EXTREME NETWORKS INC
Form 10-Q
May 06, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

Form 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 29, 2009

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 000-25711

EXTREME NETWORKS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**77-0430270**
[State or other jurisdiction	**[I.R.S Employer Identification No.]**
of incorporation or organization]	
3585 Monroe Street,	
Santa Clara, California	**95051**
[Address of principal executive office]	**[Zip Code]**

Registrant s telephone number, including area code: (408) 579-2800

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate 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 (§ 229.405 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, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer x	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

The number of shares of the Registrant s Common Stock, $.001 par value, outstanding at

April 30, 2009 was 88,795,565.

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FORM 10-Q

QUARTERLY PERIOD ENDED MARCH 29, 2009

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EXTREME NETWORKS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share amounts)

	March 29, 2009 (unaudited)	June 29, 2008 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 38,595	$ 70,370
Short-term investments	4,510	42,922
Accounts receivable, net	43,588	64,417
Inventories, net	22,752	13,942
Deferred income taxes	289	254
Prepaid expenses and other current assets, net	4,823	4,654
Total current assets	114,557	196,559
Property and equipment, net	43,204	43,348
Marketable securities	77,708	112,380
Other assets, net	13,388	13,474
Total assets	$ 248,857	$ 365,761
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 15,414	$ 16,921
Accrued compensation and benefits	11,633	18,956
Restructuring liabilities	4,459	2,612
Accrued warranty	3,193	4,824
Deferred revenue, net	32,171	31,284
Deferred revenue, net of cost of sales to distributors	12,445	14,138
Other accrued liabilities	18,254	27,728
Total current liabilities	97,569	116,463
Restructuring liabilities, less current portion	4,329	6,777
Deferred revenue, less current portion	7,604	9,006
Deferred income taxes	562	403
Other long-term liabilities	693	1,058
Commitments and contingencies (Note 3)		
Stockholders equity:		
Convertible preferred stock, $.001 par value, issuable in series, 2,000,000 shares authorized; none issued		
Common stock, $.001 par value, 750,000,000 shares authorized; 128,261,067 issued at March 29, 2009 (127,358,570 June 29, 2008) and capital in excess of par value	128	127
Treasury stock, 39,625,305 shares at March 29, 2009 (11,053,877 June 29, 2008)	(149,665)	(48,303)
Additional paid-in-capital	947,644	943,156
Accumulated other comprehensive income (loss)	264	(723)
Accumulated deficit	(660,271)	(662,203)
Total stockholders equity	138,100	232,054
Total liabilities and stockholders equity	$ 248,857	$ 365,761

(1) The information in this column is derived from the Company s consolidated balance sheet included in the Company s Annual Report on Form 10-K for the year ended June 29, 2008.

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EXTREME NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(unaudited)

	Three Months Ended		Nine Months Ended	
	March 29, 2009	March 30, 2008	March 29, 2009	March 30, 2008
Net revenues:				
Product	$ 62,017	$ 67,388	$ 208,946	$ 218,960
Service	15,185	14,642	45,330	44,562
Total net revenues	77,202	82,030	254,276	263,522
Cost of revenues:				
Product	26,142	27,126	87,686	89,421
Service	6,642	7,801	22,049	24,923
Total cost of revenues	32,784	34,927	109,735	114,344
Gross profit:				
Product	35,875	40,262	121,260	129,539
Service	8,543	6,841	23,281	19,639
Total gross profit	44,418	47,103	144,541	149,178
Operating expenses:				
Sales and marketing	24,293	25,232	75,926	74,820
Research and development	13,928	15,579	44,457	49,223
General and administrative	6,967	8,610	22,818	23,725
Restructuring charge, net of reversal	2,092		2,092	
Total operating expenses	47,280	49,421	145,293	147,768
Operating (loss) income	(2,862)	(2,318)	(752)	1,410
Interest income	672	2,693	2,965	8,326
Interest expense	(23)	(28)	(92)	(69)
Other income / (expense), net	411	(152)	1,727	(643)
(Loss) income before income taxes	(1,802)	195	3,848	9,024
Provision for income taxes	371	355	1,917	1,415
Net (loss) income	$ (2,173)	$ (160)	$ 1,931	$ 7,609
Basic and diluted net (loss) income per share:				
Net (loss) income per share - basic	$ (0.02)	$ (0.00)	$ 0.02	$ 0.07
Net (loss) income per share - diluted	$ (0.02)	$ (0.00)	$ 0.02	$ 0.07
Shares used in per share calculation - basic	88,553	115,629	96,066	114,688
Shares used in per share calculation - diluted	88,553	115,629	96,139	115,685

See accompanying notes to unaudited condensed consolidated financial statements.

