

JUNIPER NETWORKS INC

Form 10-Q

May 09, 2006

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

Form 10-Q

(Mark One)

- ☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2006
- 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 0-26339

JUNIPER NETWORKS, INC.

(Exact name of registrant as specified in its charter)

Delaware

*(State or other jurisdiction of
incorporation or organization)*

**1194 North Mathilda Avenue
Sunnyvale, California 94089**

*(Address of principal executive offices,
including zip code)*

77-0422528

*(IRS Employer
Identification No.)*

(408) 745-2000

*(Registrant's telephone number,
including area code)*

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):
Large Accelerated Filer ☐ Accelerated Filer ☐ Non-Accelerated Filer ☐

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

There were approximately 565,750,000 shares of the Company's Common Stock, par value \$0.00001, outstanding as of April 30, 2006.

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(In thousands, except per share amounts)**

	Three Months Ended March 31, 2006 2005 (Unaudited)	
Net revenues:		
Product	\$ 474,125	\$ 392,280
Service	92,589	56,832
Total net revenues	566,714	449,112
Cost of revenues:		
Product(1)	140,995	112,555
Service(1)	43,952	31,099
Total cost of revenues	184,947	143,654
Gross margin	381,767	305,458
Operating expenses:		
Research and development(1)	113,688	78,135
Sales and marketing(1)	129,429	92,111
General and administrative(1)	23,099	15,741
Amortization of purchased intangibles	23,221	18,541
Special charges	1,404	
Total operating expenses	290,841	204,528
Operating income	90,926	100,930
Interest and other income	20,767	11,077
Interest and other expense	(1,089)	(779)
Income before income taxes	110,604	111,228
Provision for income taxes	34,841	35,793
Net income	\$ 75,763	\$ 75,435
Net income per share:		
Basic	\$ 0.13	\$ 0.14

Diluted	\$	0.13	\$	0.13
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Shares used in computing net income per share:

Basic		565,927		542,651
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Diluted		603,589		587,659
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(1) Amortization of stock-based compensation included in the following cost and expense categories by period:

Cost of revenues	Product	\$	487	\$	75
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Cost of revenues	Service		1,396		384
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Research and development			10,013		2,007
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Sales and marketing			7,627		683
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General and administrative			3,542		274
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Total		\$	23,065	\$	3,423
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See accompanying Notes to the Condensed Consolidated Financial Statements

Table of Contents**Juniper Networks, Inc.****Condensed Consolidated Balance Sheets**
(In thousands)

	March 31, 2006 (Unaudited)	December 31, 2005(1)
ASSETS		
Current assets:		
Cash and cash equivalents(2)	\$ 904,295	\$ 918,401
Short-term investments(2)	510,606	510,364
Accounts receivable, net	304,750	268,907
Deferred tax assets	92,539	74,108
Prepaid expenses and other current assets	41,382	46,676
Total current assets	1,853,572	1,818,456
Property and equipment, net	321,388	319,885
Investments(2)	623,269	618,342
Restricted cash	59,894	66,074
Goodwill	4,904,306	4,904,239
Purchased intangible assets, net	245,332	269,921
Other assets	28,003	29,682
Total assets	\$ 8,035,764	\$ 8,026,599
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 160,278	\$ 165,172
Accrued compensation	68,942	97,738
Accrued warranty	28,416	28,187
Deferred revenue	240,344	213,482
Income taxes payable	65,617	56,360
Other accrued liabilities	67,779	66,461
Total current liabilities	631,376	627,400
Deferred revenue	53,486	39,330
Other long-term liabilities	31,359	60,200
Long-term debt	399,944	399,959
Commitments and contingencies		
Stockholders' equity	6,919,599	6,899,710
Total liabilities and stockholders' equity	\$ 8,035,764	\$ 8,026,599

- (1) The balance sheet at December 31, 2005 has been derived from the audited consolidated financial statements at that date, but does not include all the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.
- (2) Total cash, cash equivalent, and available-for-sale investments were \$2,038.2 million and \$2,047.1 million as of March 31, 2006 and December 31, 2005, respectively.

