

NETSCOUT SYSTEMS INC  
Form 10-Q  
November 04, 2011  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 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 September 30, 2011

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 0000-26251

**NETSCOUT SYSTEMS, INC.**

(Exact Name of Registrant as Specified in Its Charter)

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Delaware  
(State or Other Jurisdiction of

04-2837575  
(IRS Employer

Incorporation or Organization)

Identification No.)

310 Littleton Road, Westford, MA 01886

(978) 614-4000

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 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. (Check one):

Large accelerated filer  Accelerated filer

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

The number of shares outstanding of the registrant's common stock, par value \$0.001 per share, as of November 2, 2011 was 41,511,509.

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**NETSCOUT SYSTEMS, INC.**

**FORM 10-Q**

**FOR THE QUARTER ENDED SEPTEMBER 30, 2011**

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**Table of Contents****PART I: FINANCIAL INFORMATION****Item 1. Unaudited Financial Statements****NetScout Systems, Inc.****Condensed Consolidated Balance Sheets****(In thousands, except share and per share data)****(Unaudited)**

	<b>September 30, 2011</b>	<b>March 31, 2011</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 103,859	\$ 67,168
Marketable securities	68,520	133,430
Accounts receivable, net of allowance for doubtful accounts of \$301 and \$346 at September 30, 2011 and March 31, 2011, respectively	49,677	62,801
Inventories	8,963	8,925
Prepaid income taxes	3,563	3,205
Deferred income taxes	3,585	3,383
Prepaid expenses and other current assets	4,542	4,814
<b>Total current assets</b>	<b>242,709</b>	<b>283,726</b>
Fixed assets, net	15,431	13,467
Goodwill	141,356	128,177
Intangible assets, net	48,939	47,686
Deferred income taxes	23,944	25,167
Long-term marketable securities	26,528	27,880
Other assets	1,244	1,467
<b>Total assets</b>	<b>\$ 500,151</b>	<b>\$ 527,570</b>
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 7,845	\$ 9,709
Accrued compensation	17,323	21,854
Accrued other	4,862	4,786
Current portion of long-term debt	15,000	15,000
Deferred revenue	77,376	85,241
<b>Total current liabilities</b>	<b>122,406</b>	<b>136,590</b>
Other long-term liabilities	2,028	1,721
Accrued long-term retirement benefits	1,969	1,859
Long-term deferred revenue	12,833	14,735
Long-term debt, net of current portion	45,606	53,106
<b>Total liabilities</b>	<b>184,842</b>	<b>208,011</b>
<b>Commitments and contingencies (Note 12)</b>		

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Stockholders' equity:

Preferred stock, \$0.001 par value:		
5,000,000 shares authorized; no shares issued or outstanding at September 30, 2011 and March 31, 2011	0	0
Common stock, \$0.001 par value:		
150,000,000 shares authorized; 47,740,710 and 47,441,879 shares issued and 41,506,731 and 42,557,221 shares outstanding at September 30, 2011 and March 31, 2011, respectively	48	47
Additional paid-in capital	231,485	227,201
Accumulated other comprehensive loss	(864)	(676)
Treasury stock at cost, 6,233,979 and 4,884,658 shares at September 30, 2011 and March 31, 2011, respectively	(53,234)	(35,437)
Retained earnings	137,874	128,424
<b>Total stockholders' equity</b>	<b>315,309</b>	<b>319,559</b>
Total liabilities and stockholders' equity	<b>\$ 500,151</b>	<b>\$ 527,570</b>

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

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## NetScout Systems, Inc.

