

NETSCOUT SYSTEMS INC
Form 10-K
June 16, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended March 31, 2008

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)

Delaware
(State or other jurisdiction of
incorporation or organization)

310 Littleton Road, Westford, MA 01886

(978) 614-4000

04-2837575
(IRS Employer
Identification No.)

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

Common Stock, \$0.001 Par Value

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 Smaller reporting company

(Do not check if a 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 aggregate market value of common stock held by non-affiliates of the registrant as of September 30, 2007 (based on the last reported sale price on the Nasdaq Global Market as of such date) was approximately \$260,689,316. As of June 10, 2008, there were 39,086,746 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

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(1) Portions of the Registrant's Proxy Statement for the fiscal year 2008 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K. Except as expressly incorporated by reference, the proxy statement is not deemed to be part of this report.

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FORM 10-K

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PART I

Item 1. Business

NetScout Systems, Inc., or We, or NetScout or the Company, a Delaware corporation founded in 1984 and headquartered in Westford, Massachusetts, designs, develops, manufactures, markets, sells and supports a family of products that assures the performance and availability of critical business applications and services in complex, high-speed networks. We manufacture and market these products as an integrated hardware and software solution that is used by enterprises, government agencies and communications service providers worldwide. We have a single operating segment and substantially all of our identifiable assets are located in the United States of America.

In November 2007, we acquired Network General Central Corporation, or Network General, to expand our product line and customer base. Network General and its predecessors were the developers of the Sniffer branded products which for many years have been a leading brand with substantial market share and mind share in the network management market. Recently, Network General introduced the InfiniStream product line, based on the Sniffer® technology, which has been well received by the Sniffer customer base and has experienced rapid revenue growth. The acquisition has more than doubled NetScout's pre-acquisition revenue rate and doubled the employee population, consolidating our position as a leader in the application and service performance assurance market.

Businesses have continued to increase their reliance on software applications and computer networks, making them strategic assets for competitive advantage and essential to business operations. To support the growing number of users and their demands for faster and more reliable computer network access, new network technologies and products are continually being introduced. New services and applications are increasingly based on service-oriented architectures, implemented over virtualized resources, including networks, storage, and servers. Furthermore, due to the proliferation of malicious computer viruses, destructive worms and sophisticated hackers, businesses and service providers have adopted robust security systems and procedures that are not always consistent with performance goals. The result is increasingly large, geographically dispersed, and complex networks and infrastructures that are challenging to manage and make service performance levels difficult to guarantee. Computer network malfunctions, resource contention, and infrastructure and application misconfigurations can all cause service disruptions, lost revenue and customer dissatisfaction. Consequently, network operators are recognizing the critical importance of addressing customer service performance problems quickly and proactively. The NetScout Systems suite of products is designed for this rapidly growing market of organizations running complex, widely-distributed networks that are built for secure performance.

The *nGenius*® Performance Management System, our integrated, appliance-based software solution, monitors, collects and publishes information on the behavior of individual applications and services, such as Voice over Internet Protocol, or VoIP, streaming media, supply chain management, and customer relationship management, as well as the performance of the underlying network (routers, switches and communication links), and the level of activity by end-users or subscribers. The *nGenius* Solution draws on performance data collected directly from multiple sources, including our lines of network monitoring appliances, or instruments, called *nGenius* Probes and *nGenius* InfiniStream appliances as well as infrastructure devices. The probes and InfiniStream appliances monitor network traffic non-intrusively and collect in-depth information about application and network activity in real time by means of deep and direct inspection of live flows of network packets. Organizations can gain substantial visibility to better understand and manage service and application performance across the network by instrumenting strategic locations throughout a network. The live instrumentation is complemented by our Sniffer line of advanced packet-based expert analysis products for definitive troubleshooting of the most difficult and subtle performance problems.

The *nGenius* Solution generates performance information in real-time displays and customizable historical reports. These displays and reports communicate application performance, service levels, network health, and other critical metrics of availability, utilization and performance, and are delivered to the network engineering

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and operations staff in easy-to-read, Web-based formats. Our customers use the information generated by the *nGenius* Solution to detect problems early and to diagnose and solve them rapidly, thereby reducing the Mean Time to Repair/Restore, or MTTR, for service operations. Using the collected performance data they can also manage the delivery of services and monitor service-level agreements, assess infrastructure capacity against future needs, and justify requirements for additional resources.