See accompanying Notes to the Condensed Consolidated Financial Statements

Table of Contents**Juniper Networks, Inc.**

Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Three Months Ended	
	March 31,	
	2006	2005
Operating Activities:		
Net income	\$ 75,763	\$ 75,435
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	41,828	30,276
Stock-based compensation	23,065	3,423
Non-cash portion of debt issuance costs and disposal of property and equipment	363	363
Tax benefits from stock-based compensation		28,910
Changes in operating assets and liabilities:		
Accounts receivable, net	(35,437)	2,517
Prepaid expenses, other current assets and other long-term assets	(11,585)	(19,601)
Accounts payable	(5,149)	(7,167)
Accrued compensation	(28,797)	(27,618)
Accrued warranty	444	(691)
Other accrued liabilities	(18,511)	1,793
Deferred revenue	41,018	46,749
Net cash provided by operating activities	83,002	134,389
Investing Activities:		
Purchases of property and equipment	(18,228)	(22,549)
Purchases of available-for-sale investments	(132,949)	(235,235)
Maturities and sales of available-for-sale investments	126,733	191,422
Decrease (increase) in restricted cash	6,180	(73)
Minority equity investments	(90)	(968)
Net cash used in investing activities	(18,354)	(67,403)
Financing Activities:		
Proceeds from issuance of common stock	51,521	39,380
Purchases and subsequent retirement of common stock	(186,388)	
Tax benefits from stock-based compensation	56,113	
Net cash (used in) provided by financing activities	(78,754)	39,380
Net (decrease) increase in cash and cash equivalents	(14,106)	106,366
Cash and cash equivalents at beginning of period	918,401	713,182
Cash and cash equivalents at end of period	\$ 904,295	\$ 819,548

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Juniper Networks, Inc.

**Notes to the Condensed Consolidated Financial Statements
(Unaudited)**

Note 1. Summary of Significant Accounting Policies

Description of Business

Juniper Networks, Inc. (Juniper Networks or the Company) designs and sells products and services that together provide its customers with secure and assured Internet Protocol (IP) networking solutions. The Company is organized into the following three operating segments: Infrastructure, Service Layer Technologies (SLT), and Service. The Company's Infrastructure segment primarily offers scalable router products that are used to control and direct network traffic. The Company's SLT segment offers solutions that meet a broad array of its customers' priorities, from securing the network and the data on the network, to maximizing existing bandwidth and acceleration of applications across a distributed network. Together, its secure networking solutions help enable its customers to convert networks that provide commoditized and best efforts services into more valuable assets that provide differentiation, value and increased reliability and security to end users. The Company's Service segment delivers world-wide services, including technical support, professional services, as well as a number of education and training programs, to customers of the Infrastructure and SLT segments. The Company sells products and services through its direct sales force and through its strategic distribution relationships and value-added resellers.

Basis of Presentation

The Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, including normal recurring accruals, considered necessary for a fair presentation have been included. The results of operations for the three months ended March 31, 2006 are not necessarily indicative of the results that may be expected for the year ended December 31, 2006. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors, Quantitative and Qualitative Disclosures About Market Risk and the Consolidated Financial Statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

Stock-Based Compensation

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, (SFAS 123R) which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees and directors including employee stock options, restricted stock units (RSUs) and employee stock purchases under the Company's Employee Stock Purchase Plan based on estimated fair values. SFAS 123R supersedes the previous accounting under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), as allowed under Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), for periods beginning in 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS 123R. The Company has applied the provisions of SAB 107 in conjunction with its adoption of SFAS 123R.

The Company adopted SFAS 123R using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of the Company's fiscal year 2006. The Company's

Condensed Consolidated Financial Statements as of and for the three months ended March 31, 2006 reflect the impact of SFAS 123R. In accordance with the modified prospective

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Juniper Networks, Inc.

Notes to the Condensed Consolidated Financial Statements (Continued)

transition method, the Company's Condensed Consolidated Financial Statements for periods prior to 2006 have not been restated to reflect, and do not include, the impact of SFAS 123R.

SFAS 123R requires companies to estimate the fair value of stock-based payment awards on the date of grant using an option-pricing model. The Company uses the Black-Scholes-Merton option-pricing model to determine the fair-value of stock based awards under SFAS 123R, consistent with that used for pro forma disclosures under SFAS 123. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's consolidated statement of operations.

Stock-based compensation expense recognized during the period is based on the fair value of the actual awards vested or expected to vest. Stock-based compensation expense recognized in the Company's consolidated statement of operations for the three months ended March 31, 2006 included compensation expense for stock-based payment awards granted prior to, but not yet vested as of, December 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS 123 and compensation expense for the stock-based payment awards granted subsequent to December 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. In conjunction with the adoption of SFAS 123R, the Company changed its accounting policy of attributing the fair value of stock-based compensation to expense from the accelerated multiple-option approach provided by APB 25, as allowed under SFAS 123, to the straight-line single-option approach. Compensation expense for all stock-based payment awards expected to vest that were granted on or prior to December 31, 2005 will continue to be recognized using the accelerated attribution method. Compensation expense for all stock-based payment awards expected to vest that were granted or modified subsequent to December 31, 2005 is recognized on a straight-line basis. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company's pro forma information required under SFAS 123 for the periods prior to 2006, the Company accounted for forfeitures as they occurred.