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EXTREME NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Nine Months Ended	
	March 29, 2009	**March 30, 2008**
Cash flows from operating activities:		
Net income	$ 1,931	$ 7,609
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,200	5,616
Gain on value of option to put securities	(4,616)	
Mark to market, trading loss	4,616	
Provision for doubtful accounts	(232)	207
Provision for excess and obsolete inventory	838	2,111
Deferred income taxes	124	420
Amortization of warrant		1,349
Gain (loss) on retirement of assets	94	(7)
Stock-based compensation	2,630	3,732
Restructuring charge, net of reversal	2,092	
Changes in operating assets and liabilities, net		
Accounts receivable	21,060	(2,477)
Inventories	(9,651)	5,114
Prepaid expenses and other assets	(83)	3,274
Accounts payable	(1,506)	(9,508)
Accrued compensation and benefits	(7,323)	3,233
Restructuring liabilities	(2,693)	(4,826)
Accrued warranty	(1,630)	(2,130)
Deferred revenue, net	(515)	(22,836)
Deferred revenue, net of cost of sales to distributors	(1,693)	23,546
Other accrued liabilities	(11,642)	596
Net cash (used in) provided by operating activities	(3,999)	15,023
Cash flows provided by (used in) investing activities:		
Capital expenditures	(4,150)	(4,032)
Purchases of investments	(33,645)	(250,504)
Proceeds from maturities of investments and marketable securities	28,164	93,625
Proceeds from sales of investments and marketable securities	81,354	142,944
Net cash provided by (used in) investing activities	71,723	(17,967)
Cash flows (used in) provided by financing activities:		
Proceeds from issuance of common stock	1,864	3,248
Proceeds from exercise of warrants		9
Repurchase of common stock, including expenses	(101,363)	
Net cash (used in) provided by financing activities	(99,499)	3,257
Net decrease in cash and cash equivalents	(31,775)	313

Cash and cash equivalents at beginning of period	70,370	71,573
Cash and cash equivalents at end of period	$ 38,595	$ 71,886

See accompanying notes to the unaudited condensed consolidated financial statements.

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EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Summary of Significant Accounting Policies

Basis of Presentation

The unaudited condensed consolidated financial statements of Extreme Networks, Inc. (referred to as the **Company** or **Extreme Networks**) included herein have been prepared under the rules and regulations of the Securities and Exchange Commission (**SEC**). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted under such rules and regulations. The condensed consolidated balance sheet at June 29, 2008 was derived from audited financial statements as of that date but does not include all disclosures required by generally accepted accounting principles for complete financial statements. These interim financial statements and notes should be read in conjunction with the Company s audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended June 29, 2008.

The unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations and cash flows for the interim periods presented and the financial condition of Extreme Networks at March 29, 2009. The results of operations for the third quarter of fiscal 2009 are not necessarily indicative of the results that may be expected for fiscal 2009 or any future periods.

Cash, Cash Equivalents, and Investments

The Company considers highly liquid investments with maturities of three months or less at the date of purchase to be cash equivalents. Investments with maturities of greater than three months at the date of purchase are classified as non-cash equivalents. Of these, investments with maturities of less than one year at balance sheet date are classified as Short Term Investments. Investments with maturities of greater than one year at balance sheet date are classified as Marketable Securities. Except for direct obligations of the United States government, securities issued by agencies of the United States government, and money market funds, the Company diversifies its investments by limiting its holdings with any individual issuer.

Investments include available-for-sale investment-grade debt securities and trading securities that the Company carries at fair value. The Company accumulates unrealized gains and losses on the Company s available-for-sale debt securities, net of tax, in accumulated other comprehensive income in the stockholders equity section of its balance sheets. Such an unrealized gain or loss does not reduce net income for the applicable accounting period. The Company records unrealized and realized gains and losses on the Company s trading securities, net of tax, in other income (expense), net, in its statements of operations.