## Condensed Consolidated Statements of Operations

(In thousands, except per share data)

(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2011	2010	2011	2010
<b>Revenue:</b>				
Product	\$ 38,080	\$ 37,301	\$ 67,611	\$ 71,273
Service	34,544	32,112	68,309	64,951
Total revenue	72,624	69,413	135,920	136,224
<b>Cost of revenue:</b>				
Product	9,061	8,808	16,708	17,659
Service	6,516	5,499	12,765	11,223
Total cost of revenue	15,577	14,307	29,473	28,882
Gross profit	57,047	55,106	106,447	107,342
<b>Operating expenses:</b>				
Research and development	11,160	9,811	22,480	19,589
Sales and marketing	26,854	25,691	53,626	50,810
General and administrative	7,037	5,825	13,571	11,122
Amortization of acquired intangible assets	494	477	976	954
Total operating expenses	45,545	41,804	90,653	82,475
Income from operations	11,502	13,302	15,794	24,867
<b>Interest and other income (expense), net:</b>				
Interest income	101	199	200	377
Interest expense	(477)	(658)	(977)	(1,280)
Other income (expense), net	(459)	(3)	(457)	1
Total interest and other income (expense), net	(835)	(462)	(1,234)	(902)
Income before income tax expense	10,667	12,840	14,560	23,965
Income tax expense	3,616	4,592	5,110	8,572
Net income	\$ 7,051	\$ 8,248	\$ 9,450	\$ 15,393
Basic net income per share	\$ 0.17	\$ 0.20	\$ 0.22	\$ 0.37
Diluted net income per share	\$ 0.17	\$ 0.19	\$ 0.22	\$ 0.36
<b>Weighted average common shares outstanding used in computing:</b>				
Net income per share basic	42,258	41,922	42,433	41,867
Net income per share diluted	42,720	42,778	43,061	42,626

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

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## NetScout Systems, Inc.

## Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Six Months Ended September 30,	
	2011	2010
<b>Cash flows from operating activities:</b>		
Net income	\$ 9,450	\$ 15,393
Adjustments to reconcile net income to cash provided by operating activities, net of the effects of the acquisition of Psytechnics:		
Depreciation and amortization	7,977	6,875
Loss on disposal of fixed assets	127	76
Share-based compensation expense associated with equity awards	3,947	2,679
Deferred income taxes	1,163	2,338
Other losses (gains)	(67)	0
Changes in assets and liabilities		
Accounts receivable	13,583	24,108
Inventories	(1,948)	(3,579)
Prepaid expenses and other assets	463	1,100
Accounts payable	(1,329)	(892)
Accrued compensation and other expenses	(5,205)	(2,501)
Deferred revenue	(10,233)	(15,013)
Net cash provided by operating activities	17,928	30,584
<b>Cash flows from investing activities:</b>		
Purchase of marketable securities	(67,380)	(29,146)
Proceeds from maturity of marketable securities	133,839	55,660
Purchase of fixed assets	(5,792)	(2,610)
Acquisition of Psytechnics, net of cash acquired	(16,945)	0
Net cash provided by investing activities	43,722	23,904
<b>Cash flows from financing activities:</b>		
Proceeds from the exercise of stock options	196	593
Treasury stock repurchases	(17,797)	0
Repayment of long-term debt	(7,500)	(5,000)
Excess tax benefit from stock options exercised	142	640
Net cash used in financing activities	(24,959)	(3,767)
Net increase (decrease) in cash and cash equivalents	36,691	50,721
Cash and cash equivalents, beginning of period	67,168	63,322
Cash and cash equivalents, end of period	<b>\$ 103,859</b>	<b>\$ 114,043</b>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid for interest	\$ 842	\$ 1,787



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Cash paid for income taxes	\$ 3,934	\$ 5,318
<b>Non-cash transactions:</b>		
Transfers of inventory to fixed assets	\$ 1,910	\$ 1,348
Additions to property, plant and equipment included in accounts payable	<b>\$ 96</b>	<b>\$ 0</b>

The accompanying notes are an integral part of these consolidated financial statements, see Note 1.

**Table of Contents****NetScout Systems, Inc.****Notes to Condensed Consolidated Financial Statements****(Unaudited)****1. Basis of Presentation**

The accompanying unaudited interim consolidated financial statements have been prepared by NetScout Systems, Inc., or NetScout or the Company. Certain information and footnote disclosures normally included in financial statements prepared under generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). In the opinion of management, the unaudited interim consolidated financial statements include all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of the Company's financial position, results of operations and cash flows. The results reported in these consolidated financial statements are not necessarily indicative of results that may be expected for the entire year. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements, including the notes thereto, included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2011.

