nothing in this Agreement shall obligate the Company or an Affiliate, their respective shareholders, Board, officers or employees to continue any relationship that you might have as a director or consultant for the Company or an Affiliate.

9. **Withholding Obligations** .

9.1. At the time the Option is exercised, in whole or in part, or shares of Common Stock are issued upon settlement of Stock Units or at any relevant tax withholding event, you hereby authorize withholding from payroll and any other amounts

payable to you, or otherwise agree to make adequate provision for (including by means of a “cashless exercise” pursuant to a program developed under Regulation T as promulgated by the Federal Reserve Board to the extent permitted by the Company or a mandatory sale to cover taxes program), any sums required to satisfy non-U.S. and U.S. federal, state and local tax withholding obligations of the Company or an Affiliate, which arise in connection with the Award.

9.2. The Option is not exercisable and shares of Common Stock are not issuable upon settlement of Stock Units unless the tax withholding obligations of the Company or any Affiliate are satisfied. Accordingly, you may not be able to exercise the Option or receive shares of Common Stock upon settlement of Stock Units even though the Award is vested.

10. **Sell to Cover; Aggregation of Sale Orders** . In a sale of shares of Common Stock to cover tax withholding obligations, you understand that such sales will be made through E*TRADE Financial Services, Inc. or such other stock plan service provider as may be selected by the Company in the future. With respect to each customer for whose account there is entered a “sell” order at roughly the same point in time, E*TRADE Financial Services, Inc. or such other stock plan service provider, may execute such trades at different prices over a period of time, which may include multiple trading days, in which case it may, but is not required to, aggregate the proceeds of all such trades and credit each customer’s account to reflect the average price obtained over that period of time, rather than at the potentially higher or lower price obtained with respect to the sale of a specific share of Common Stock of the Company. You hereby acknowledge this protocol and consent to such aggregation of your sale order and such crediting of your account with the average price obtained during the relevant period of time.

11. **Professional Advice** . The acceptance and exercise or settlement of the Award and the sale of Award Shares has consequences under non-U.S. and U.S. federal and state tax and securities laws which may vary depending upon your individual circumstances. Accordingly, you acknowledge that you have been advised to consult your personal legal and tax advisor in connection with this Agreement and your dealings with respect to the Award and the Award Shares. You further acknowledge that the Company has made no warranties or representations to you with respect to the tax consequences of the grant and exercise or settlement of the Award or the sale of the Award Shares and you are in no manner relying on the Company or its representatives for an assessment of such consequences.

12. **Governing Plan Document** . Your Award is subject to all applicable provisions of the Plan, which are hereby made a part of your Award, and is further subject to all interpretations, amendments, rules and regulations which may from time to time be promulgated and adopted pursuant to the Plan. In the event of any conflict between the provisions of your Award and those of the Plan, the provisions of the Plan shall control.

13. **Damages** . You shall be liable to the Company for all costs and damages, including incidental and consequential damages, resulting from a disposition of Award Shares which is not in conformity with the provisions of this Agreement.

14. **Governing Law and Venue** . This Agreement shall be governed by, and construed in accordance with, the laws of the State of Washington excluding those laws that direct the application of the laws of another jurisdiction. For purposes of any action, lawsuit or other proceedings brought to enforce this Agreement, relating to it, or arising from it, the parties hereby submit to and consent to the sole and exclusive jurisdiction of the courts of King County, Washington, or the federal courts for the United States for the Western District of Washington, and no other courts, where your Award is made and/or to be performed.

15. **Electronic Delivery and Acceptance**. The Company may, in its sole discretion, decide to deliver any documents related to current or future participation in the Plan by electronic means. You hereby consent to receive such documents by electronic delivery and agree to participate in the Plan through an on-line or electronic system established and maintained by the Company or a third party designated by the Company.

16. **Severability**. The provisions of this Agreement are severable and if any one or more provisions are determined to be illegal or otherwise unenforceable, in whole or in part, the remaining provisions shall nevertheless be binding and enforceable.

17. **Imposition of Other Requirements**. The Company reserves the right to impose other requirements on your participation in the Plan, the Award and on any shares of Common Stock acquired under the Plan, to the extent the Company determines it is necessary or advisable for legal or administrative reasons, and to require you to sign any additional agreements or undertakings that may be necessary to accomplish the foregoing.