Prior to the fiscal second quarter of 2009, the Company classified Auction Rate Securities (**ARS**) as non-current investments available-for-sale. Beginning in the fiscal second quarter of 2009, the Company classified ARS as trading securities and as non-current investments.

ARS are investments with contractual maturities generally between 0 and 40 years. Examples of the underlying collateral for these securities include municipal bonds, preferred stock, and a pool of student loans or collateralized debt obligations with interest rates resetting every 7 to 49 days through an auction process. At the end of each reset period, investors may sell or continue to hold the securities at par. As of March 29, 2009, the Company held $40.8 million principal amount in ARS, with contractual maturities from 25 to 40 years. All of these ARS are backed by student loans, are over-collateralized, and on an aggregate basis, 93% are guaranteed by the U.S. Department of Education. In addition, all ARS held by the Company are rated as either AA or AAA.

Historically, the Company s ARS were highly liquid, using a Dutch auction process that reset the applicable interest rate at predetermined intervals, typically every 7 to 28 days, which in turn provided liquidity at par value. However, as a result of liquidity issues in the global credit and capital markets, the auctions for all of the Company s ARS failed beginning in February 2008 when sell orders exceeded buy orders. The failures of these auctions do not affect the value of the collateral underlying the ARS, and the Company continues to earn and receive interest on the Company s ARS at contractually set rates.

As of March 29, 2009, there continues to be no auction market for the Company s ARS. In the absence of a liquid market to value these securities, the Company has used a discounted cash flow model to estimate the fair value of its investments in ARS as of March 29, 2009. The valuation model is based on the following key assumptions:

17 years to liquidity based on weighted average expected life of a security and its underlying collateral;

continued receipt of contractual interest; and

discount rates ranging from 4.0% to 6.0%, which incorporate a spread for both credit and liquidity risk.

Based on the discounted cash flow model described above, the Company determined that, at March 29, 2009, the fair value of the ARS was $36.2 million, which was 89% ($4.6 million unrealized loss) of the principal value of $40.8 million. This represented a decrease in the valuation of the ARS from 94% ($2.5 million unrealized loss) of principal value as of June 28, 2008. The market conditions related to the availability of liquidity and credit continued to worsen in the third quarter of fiscal 2009 from the fourth quarter of fiscal 2008, thereby increasing the discount rates in the valuation model. Accordingly, the increase in discount rate decreased the valuation of the ARS from 94% to 89% of their stated par value as of June 29, 2008 as compared to March 29, 2009, respectively.

On November 7, 2008, the Company accepted an offer (the **UBS Rights Offer**) from UBS AG (**UBS**), providing the Company with rights related to its ARS (the **Rights**). The Rights permit the Company to require UBS to purchase its ARS at par value, which is defined as the price equal to the liquidation preference of the ARS plus accrued but unpaid dividends or interest, at any time during the period of June 30, 2010 through July 2, 2012. Conversely, UBS has the right, in its discretion, to purchase or sell the Company s ARS at any time until July 2, 2012, so long as the Company receives payment at par value upon any sale or disposition. The Company expects to sell its ARS under the Rights back to UBS during the period starting in 2010. However, if the Rights are not exercised before July 2, 2012, they will expire and UBS will have no further rights or obligation to buy the Company s ARS. As long as the Company holds its ARS, they will continue to accrue interest under the terms of the ARS.

The Rights represent a firm agreement in accordance with SFAS 133, which defines a firm agreement as an agreement with an unrelated party, binding on both parties and usually legally enforceable, with the following characteristics: a) the agreement specifies all significant terms, including the quantity to be exchanged, the fixed price, and the timing of the transaction, and b) the agreement includes a disincentive for nonperformance that is sufficiently large to make performance probable. The enforceability of the Rights results in the creation of an asset akin to a Put Option (the Company has the right to put the ARS back to UBS at some specified date for a payment equal to the par value of the ARS). The Put Option is a free standing asset separate from the ARS.