*Revision of previously reported amounts*

During the three-month interim period ended September 30, 2011, the Company identified errors in the presentation of its Condensed Consolidated Statement of Cash Flows for prior fiscal periods. Transfers from inventory to fixed assets were presented as cash outflows within the Purchase of Fixed Assets line and cash inflows within the Inventories line of the Consolidated Statement of Cash Flows. Such items should have been netted down within the Consolidated Statement of Cash Flows and disclosed as a non-cash activity. The Company revised the amounts related to cash provided by operating activities and cash provided by (used in) investing activities in its Consolidated Statement of Cash Flows to correct for these immaterial errors. The Company has detailed the adjustments to prior periods below:

	Year Ended March 31, 2010	Three Months Ended June 30, 2010	Six Months Ended September 30, 2010	Three Months Ended June 30, 2011
Net cash provided by operating activities:				
As reported	\$ 47,224	\$ 23,854	\$ 31,932	\$ 6,319
As adjusted	45,654	23,138	30,584	4,755
Change	\$ 1,570	\$ 716	\$ 1,348	\$ 1,564
Net cash provided by (used in) investing activities:				
As reported	\$ (61,075)	\$ 13,046	\$ 22,556	\$ (28,994)
As adjusted	(59,505)	13,762	23,904	(27,430)
Change	\$ 1,570	\$ 716	\$ 1,348	\$ 1,564

The Company has also revised the Consolidated Statement of Cash Flows for the nine month and full year periods in the fiscal year ending March 31, 2011. These revisions changed cash flows from operating activities and cash flows from investing activities by \$1.3 million in each period such that: cash flows from operations decreased from \$46.0 million to \$44.7 million, and cash flows from investing activities increased from \$14.0 million to \$15.3 million for the nine month period; cash flows from operations decreased from \$68.5 million to \$67.2 million, and cash out flows from investing activities decreased from \$61.3 million to \$60.0 million for the full year. The adjustments did not change from the six month period through the remainder of the fiscal year ended March 31, 2011 as later inventory transfers occurred in the same accounting period in which the items were purchased; as such those transactions were properly netted down within operating cash flows and shown gross in investing cash flows. The Company has concluded that the errors described above were immaterial to all periods discussed. These errors had no effect on net income or net income per share.



**Table of Contents****2. Concentration of Credit Risk and Significant Customers**

Financial instruments, which include cash, cash equivalents, accounts receivable and accounts payable, are stated at cost, plus accrued interest where applicable, which approximates fair value. Long-term marketable securities include auction rate securities, which are currently illiquid, corporate bonds and U.S. government and municipal obligations. Auction rate securities are stated at fair value based on discounted cash flow calculations.

At September 30, 2011, the Company had one customer which accounted for more than 10% of the accounts receivable balance. At March 31, 2011, the Company had one customer which accounted for more than 10% of the accounts receivable balance. During the three and six months ended September 30, 2011 and 2010, no direct customer or indirect channel partner accounted for more than 10% of total revenue. Historically, the Company has not experienced any significant non-performance by its customers nor does the Company anticipate non-performance by its customers in the future; accordingly, the Company does not require collateral.

**3. Share-Based Compensation**

The following is a summary of share-based compensation expense (in thousands):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2011	2010	2011	2010
Cost of product revenue	\$ 41	\$ 31	\$ 88	\$ 51
Cost of service revenue	47	70	112	130
Research and development	525	368	1,102	641
Sales and marketing	607	588	1,377	1,072
General and administrative	568	444	1,268	785
	\$ 1,788	\$ 1,501	\$ 3,947	\$ 2,679

On September 7, 2011, the Company's stockholders approved an amendment and restatement of the 2007 Equity Incentive Plan (the Amended 2007 Plan) to increase the shares of common stock reserved for issuance by 8,000,000 shares. A total of 13,000,000 shares are reserved for issuance under the Amended 2007 Plan. In addition, any shares not delivered to a participant because an award is exercised through a reduction of shares subject to the award (cashless exercise) will not be available for issuance under the Amended 2007 Plan and any shares reacquired by the Company to cover withholding taxes upon exercise of a stock option or stock appreciation right or as consideration for the exercise of a stock option or stock appreciation right will not become available for issuance under the Amended 2007 Plan. Furthermore, the share reserve under the Amended 2007 Plan is reduced one share for each share of common stock issued pursuant to a stock option or stock appreciation right and two shares for each share of common stock issued pursuant to restricted stock, restricted stock units, performance stock awards, or other stock awards granted under the Amended 2007 Plan on or after March 31, 2011.