Prior to the adoption of SFAS 123R, no stock-based compensation expense had been recognized in the Company's consolidated statement of operations, other than those related to acquisitions. As a result of adopting SFAS 123R, pre-tax stock-based compensation expense recorded for the three months ended March 31, 2006 of \$23.1 million was related to employee stock options, RSUs, and employee stock purchases under the Company's Employee Stock Purchase Plan. Pre-tax stock-based compensation expense of \$3.4 million for the three months ended March 31, 2005, which the Company recorded under APB 25, was related to options assumed from acquisitions. The pre-tax compensation expense was \$18.8 million higher than the expense that would have been recorded had the Company continued to account for stock-based compensation under APB 25. Net income for the three months ended March 31, 2006 was \$13.5 million lower than would have been reported had the Company continued to account for stock-based compensation under APB 25. Unamortized deferred compensation associated with stock options assumed from past acquisitions of \$15.6 million has been reclassified to additional paid-in capital in the Company's consolidated balance sheet upon the adoption of SFAS 123R. Additional information is discussed in Note 6.

In accordance with SFAS 123R, beginning in the three months ended March 31, 2006, the Company has presented tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options as financing cash flows. Prior to the adoption of SFAS 123R, tax benefits of stock option exercises were presented as operating cash flows. Tax benefits, related to tax deductions in excess of the compensation cost recognized, of \$56.1 million presented as financing cash flows for the first quarter of 2006 would have been classified as operating cash flows if the Company had not adopted SFAS 123R.

Table of Contents**Juniper Networks, Inc.****Notes to the Condensed Consolidated Financial Statements (Continued)**

The following table illustrates the pro forma net income and earnings per share, net of related tax effect, had the Company applied the fair value recognition provisions of SFAS 123 to employee stock benefits, including shares issued under the stock option plans and under the Employee Stock Purchase Plan (in millions, except per share amounts):

	Three Months Ended March 31, 2005
Net income as reported	\$ 75.4
Add: amortization of deferred stock compensation included in reported net income, net of tax	2.1
Deduct: total stock-based employee compensation expense determined under fair value based method, net of tax	(26.4)
Pro forma net income	\$ 51.1
Basic net income per share:	
As reported	\$ 0.14
Pro forma	\$ 0.09
Diluted net income per share:	
As reported	\$ 0.13
Pro forma	\$ 0.09

As previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2005, the Company determined that the calculation of the pro forma stock-based compensation expense disclosed under SFAS 123 for 2004, as reported, inadvertently did not include the proper fair value for options assumed in the acquisition in 2004. Accordingly, the amount of pro forma stock-based compensation expense reported in the table above has been revised to reflect the proper fair value for options assumed from the 2004 acquisition. For the three months ended March 31, 2005, the previously reported pro forma net income was \$52.2 million, the previously reported pro forma basic net income per share was \$0.10, and the previously reported pro forma diluted net income per share was \$0.09. This revision has no impact on the Company's previously reported consolidated results of operations or financial condition.

Revenue Recognition

Juniper Networks sells products and services through its direct sales force or through its strategic distribution relationships and value-added resellers. The Company's infrastructure and SLT products are integrated with software that is essential to the functionality of the equipment. Additionally, the Company provides unspecified software upgrades and enhancements related to the equipment through its maintenance contracts for most of its products. Accordingly, the Company accounts for revenue in accordance with Statement of Position No. 97-2, *Software Revenue Recognition*, and all related interpretations. The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery or performance has occurred, the sales price is fixed or determinable and collectibility

is reasonably assured. Evidence of an arrangement generally consists of customer purchase orders and, in certain instances, sales contracts or agreements. Shipping terms and related documents, or written evidence of customer acceptance, when applicable, are used to verify delivery or performance. In instances where final acceptance of the product, system, or solution is specified by the customer, revenue is deferred until all acceptance criteria have been met. The Company assesses whether the sales price is fixed or determinable based on payment terms and whether the sales price is subject to refund or adjustment.

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Juniper Networks, Inc.

Notes to the Condensed Consolidated Financial Statements (Continued)

Collectibility is assessed based on the creditworthiness of the customer as determined by credit checks and the customer's payment history to the Company.

For arrangements with multiple elements, we allocate revenue to each element using the residual method based on vendor specific objective evidence of fair value of the undelivered items. Under the residual method, the amount of revenue allocated to delivered elements equals the total arrangement consideration less the aggregate fair value of any undelivered elements. Vendor specific objective evidence of fair value is based on the price charged when the element is sold separately.

For sales to direct end-users and value-added resellers, the Company recognizes product revenue upon transfer of title and risk of loss, which is generally upon shipment. It is the Company's practice to identify an end-user prior to shipment to a value-added reseller. For the end-users and value-added resellers, the Company has no significant obligations for future performance such as rights of return or pricing credits. A portion of the Company's sales are made through distributors under agreements allowing for pricing credits and/or rights of return. Product revenue on sales made through these distributors is recognized upon sell-through as reported by the distributors to the Company.