In October 2008, the Company entered into a secured line of credit collateralized by the Company s ARS held by UBS. The maximum amount available under this line of credit is $28.8 million. The Company has used a discounted cash flow model to estimate the fair value of the Put Option as of March 29, 2009, assuming that the Company would borrow the entire amount available under this line of credit, therefore the remaining exposure for the Company is the $12.0 million not collateralized by the line of credit. This resulted in an increase in fair value of the Put Option because the risk of counterparty non-performance diminishes. The valuation model is based on the following key assumptions:

- 1.25 years to recover par value from UBS;
- continued receipt of contractual interest;
- discount rates ranging from 4.0% to 6.0%, which incorporate a spread for both credit and liquidity risk for cashflows related to contractual interest; and
- discount rate equal to the risk-free rate plus a premium associated with the risk for a default by UBS on the UBS Rights Offer.

Using the discounted cash flow model described above, the Company determined the fair value of the Put Option was $4.6 million. The Company recorded the fair value of the Put Option with the corresponding credit in other income (expense) in the condensed consolidated statements of operations for the period ended March 29, 2009. The Put Option does not meet the definition of a derivative instrument under SFAS 133 because the terms of the Put Option do not provide for net settlement, i.e., the Company must tender the ARS to receive the settlement and the ARS are not readily convertible to cash. Therefore, the Company has elected to measure the Put Option at fair value under SFAS 159, which permits an entity to elect the fair value option for recognized financial assets, in order to match the changes in the fair value of the ARS. As a result, unrealized gains and losses are included in earnings in the current and future periods. The Company expects that future changes in the fair value of the Put Option will approximate fair value movements in the related ARS.

Prior to accepting the UBS Rights Offer, the Company recorded $3.5 million of unrealized losses on its ARS, net of a tax benefit, in accumulated other comprehensive income in the shareholders equity section of the Company s balance sheets. In connection with the Company s acceptance of the UBS Rights Offer in November 2008, the Company transferred its ARS from investments available-for-sale to trading securities in accordance with SFAS 115. Upon transfer to trading securities, the Company immediately transferred $3.5 million of unrealized losses previously recorded in accumulated other comprehensive income in the consolidated balance sheet to other income (expense). The

Company recognized a loss of $3.3 million and a gain of $2.2 million in the second and third quarters of fiscal 2009, respectively, in other income (expense) in the condensed consolidated statements of operations.

The transfer to trading securities reflects management s intent to exercise its Put Option during the period June 30, 2010 to July 3, 2012. Prior to the Company s agreement with UBS, the Company s intent was to hold the ARS until the market recovered. Accordingly, the Company continues to classify the ARS under long term assets in the Company s Consolidated Balance Sheet for the period ended March 29, 2009.

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Fair Value Measurements

Effective June 30, 2008, the Company adopted SFAS No. 157, Fair Value Measurements (**SFAS No. 157**). In February 2008, the Financial Accounting Standards Board (**FASB**) issued Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157, which provides a one-year deferral of the effective date of SFAS No. 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Therefore, the Company has adopted the provisions of SFAS No. 157 with respect to its financial assets and liabilities only. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined under SFAS No. 157 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS No. 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on the following three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value:

Level 1 - Quoted prices in active markets for identical assets or liabilities;

Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

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The following table presents the Company s fair value hierarchy for its financial assets measured at fair value on a recurring basis as of March 29, 2009:

	Level 1	Level 2	Level 3	Total
		(In thousands)		
Assets				
Investments:				
Commercial paper	$	$	$	$
Federal agency notes		16,659		16,659
Money market funds	35,410			35,410
Corporate notes/bonds		24,676		24,676
Auction rate securities			36,266	36,266
Put Option			4,616	4,616
Derivative instruments:				
Foreign currency forward contracts		684		684
Total	$ 35,410	$ 42,019	$ 40,882	$ 118,311

The following table provides a summary of changes in the fair value of the Company s Level 3 financial assets as of March 29, 2009 (in thousands):

	Auction Rate Securities
Amortized Cost as of June 29, 2008	$ 40,836
Unrealized loss	(2,517)
Balance as of June 29, 2008	$ 38,319
Change in interest accrued	27
Purchases	
Change in unrealized loss	(1,030)
Balance as of September 28, 2008	$ 37,316
Change in interest accrued	(4)
Purchases	
Change in unrealized loss	(3,231)
Balance as of December 28, 2008	$ 34,081
Change in interest accrued	21
Purchases	
Change in unrealized gain	2,164
Balance as of March 29, 2009	$ 36,266

During the quarter ended December 28, 2008, the Company designated these securities as trading securities. Accordingly, the cumulative unrealized loss of $3.5 million as of the end of first quarter of fiscal 2009 was reclassified and recorded in the Statement of Operations during the second quarter of fiscal 2009. The Company recognized a loss of $3.3 million and a gain of $2.2 million in the second and third quarters of fiscal 2009, respectively, in other income (expense) in the condensed consolidated statements of operations.