On September 7, 2011 the Company's shareholders approved the 2011 Employee Stock Purchase Plan (the ESPP), under which 2,500,000 shares of the Company's common stock have been reserved for issuance. Effective March 1, 2012, eligible employees may purchase shares of the Company's common stock through regular payroll deductions of up to 20% of their eligible compensation. Under the terms of the offering under the ESPP, the number of shares of the Company's common stock which a participant could purchase during any purchase period is limited to 2,000. In addition, the fair market value of shares purchased by an individual participant in the plan may not exceed \$25,000 in any calendar year. The purchase price per share at which shares of common stock are sold on each purchase date during an offering period is determined by the Company's Board of Directors as of the beginning of the offering period, but may not be less than 85% of the lesser of the fair market value per share of common stock on that purchase date or the fair market value per share of common stock on the first day of the offering period. During the three and six months ended September 30, 2011, no shares were issued under the ESPP.

**Table of Contents****4. Cash, Cash Equivalents and Marketable Securities**

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents and those investments with original maturities greater than three months to be marketable securities. Cash and cash equivalents consisted of money market instruments and cash maintained with various financial institutions at September 30, 2011 and March 31, 2011.

**Marketable Securities**

The following is a summary of marketable securities held by NetScout at September 30, 2011 classified as short-term and long-term (in thousands):

	Amortized Cost	Unrealized Gains (Losses)	Fair Value
Type of security:			
U.S. government and municipal obligations	\$ 16,768	\$ (3)	\$ 16,765
Commercial paper	25,083	(1)	25,082
Corporate bonds	25,404	14	25,418
Certificates of deposit	1,257	(2)	1,255
<b>Total short-term marketable securities</b>	<b>68,512</b>	<b>8</b>	<b>68,520</b>
Auction rate securities	19,517	(2,145)	17,372
U.S. government and municipal obligations	8,833	(17)	8,816
Corporate bonds	339	1	340
<b>Total long-term marketable securities</b>	<b>28,689</b>	<b>(2,161)</b>	<b>26,528</b>
<b>Total marketable securities</b>	<b>\$ 97,201</b>	<b>\$ (2,153)</b>	<b>\$ 95,048</b>

The following is a summary of marketable securities held by NetScout at March 31, 2011, classified as short-term and long-term (in thousands):

	Amortized Cost	Unrealized Gains (Losses)	Fair Value
Type of security:			
U.S. government and municipal obligations	\$ 86,670	\$ (1)	\$ 86,669
Commercial paper	24,111	(1)	24,110
Corporate bonds	13,364	17	13,381
Certificates of deposit	5,251	12	5,263
Auction rate securities	4,007	0	4,007
<b>Total short-term marketable securities</b>	<b>133,403</b>	<b>27</b>	<b>133,430</b>
Auction rate securities	19,784	(2,302)	17,482
U.S. government and municipal obligations	8,716	3	8,719
Corporate bonds	1,678	1	1,679
<b>Total long-term marketable securities</b>	<b>30,178</b>	<b>(2,298)</b>	<b>27,880</b>
<b>Total marketable securities</b>	<b>\$ 163,581</b>	<b>\$ (2,271)</b>	<b>\$ 161,310</b>

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Contractual maturities of the Company's marketable securities held at September 30, 2011 and March 31, 2011 were as follows (in thousands):

	September 30, 2011	March 31, 2011
Available-for-sale securities:		
Due in 1 year or less	\$ 68,520	\$ 133,430
Due after 1 year through 5 years	9,156	10,398
Due after 10 years	17,372	17,482
	\$ 95,048	\$ 161,310

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The Company's long-term marketable securities include investments in auction rate securities. Beginning in February 2008 and continuing through September 30, 2011, auctions have failed resulting in a lack of short-term liquidity for these securities, which has caused the Company to classify \$17.4 million as long-term on its consolidated balance sheet. As of September 30, 2011, the Company's auction rate securities consisted of three positions issued by municipal agencies with a total par value of \$19.5 million and a current estimated market value totaling \$17.4 million. As of September 30, 2011, these marketable securities were AAA rated. The securities are collateralized by student loans with underlying support by the federal government through the Federal Family Education Loan Program and by monoline insurance companies.