Increases in both application complexity and traffic loads have given rise to the need for higher speed infrastructures and Quality of Service, or QoS, prioritization policies to optimize service and application performance. To meet the ongoing challenges required for visibility into the health and activity of these applications, services and infrastructures, NetScout continuously extends the *nGenius* Performance Management System. During fiscal year 2008, we delivered major product enhancements across our product lines, more tightly integrating deep packet forensics into our top-down performance troubleshooting workflows, improving the flexibility of our industry-leading advanced early warning capabilities, and adding support for new sources of performance metrics. We also announced a ground-breaking product integration initiative with Hewlett Packard, Inc., or HP, to tightly couple our management products and deliver NetScout's powerful application-aware performance information into HP's sector-leading enterprise and business service management platforms. And most importantly, we added a major new set of complementary monitoring and troubleshooting products through our acquisition of Network General, allowing us to combine Sniffer technologies—the most powerful and well-known expert packet analysis tools in the world—with the enterprise-scale real-time monitoring and reporting strengths of the *nGenius* System.

We market and distribute our products both through our own direct sales force and through channel partners that include distributors, resellers, service providers and systems integrators. Our principal customers are Global 5000 enterprises, representing a wide range of industries including financial services, technology, telecommunications, healthcare, retail, manufacturing, and wireless service providers, as well as many large agencies of the federal government. We had no one customer or channel partner representing more than 10% of revenues in fiscal years 2008, 2007 or 2006.

Our principal executive offices are located at 310 Littleton Road, Westford, Massachusetts, and our telephone number is (978)614-4000.

Industry Background

Large enterprises, government agencies, and telecommunications service providers are critically dependent upon their computer data networks and on the Internet to generate and deliver information and business services to their constituents, namely their customers, suppliers, investors, employees, and citizens. Simultaneously, these data networks are taking on new roles: subsuming the role of the voice network and serving as the platform for the next generation of massively distributed, virtualized, service-oriented application architectures. Furthermore, rapidly advancing server technology and mushrooming multimedia applications continue to drive up traffic levels and have spawned a new wave of infrastructure upgrades, including broad deployment of 10 Gigabit per second Ethernet network technology. In parallel, the telecommunications sector continues to undergo fundamental changes with the accelerating transition to IP (Internet Protocol)-based services, requiring new network infrastructures and presenting new and daunting challenges for assessing and assuring service quality. The combination of these fundamental trends produces unprecedented complexity coupled with unparalleled business impact requiring capable management technology.

Large organizations have been bracing themselves for these challenges by investing in new, more powerful performance management solutions and making organizational and process changes to be able to prevent and resolve service disruptions more rapidly while keeping operating costs, including personnel costs, under control. Core to these changes is the view of the service delivery infrastructure not simply as a collection of servers, storage devices, network equipment and applications that can be managed in isolation of one another, but as an integral system containing all of these elements whose complex interactions and relationships must be managed

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as a whole. Further, growing enterprise adoption of service-oriented business process initiatives such as ITIL (Information Technology Infrastructure Library) and COBIT (Control Objectives for Information and related Technology) reflect Information Technology, or IT, departments' attempts to transform from tactical business enablers to strategic business partners within the organizations they serve. These movements are breaking down organizational walls in IT that traditionally have separated the network group from the data center, server and application groups, and similar walls within communications service providers that have separated transport, access, and service teams. These changes necessitate management solutions that can address both new technologies and emerging workflow and organizational models.

The leaders of the server, network, and application management segments of the industry have responded to these new realities with a series of acquisitions and strategy announcements, all aimed at strengthening the scope of their management system positions.

Although the intrinsic need for better network, application, and service management solutions is growing, successful vendors must demonstrate not only technical superiority, but also a sound understanding of the implications of the transformational changes in the industry, as well as the ability to deliver new solutions to match evolving customer needs. These vendors must also prove their staying power and stability, and demonstrate the ability to partner successfully with industry leaders.

NetScout's Advanced Performance Management Solution

Our solution is based on three principles: early support for emerging new architectures and technologies, end-through-end scope, and smooth integration with our customers' systems environment and management processes.