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Revenue Recognition

Historically, the Company s products have been hardware-focused and the Company has recognized revenue in accordance with the principles of SAB 104 and EITF 00-21. The Company has been monitoring a variety of factors with respect to its product evolution, including whether the software component of its products is becoming more-than-incidental to the hardware product. As noted in the Company s Annual Report in Form 10-K for the year ended June 29, 2008, the Company anticipated a transition to the American Institute of Certified Public Accountants Statement of Position 97-2 *Software Revenue Recognition* (**SOP 97-2**) and related interpretations with respect to the sale of products with a significant software component.

During the first quarter of fiscal 2009, the Company concluded that software had become more-than-incidental to the product shipped. Effective beginning the first quarter of fiscal 2009, the Company adopted SOP 97-2 for products shipped during the quarter containing software that is more-than-incidental. Such shipments grew during the second quarter of fiscal 2009 to represent of a majority of the Company s shipped products. For arrangements with multiple software elements, the Company allocates revenue to each element of the arrangement using the residual method based on vendor specific objective evidence of fair value of the undelivered elements. The Company determines vendor specific objective evidence of fair value based on the price charged when the item is sold separately. The adoption of SOP 97-2 did not have a significant impact on our results of operations for the first three quarters of fiscal 2009.

The Company applies the provisions of Staff Accounting Bulletin No. 104, Revenue Recognition , and Emerging Issues Task Force No. 00-21, Revenue Arrangements with Multiple Deliverables to the sales of products and services for which software is incidental to the Company s equipment. When sales arrangements contain multiple deliverables, such as hardware, service contracts and other services, the Company determines whether the deliverables represent separate units of accounting and then allocates revenue to the delivered elements using the residual method.

The Company derives the majority of its revenue from sales of its modular and stackable networking equipment, with the remaining revenue generated from service fees relating to the service contracts, professional services, and training for its products. The Company generally recognizes product revenue from its value-added resellers and end-user customers at the time of shipment, provided that persuasive evidence of an arrangement exists, delivery has occurred, the price of the product is fixed or determinable, and collection of the sales proceeds is reasonably assured. In instances where the criteria for revenue recognition are not met, revenue is deferred until all criteria have been met. Revenue from service obligations under service contracts is deferred and recognized on a straight-line basis over the contractual service period. Service contracts typically range from one to two years.

The Company makes certain sales to partners in two distribution channels, or tiers. The first tier consists of a limited number of independent distributors that sell primarily to resellers and, on occasion, to end-user customers. The Company defers recognition of revenue on all sales to these distributors until the distributors sell the product, as evidenced by monthly sales-out reports that the distributors provide. The Company grants these distributors the right to return a portion of unsold inventory for the purpose of stock rotation. The Company also grants these distributors certain price protection rights. The distributor-related deferred revenue and receivables are adjusted at the time of the stock rotation return or price reduction. The Company also provides distributors with credits for changes in selling prices, and allows distributors to participate in cooperative marketing programs. The Company maintains estimated accruals and allowances for these exposures based upon the Company s historical experience. In connection with cooperative advertising programs, the Company does not meet the criteria in EITF 01-09 for recognizing the expenses as marketing expenses and accordingly, the costs are recorded as a reduction to revenue in the same period that the related revenue is recorded.

The second tier of the distribution channel consists of a large number of third-party value-added resellers that sell directly to end-users. For product sales to value-added resellers, the Company does not grant return privileges, except for defective products during the warranty period, nor does the Company grant pricing credits. Accordingly, the Company recognizes revenue upon transfer of title and risk of loss to the value-added reseller, which is generally upon shipment. The Company reduces product revenue for cooperative marketing activities and certain price protection rights that may occur under contractual arrangements with its resellers.