At September 30, 2011, the Company valued its outstanding long-term auction rate securities at fair value using a discounted cash flow model. This model estimated future interest income using maximum rate formulas applicable to each of these securities which consider historical spreads for benchmark rates included in these formulas as well as rates for U.S. Treasuries. The model then discounts the estimated future interest income using a risk based discount rate that considers known U.S. Treasury yields as of September 30, 2011, historical spreads in comparison to U.S. Treasuries, and a liquidity risk premium. As these securities have retained investment grade credit ratings, the Company has not applied a credit spread to its discount rate. The valuation also includes assumptions as to when these securities will return to liquidity, of which the weighted average period is estimated at between 51 and 55 months depending on the security being valued. This valuation resulted in a cumulative temporary decline in value of \$2.1 million (\$1.3 million, net of tax) as of September 30, 2011 recorded within accumulated other comprehensive income (loss) on the balance sheet. This represents a reduction in the valuation reserve of \$112 thousand (\$71 thousand, net of tax) during the three months ended September 30, 2011 reflecting changes in market interest rates used to value the securities. To the extent the Company determines that any impairment is other-than-temporary, the Company would record a charge to earnings.

The Company has the ability and intent to hold these securities until a recovery in the auction process or other liquidity event occurs. Based on the Company's current cash position, expected operating cash flows and the Company's other sources of cash, the Company does not believe that it is more likely than not that it will be required to sell the securities before a recovery in the auction process or other liquidity event occurs. Additionally, the Company believes that the present value of expected future cash flows consisting of interest payments and the return of principal is sufficient to recover the amortized cost basis of the securities and expects to collect these cash flows. Therefore, the Company does not believe that the decline in value of its auction rate securities is other than temporary, or that any portion of the temporary decline is the result of a credit loss.

**5. Fair Value Measurements**

The Company follows the authoritative guidance for fair value measurements of its financial assets and financial liabilities.

The guidance clarifies the definition of fair value as an exit price representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. The following summarizes the three-tier value hierarchy, which prioritizes, in descending order, the inputs used in measuring fair value as follows:

Level I	Observable inputs for identical securities such as quoted prices in active markets,
Level II	Inputs other than the quoted prices in active markets that are observable either directly or indirectly, and
Level III	Unobservable inputs in which there is little or no market data, which requires the Company to develop its own assumptions.

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This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company measures certain financial assets and liabilities at fair value, including marketable securities and derivative financial instruments.

The Company's Level I investments are classified as such because they are valued using quoted market prices or alternative pricing sources with reasonable levels of price transparency.

The Company's Level II investments are classified as such because fair value is being calculated using data from similar but not identical issues, or a discounted cash flow model using the contractual interest rate as compared to the underlying interest yield curve. The Company's short-term auction rate securities at March 31, 2011 were classified as Level II since the amount which was redeemed in April 2011 was based upon a redemption notice for an inactive market. The Company's derivative financial instruments consist of forward foreign exchange contracts and are classified as Level II because the fair values of these derivatives are determined using models based on market observable inputs, including spot prices for foreign currencies and credit derivatives, as well as an interest rate factor. For further information on the Company's derivative instruments refer to Note 10.

The Company's long-term auction rate securities are classified as Level III of the fair value hierarchy due to the limited market data for pricing these securities and the subjective factors considered to create a liquidity discount.