18. **Notices** . All notices and other communications under this Agreement shall be in writing. Unless and until you are notified in writing to the contrary, all notices, communications, and documents directed to the Company and related to the Agreement, if not delivered by hand, shall be mailed, addressed as follows:

F5 Networks, Inc.
401 Elliott Ave West

Unless and until the Company is notified in writing to the contrary, all notices, communications, and documents intended for you and related to this Agreement, if not delivered by hand, shall be mailed to your last known address as shown on the Company's books. Notices and communications shall be mailed by first class mail, postage prepaid. All mailings and deliveries related to this Agreement shall be deemed received when actually received, if by hand delivery, and five (5) business days after mailing, if by mail.

19. **Amendment of this Agreement** . The Board at any time, and from time to time, may amend the terms of this Agreement; provided, however, that the rights under this Agreement shall not be impaired by any such amendment unless (i) the Company requests your consent and (ii) you consent in writing; provided, however, that the Company may amend the terms of the Agreement without your consent pursuant to Section 17 hereof, if it determines that such amendment is necessary for legal reasons.

20. **Non-U.S. Participants** . Notwithstanding any provisions in this Agreement, if you are a resident or citizen of, or are working in, a country outside the United States at any time during the life of the Award, your participation in the Plan shall be subject to such special terms and conditions for your country as the Company determines. Moreover, if you transfer residence and/or employment to, or are considered a citizen or resident for local law purposes of, a country outside the United States, the special terms and conditions for such country will apply to you, to the extent the Company determines that the application of such terms and conditions is necessary or advisable for legal or administrative reasons.

21. **Waiver** . You acknowledge that a waiver by the Company of breach of any provision of this Agreement shall not operate or be construed as a waiver of any other provision of this Agreement, or of any subsequent breach by you or any other Participant.

22. **Insider Trading Restrictions/Market Abuse Laws** . You acknowledge that you may be subject to insider trading restrictions and/or market abuse laws in applicable jurisdictions, including the United States and, if different, your country, your broker's country or the country where the shares of Common Stock are listed, which may affect your ability to accept or otherwise acquire, or sell, attempt to sell or otherwise dispose of, shares of Common Stock or rights to shares of Common Stock (*e.g.* , Stock Units) under the Plan or rights linked to the value of the shares of Common Stock during such times as you are considered to have "inside information" regarding the Company (as defined by the laws or regulations in the applicable jurisdiction) or the trade in shares of Common Stock or the trade in rights to shares of Common Stock under the Plan. Local insider trading laws and regulations may prohibit the cancellation or amendment of orders you place before you possessed inside information. Furthermore, you could be prohibited from (i) disclosing the inside information to any third party (other than on a "need to know" basis) and (ii) "tipping" third parties or otherwise causing them to buy or sell securities: keeping in mind that the term "third parties" includes fellow employees. Any restrictions under these laws or regulations may be separate from and in addition to any restrictions that may be imposed under any applicable Company insider trading policy. You acknowledge that it is your responsibility to comply with any applicable restrictions, and you should speak to your personal advisor on this matter.

CERTIFICATIONS

I, François Locoh-Donou, certify that:

- 1) I have reviewed this Quarterly Report on Form 10-Q of F5 Networks, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal controls over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal controls over financial reporting; and
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting, which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 2, 2019

/s/ FRANÇOIS LOCOH-DONOU

François Locoh-Donou
Chief Executive Officer and President

CERTIFICATIONS

I, Francis J. Pelzer, certify that:

- 1) I have reviewed this Quarterly Report on Form 10-Q of F5 Networks, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal controls over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal controls over financial reporting; and
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting, which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date:

August 2, 2019

/s/ FRANCIS J. PELZER

Francis J. Pelzer

Executive Vice President,

Chief Financial Officer

(principal financial officer and principal accounting officer)

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of F5 Networks, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, François Locoh-Donou, President and Chief Executive Officer and Francis J. Pelzer, Executive Vice President and Chief Financial Officer (principal financial officer and principal accounting officer) of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 2, 2019

/s/ FRANÇOIS LOCOH-DONOU

François Locoh-Donou
Chief Executive Officer and President

/s/ FRANCIS J. PELZER

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

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