The Company provides an allowance for sales returns based on its historical returns, analysis of credit memo data and its return policies. The allowance for sales returns was $1.1 million and $1.2 million as of March 29, 2009 and June 29, 2008, respectively, for estimated future returns that were recorded as a reduction of our accounts receivable. The provision for returns is charged to net revenues in the accompanying consolidated statements of operations, and was $0 and $0.3 million in the third quarter of fiscal 2009 and the third quarter of fiscal 2008, respectively. If the historical data that we use to calculate the estimated sales returns and allowances does not properly reflect future levels of product returns, these estimates will be revised, thus resulting in an impact on future net revenues. The Company estimates and adjusts this allowance at each balance sheet date.

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Inventory, Net

Inventory is stated at the lower of cost or market. Cost is computed using standard cost, which approximates actual cost, on a first-in, first-out basis. The Company provides inventory allowances based on excess and obsolete inventories determined primarily by future demand forecasts. At the point of the loss recognition, a new, lower-cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. Any written down or obsolete inventory subsequently sold has not had a material impact on gross profit for any of the periods disclosed.

Inventories, which are net of write-downs for excess and obsolete inventory (which the Company determines primarily based on future demand forecasts) of $3.4 million and $3.2 million at March 29, 2009 and June 29, 2008, respectively, consist of (in thousands):

	March 29, 2009	June 29, 2008
Raw materials	$ 33	$ 59
Finished goods	22,719	13,883
Total	$ 22,752	$ 13,942

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Deferred Revenue, Net

Deferred revenue, net represents amounts for (i) deferred services revenue (support arrangements, professional services and training), and (ii) deferred product revenue net of the related cost of revenues where the revenue recognition criteria have not been met related to sales by the Company to its resellers or directly to its end-customers. Product revenue includes shipments to end-users and value-add resellers. The following table summarizes deferred revenue, net at March 29, 2009 and June 29, 2008, respectively (in thousands):

	March 29, 2009	June 29, 2008
Deferred services	$ 38,153	$ 39,522
Deferred product		
Deferred revenue	2,612	1,249
Deferred cost of sales	(990)	(481)
Deferred product revenue, net	1,622	768
Balance at end of period	39,775	40,290
Less: current portion	32,171	31,284
Non-current deferred revenue, net	$ 7,604	$ 9,006

The Company offers renewable support arrangements, including extended warranty contracts, to its customers that range generally from one to five years. Deferred support revenue is included within deferred revenue, net within the Services category above. The change in the Company s deferred support revenue balance in relation to these arrangements was as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	March 29, 2009	March 30, 2008	March 29, 2009	March 30, 2008
Balance beginning of period	$ 37,931	$ 39,472	$ 38,778	$ 40,787
New support arrangements	13,496	11,950	40,969	37,845
Recognition of support revenue	(13,709)	(13,157)	(42,029)	(40,367)
Balance end of period	37,718	38,265	37,718	38,265
Less current portion	30,114	28,800	30,114	28,800
Non-current deferred revenue	$ 7,604	$ 9,465	$ 7,604	$ 9,465

Deferred Revenue, Net of Cost of Sales to Distributors

At the time of shipment to distributors, the Company records a trade receivable at the contractual price since there is a legally enforceable right to current payment from the distributor. The Company relieves inventory for the carrying value of goods shipped since legal title has passed to the distributor, and the Company records deferred revenue and deferred cost of sales in Deferred revenue, net of cost of sales to distributors in the liability section of its consolidated balance sheets. Deferred revenue, net of cost of sales to distributors effectively represents the gross profit on the sale to the distributor; however, the amount of gross profit the Company recognizes in future periods will frequently be less than the originally recorded deferred revenue, net of cost of sales to distributors as a result of price concessions negotiated at time of sell-through to end customers. The Company sells each item in its product catalog to all of its distributors worldwide at contractually discounted prices. However, distributors resell the Company s products to end customers at a very broad range of individually negotiated price points based on customer, product, quantity, geography, competitive pricing, and other factors. The majority of the Company s distributors resales are priced at a discount from list price. Often, under these circumstances, the Company remits back to the distributor a portion of their original purchase price after the resale transaction is completed. Thus, a portion of the deferred revenue balance represents a portion of distributors original purchase price that will be remitted back to the distributor in the future. The wide range and variability of negotiated price credits granted to distributors does not allow the Company to accurately estimate the portion of the balance in the deferred revenue that will be remitted to the distributors. Therefore, the Company does not reduce deferred revenue by anticipated future price credits; instead, price credits are typically recorded against deferred

revenue, net of cost of sales to distributors when incurred, which is generally at the time the distributor sells the product.