The following table summarizes the valuation of the Company's financial assets and liabilities by the above categories as of September 30, 2011 (in thousands):

	<b>Total Fair Value</b>	<b>Level I</b>	<b>Level II</b>	<b>Level III</b>
<b>ASSETS:</b>				
Cash and cash equivalents	\$ 103,859	\$ 103,859	\$ 0	\$ 0
U.S. government and municipal obligations	25,581	25,581	0	0
Commercial paper	25,082	0	25,082	0
Corporate bonds	25,758	25,758	0	0
Certificate of deposits	1,255	0	1,255	0
Auction rate securities	17,372	0	0	17,372
Derivative financial instruments	18	0	18	0
	<b>\$ 198,925</b>	<b>\$ 155,198</b>	<b>\$ 26,355</b>	<b>\$ 17,372</b>
<b>LIABILITIES:</b>				
Derivative financial instruments	\$ (412)	\$ 0	\$ (412)	\$ 0
	<b>\$ (412)</b>	<b>\$ 0</b>	<b>\$ (412)</b>	<b>\$ 0</b>

The following table sets forth a reconciliation of changes in the fair value of the Company's Level III financial assets (in thousands):

	<b>Three Months Ended September 30, 2011</b>	<b>Six Months Ended September 30, 2011</b>
Balance at beginning of period	\$ 17,248	\$ 17,482
Change in accrued interest receivable	12	(17)
Redemptions	0	(250)
Reversal of temporary loss on redeemed securities	0	45
Unrealized gains included in other comprehensive income	112	112
Balance at end of period	\$ 17,372	\$ 17,372





**Table of Contents****6. Inventories**

Inventories are stated at the lower of actual cost or net realizable value. Cost is determined by using the first-in, first-out (FIFO) method. Inventories consist of the following (in thousands):

	September 30, 2011	March 31, 2011
Raw materials	\$ 4,995	\$ 4,548
Work in process	480	27
Finished goods	3,488	4,350
	\$ 8,963	\$ 8,925

**7. Acquisition**

On April 1, 2011, the Company acquired all of the outstanding equity of Psytechnics, Ltd. (Psytechnics) a supplier of voice video network monitoring software. Psytechnics was acquired to expand NetScout's voice video monitoring capabilities using Psytechnics' existing software offering, Experience Manager. The results of Psytechnics' operations have been included in the consolidated financial statements since that date. The total purchase price of \$17 million consisted entirely of cash consideration. The goodwill recognized primarily relates to the value in combining Psytechnic's product with our customer base.

The following table summarizes the allocation of the purchase price (in thousands):

Allocation of the purchase consideration:	
Current assets, including cash and cash equivalents of \$69	1,099
Fixed assets	50
Identifiable intangible assets	4,350
Goodwill	13,179
Total assets acquired	18,678
Current liabilities	(1,198)
Deferred revenue	(466)
	\$ 17,014

The Company has analyzed the realizability of the deferred tax assets of Psytechnics and has concluded that it is appropriate to provide a valuation allowance against these balances, given the weight of the historical objective evidence. The net asset balance reserved is \$3.1 million and primarily consists of net operating loss carry forwards and tax basis in intangibles previously amortized for financial reporting purposes attributable to the U.K. operations of the acquired entity. The Company will continue to evaluate additional positive and negative evidence relating to the realizability of these assets within the first year of the transaction; any resulting changes to the valuation allowance attributable to facts existing as of the acquisition date but unknown at the time of the assessment would be recorded against goodwill. Any new facts resulting in changes to the valuation allowance will be recorded as a component of earnings.

Goodwill was recognized for the excess purchase price over the fair value of the assets acquired. Goodwill from the Psytechnics acquisition will be included within the Company's one reporting unit and will be included in the Company's enterprise-level annual review for impairment. No goodwill associated with this transaction will be deductible for tax purposes.

The following table reflects the fair value of the acquired identifiable intangible assets and related estimates of useful lives (in thousands):

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	<b>Fair Value</b>	<b>Useful Life (Years)</b>
Acquired software	\$ 1,200	5
Customer relationships	450	10
Core technology	2,700	10
	\$ 4,350	

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The weighted average useful life of identifiable intangible assets acquired from Psytechnics is 8.6 years. These assets are amortized using an accelerated amortization method.