The following table summarizes deferred revenue, net of cost of sales to distributors at March 29, 2009 and June 29, 2008, respectively (in thousands):

	March 29, 2009	June 29, 2008
Deferred revenue	$ 16,908	$ 19,232
Deferred cost of Sales	(4,463)	(5,094)
Total deferred revenue, net of cost of sales to distributors	$ 12,445	$ 14,138

Guarantees and Product Warranties

Financial Accounting Standards Board (**FASB**) Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (**FIN 45**) requires that upon issuance of a guarantee, the guarantor must disclose and recognize a liability for the fair value of the obligation it assumes under that guarantee.

The Company has determined that the requirements of FIN 45 apply to the Company s standard product warranty liability. The following table summarizes the activity related to the Company s product warranty liability during the first nine months of fiscal 2009 and fiscal 2008, respectively (in thousands):

	Nine months ended	
	March 29, 2009	March 30, 2008
Balance beginning of period	$ 4,824	$ 7,182
New warranties issued	5,486	4,290
Warranty expenditures	(5,027)	(5,004)
Change in estimates	(2,090)	(1,415)
Balance end of period	$ 3,193	$ 5,053

The Company s standard hardware warranty period is typically 12 months from the date of shipment to end-users. For certain access products, the Company offers a lifetime hardware warranty commencing on the date of shipment from the Company and ending five (5) years following the Company s announcement of the end of sale of such product. Upon shipment of products to the Company s customers, the Company estimates expenses for the cost to repair or replace products that may be returned under warranty and accrue a liability in cost of product revenue for this amount. The determination of the Company s warranty requirements is based on actual historical experience with the product or product family, estimates of repair and replacement costs and any product warranty problems that are identified after shipment. The Company estimates and adjusts these accruals at each balance sheet date in accordance with changes in these factors. For the nine months ended March 29, 2009, the Company recorded $2.1 million for a change in estimates in warranty reserve resulting from reduction in actual returns and associated warranty cost.

In the normal course of business to facilitate sales of the Company s products, the Company indemnifies the Company s resellers and end-user customers with respect to certain matters. The Company has agreed to hold the customer harmless against losses arising from a breach 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. It is not possible to estimate 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. Historically, payments made by the Company under these agreements have not had a material impact on the Company s operating results or financial position.

Recently Issued Accounting Standards

On October 10, 2008, the FASB issued FSP No. 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active, (**FSP 157-3**) that clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key

considerations in determining the fair value of a financial asset when the market for that financial assets is not active. FSP 157-3 is applicable to the valuation of auction-rate securities held by the Company for which there was no active market as of March 29, 2009. FSP 157-3 is effective upon issuance, including prior periods for which the financial statements have not been issued. The adoption of FSP 157-3 during the nine month period ended March 29, 2009 did not have a material impact on the Company s consolidated results of operations or financial condition.

In April 2009, the FASB issued FSP No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, which provides guidance on determining fair value when there is no active market or where the price inputs being used represent distressed sales. FSP No. 157-4 is effective for interim and annual periods ending after June 15, 2009. The Company is currently evaluating the impact that the adoption of FSP No. 157-4 may have on its consolidated results of operations and financial condition.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, which provides operational guidance for determining other-than-temporary impairments (OTTI) for debt securities. FSP No. 115-2 and 124-2 is effective for interim and annual periods ending after June 15, 2009. The Company is currently evaluating the impact that the adoption of FSP No. 115-2 and 124-2 may have on its consolidated results of operations and financial condition.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures About Fair Value of Financial Instruments* (**FSP FAS 107-1**). FSP FAS 107 extends the disclosure requirements of FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments* (**Statement 107**), to interim financial statements of publicly traded companies as defined in APB Opinion No. 28, Interim Financial Reporting. Statement 107 requires disclosures of the fair value of all financial instruments (recognized or unrecognized), except for those specifically listed in paragraph 8 of Statement 107, when practicable to do so. These fair value disclosures must be presented together with the carrying amount of the financial instruments in a manner that clearly distinguishes between assets and liabilities and indicates how the carrying amounts relate to amounts reported on the balance sheet. An entity must also disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments. FSP FAS 107 is effective for interim reporting periods ending after June 15, 2009. The Company is currently evaluating the impact that the adoption of FSP FAS 107 may have on its consolidated results of operations and financial condition.

Effective June 30, 2008, the Company adopted SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities (**SFAS 159**). SFAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The provisions of SFAS 159 are optional and adoption began for fiscal years beginning after November 15, 2007. The Company adopted the fair value option as it relates to ARS Put Option under this Statement and the adoption did not have a material impact on the Company s consolidated results of operations or financial condition.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles (SFAS 162).* SFAS No. 162 defines the order in which accounting principles that are generally accepted should be followed. SFAS No. 162 was effective during the first quarter of fiscal 2009. The adoption of SFAS No. 162 did not have an impact on the Company s consolidated results of operations or financial condition.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations* (**SFAS 141R**). SFAS 141R will significantly change the accounting for business combinations. Under SFAS 141R, an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. It also amends the accounting treatment for certain specific items including acquisition costs and non controlling minority interests and includes a substantial number of new disclosure requirements. SFAS 141R applies prospectively to the Company for business combinations for which the acquisition date is on or after June 29, 2009. The Company is currently evaluating the impact that the adoption of SFAS 141R may have on its consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51* (**SFAS 160**). SFAS 160 clarifies the classification in a company s consolidated balance sheet and the accounting for and disclosure of transactions between the company and holders of noncontrolling interests. SFAS 160 is effective for the Company on January 1, 2009. Early adoption is not permitted. The Company does not expect the adoption of SFAS 160 will have a material impact on its consolidated financial statements.

2. Employee Benefit Plans (including Share-Based Compensation)

Stock Option Plans

The Company has several stock-based compensation plans (the **Plans**) that are described in the Company s Annual Report on Form 10-K for the fiscal year ended June 29, 2008. The Company, under the various equity plans, grants stock options for shares of common stock to employees and directors. The Plans provide that the options shall be exercisable over a period not to exceed ten years. The majority of options granted under the Plans vest over a period of four years.

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A summary of stock option activity under the Plans for the three months ended March 29, 2009 is presented as follows:

	Number of Shares (000 s)	Weighted Average Exercise Price Per Share
Balance at June 29, 2008 (10,459 options exerciseable at a weighted-average exercise price of $5.87 per share)	18,969	$ 5.05
Options exercised	(394)	$ 2.84
Options canceled/expired	(1,237)	$ 5.22
Balance at September 28, 2008 (10,322 options exerciseable at a weighted-average exercise price of $5.82 per share)	17,338	$ 5.09
Options granted	2,449	$ 2.04
Options canceled/expired	(789)	$ 4.61
Balance at December 28, 2008 (10,580 options exerciseable at a weighted-average exercise price of $5.72 per share)	18,998	$ 4.72
Options granted	247	$ 1.77
Options canceled/expired	(879)	$ 4.27
Balance at March 29, 2009 (10,982 options exerciseable at a weighted-average exercise price of $5.60 per share)	18,366	$ 4.70

The weighted-average grant-date per share fair value of options granted in the third quarter of fiscal 2009 and 2008 were $0.53 and $0.94, respectively.

Employee Stock Purchase Plan (ESPP)

Under the Company s 1999 Employee Stock Purchase Plan, employees purchased 174,838 shares for $0.3 million with a weighted-average estimated per share fair value of $0.63 during the third quarter of fiscal 2009. Employees purchased 161,900 shares for $0.5 million with a weighted-average estimated per share fair value of $0.83 in the third quarter of fiscal 2008.

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Stock Awards

Stock awards may be granted under the 2005 Plan on terms approved by the Board of Directors. Stock awards generally provide for the issuance of restricted stock which vests over a fixed period. A summary of the status of the Company s non-vested stock awards as of March 29, 2009 and changes during the first nine months of fiscal 2009 is presented below:

	Number of Shares (000 s)	Weighted-Average Grant-Date Fair Value
Non-vested stock outstanding at June 29, 2008	361	$ 3.76
Vested	(182)	3.52
Canceled	(10)	3.53
Non-vested stock outstanding at September 28, 2008	169	$ 4.59
Granted	742	$ 2.04
Vested	(50)	3.98
Non-vested stock outstanding at December 28, 2008	861	