The following table presents the pro forma results of the historical Consolidated Statements of Operations of the Company and Psytechnics for the three and six months ended September 30, 2011 and 2010, giving effect to the merger as if it occurred on April 1, 2011 and 2010 (in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	September 30,		September 30,	
	2011	2010	2011	2010
Pro forma revenue	\$ 72,624	\$ 69,892	\$ 135,920	\$ 137,487
Pro forma net income	\$ 7,051	\$ 7,410	\$ 9,450	\$ 13,699
Pro forma income per share:				
Basic	\$ 0.17	\$ 0.18	\$ 0.22	\$ 0.33
Diluted	\$ 0.17	\$ 0.17	\$ 0.22	\$ 0.32
Pro forma shares outstanding				
Basic	42,258	41,922	42,433	41,867
Diluted	42,720	42,778	43,061	42,626

The pro forma revenue, net income and income per share for the three and six months ended September 30, 2011, is the same as the results reported in the Consolidated Statement of Operations of the Company for the three and six months ended September 30, 2011. The pro forma results for the three and six months ended September 30, 2010 primarily includes adjustments for amortization of intangibles, interest income and interest expense. This pro forma information does not purport to indicate the results that would have actually been obtained had the acquisition been completed on the assumed date, or which may be realized in the future.

Since the date of acquisition we have recorded \$650 thousand of revenue earned by Psytechnics within our consolidated financial statements.

**8. Goodwill & Intangible Assets****Goodwill**

The carrying amount of goodwill was \$141.4 million and \$128.2 million as of September 30, 2011 and March 31, 2011. The Company's goodwill resulted from the acquisition of Psytechnics in April 2011, Network General Central Corporation (Network General) in November 2007, the acquisition of substantially all of the assets of Quantiva, Inc. in April 2005 and the acquisition of NextPoint Networks, Inc. in July 2000.

	September 30,
	2011
Balance as of March 31, 2011	\$ 128,177
Goodwill related to the acquisition of Psytechnics	13,179
Balance as of September 30, 2011	\$ 141,356

**Intangible Assets**

The net carrying amounts of intangible assets were \$48.9 million and \$47.7 million as of September 30, 2011 and March 31, 2011, respectively. Intangible assets acquired in a business combination are recorded under the acquisition method of accounting at their estimated fair values at the date of acquisition. The Company amortizes intangible assets over their estimated useful lives, except for the acquired trade name which resulted from the Network General acquisition, which has an indefinite life and thus is not amortized. The carrying value of the indefinite lived trade name will be evaluated for potential impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired.



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Intangible assets consist of the following as of September 30, 2011 (in thousands):

	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net</b>
Acquired software	\$ 21,100	\$ (15,691)	\$ 5,409
Customer relationships	29,650	(7,401)	22,249
Indefinite lived trade name	18,600	0	18,600
Core technology	2,700	(104)	2,596
Net beneficial leases	336	(326)	10
Other	103	(28)	75
	\$ 72,489	\$ (23,550)	\$ 48,939

Amortization of software and core technology included as cost of product revenue was \$1.1 million and \$2.2 million for the three and six months ended September, 2011, respectively. Amortization of other intangible assets included as operating expense was \$521 thousand and \$976 thousand for the three and six months ended September 30, 2011, respectively.

Intangible assets consist of the following as of March 31, 2011 (in thousands):

	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net</b>
Acquired software	\$ 19,900	\$ (13,598)	\$ 6,302
Customer relationships	29,200	(6,437)	22,763
Indefinite lived trade name	18,600	0	18,600
Net beneficial leases	336	(315)	21
	\$ 68,036	\$ (20,350)	\$ 47,686

Amortization of software included as cost of product revenue was \$995 thousand and \$2.0 million for the three and six months ended September 30, 2010, respectively. Amortization of other intangible assets included as operating expense was \$477 thousand and \$954 thousand for the three and six months ended September 30, 2010, respectively.

The following is the expected future amortization expense as of September 30, 2011 for the years ended March 31 (in thousands):

2012 (remaining six months)	\$ 3,246
2013	5,036
2014	2,644
2015	2,526
2016	2,382
Thereafter	14,505
	\$ 30,339

The weighted average amortization period of acquired software and customer relationships is 5.5 and 15.4 years respectively. The weighted average amortization period for amortizing intangibles is 11.0 years.

**9. Capitalized Software Development Costs**

Net capitalized software development costs for NetScout's nGenius Service Delivery Manager product totaled \$153 thousand and \$255 thousand at September 30, 2011 and March 31, 2011, respectively. This product was released on June 29, 2010, and is being amortized on a straight-line basis over two years. Amortization included as cost of product revenue related to this product was \$51 thousand, \$102 thousand, \$51 thousand and \$102 thousand for the three and six months ended September 30, 2011 and 2010, respectively.

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NetScout operates internationally and, in the normal course of business, is exposed to fluctuations in foreign currency exchange rates. The exposures result from costs that are denominated in currencies other than the U.S. dollar, primarily the Euro, British Pound, Canadian Dollar, and Indian Rupee. The Company manages its foreign cash flow risk by hedging forecasted cash flows for operating expenses denominated in foreign currencies for up to twelve months, within specified guidelines through the use of forward contracts. The Company enters into foreign currency exchange contracts to hedge cash flow exposures from costs that are denominated in currencies other than the U.S. dollar. These hedges are designated as cash flow hedges at inception.

All of the Company's derivative instruments are utilized for risk management purposes, and the Company does not use derivatives for speculative trading purposes. These contracts will mature over the next twelve months and are expected to impact earnings on or before maturity.

The notional amounts and fair values of derivative instruments in the condensed consolidated balance sheets as of September 30, 2011 and March 31, 2011 were as follows (in thousands):

	Notional Amounts (a)		Other Current Assets		Accrued Other Liabilities	
	September 30, 2011	March 31, 2011	September 30, 2011	March 31, 2011	September 30, 2011	March 31, 2011
<b>Derivatives Designated as Hedging Instruments:</b>						
Forward contracts	\$ 13,220	\$ 10,943	\$ 18	\$ 158	\$ 412	\$ 92

(a) Notional amounts represent the gross contract/notional amount of the derivatives outstanding.

The following table provides the effect foreign exchange forward contracts had on other comprehensive income (loss) (OCI) and results of operations for the three months ended September 30, 2011 and 2010 (in thousands):

	Gain (Loss) Recognized in OCI on Derivative (a)		Effective Portion Gain (Loss) Reclassified from Accumulated OCI into Income (b)		Ineffective Portion Gain (Loss) Recognized in Income (Amount Excluded from Effectiveness Testing) (c)			
	September 30, 2011	September 30, 2010	Location	September 30, 2011	September 30, 2010	Location	September 30, 2011	September 30, 2010
	<b>Derivatives in Cash Flow Hedging Relationships</b>							
Forward contracts	\$ (480)	\$ 433	Research and development	\$ (17)	\$ (14)	Research and development	\$ 21	\$ 24
			Sales and marketing	73	(157)	Sales and marketing	31	(6)
	\$ (480)	\$ 433		\$ 56	\$ (171)		\$ 52	\$ 18

(a) The amount represents the change in fair value of derivative contracts due to changes in spot rates.

(b) The amount represents reclassification from other comprehensive income to earnings that occurs when the hedged item affects earnings.



- (c) The amount represents the change in fair value of derivative contracts due to changes in the difference between the spot price and forward price that is excluded from the assessment of hedge effectiveness and therefore recognized in earnings. No gains or losses were reclassified as a result of discontinuance of cash flow hedges.

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The following table provides the effect foreign exchange forward contracts had on OCI and results of operations for the six months ended September 30, 2011 and 2010 (in thousands):

	Gain (Loss)		Effective Portion		Ineffective Portion			
	Recognized in		Gain (Loss)		Recognized in			
	OCI on		Reclassified from		Income (Amount Excluded from			
	Derivative		Accumulated		Effectiveness Testing)			
	(a)		(b)		(c)			
	September	September	Location	September	September	Location	September	September
Derivatives in Cash Flow	30,	30, 2010		30, 2011	30, 2010		30, 2011	30,
Hedging Relationships	2011	2010		2011	2010		2011	2010
Forward contracts	\$ (296)	\$ (129)	Research and development	\$ (3)	\$ (7)	Research and development	\$ 77	\$ 8
			Sales and marketing	234	(426)	Sales and marketing	35	1
	\$ (296)	\$ (129)		\$ 231				