Early support for emerging new technologies and application architectures is highly valued by our customers who are often leaders within their industries and depend on rapid technology absorption to maintain or extend their market positions. Advanced performance management, offering superior visibility, is most needed where these new technologies and architectures are first deployed and their behavior and impact are unknown in advance. NetScout has developed an architecture and technology, called the Common Data Model, or CDM, that uniquely enables the customer to monitor and manage all their key applications throughout their often world-wide networks in the same consistent manner. This technology also enables rapid product development, which benefits our customers through faster access to new features, and results in delivery of multiple software and firmware releases annually, which are part of our service delivery to customers currently active in our maintenance program.

We have developed our unique technology and product architecture around the firm conviction that packet-flow-based performance data is the most powerful basis for high-value, business-relevant service assurance solutions. The CDM technology allows us to collect performance data from multiple sources spanning virtually any network or application technology or topology, whether retrieved from our *nGenius* Probes, *nGenius* InfiniStream appliances, standards-based infrastructure devices, or value-added performance information from our technology partners' devices. Furthermore, our technology readily accommodates new application types, such as peer-to-peer applications; new network technologies, such as OC-48 Packet-over-SONET or 10 Gigabit per second Ethernet; and new application design techniques, such as Service-oriented Architectures, or SOA, are readily accommodated by this framework. CDM data is mapped into a common performance data repository, where *nGenius* Performance Manager can be used to provide a comprehensive solution for real-time monitoring, troubleshooting, and capacity planning, and *nGenius* K2 can be used for intelligent early warnings and service performance management across the enterprise. The CDM technology foundation has allowed us to stay ahead of competition by offering superior visibility into service and application traffic.

To make the greatest impact on assuring performance of applications and services, NetScout is integrating with third-party event management consoles and business service management systems. This integration allows

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operators to receive alarms on impending performance problems and to drill down into the *nGenius* K2 and Performance Manager applications to perform detailed problem analysis and troubleshooting. By partnering and integrating, NetScout fills a significant gap in our customers increasingly integrated operations: visibility into the interaction of applications, services, and infrastructure resources from a network vantage point.

NetScout Products and Performance Technology

We develop, manufacture, sell and support network performance management solutions under the *nGenius* and *Sniffer* brands. The *nGenius* Performance Management System, based on our patent-pending CDM technology, is a robust and complete solution, consisting of integrated hardware and software components that monitor, measure and report on the network's ability to fulfill its performance, cost and service-level objectives. The system is comprised primarily of two components—data collection (via our *nGenius* Probes, *nGenius* InfiniStreams, *nGenius* Collectors, and Simple Network Management Protocol, or SNMP, polling) and information filtering, aggregation, recording, analysis and presentation via our Sniffer Intelligence, Sniffer Portable, *nGenius* Performance Manager and *nGenius* K2 software applications.

Subsequent to the acquisition of Network General in November 2007, we began to integrate Network General's products and technologies into the *nGenius* Performance Management System. We are combining the Network General InfiniStream product technology with our similar *nGenius* Application Fabric Monitor product, or AFMon, into a new *nGenius* InfiniStream branded product that will be a leading element of the *nGenius* Performance Management System. We are continuing to market most other Network General products while ending sale on primarily the older product lines that have experienced revenue deterioration over the past several years. We will, however, continue to support substantially all of Network General's pre-acquisition products for those customers currently under maintenance programs.

With the acquisition of Network General, we also added a wide range of other products to our *nGenius* System solution. In addition to the integration of the InfiniStream product, product integrations and migrations are taking place across multiple points within NetScout's solutions architecture, both at the instrumentation and analysis software levels. Most notably, the advanced protocol decode and packet analysis capabilities of the Sniffer Portable and Sniffer Intelligence applications significantly extend NetScout's flow-based solution strengths. New product releases in this area include Sniffer Financial Intelligence, which adds specific capabilities to support technologies of high importance to financial trading architectures, and Sniffer Mobile Intelligence, which delivers analysis capabilities optimized for tracking service delivery within mobile communications operator environments.

Our solutions are aligned with the needs of our target customers according their specific levels of integrated service assurance processes and priorities and offered at three tiers of capability. Most IT organizations today practice reactive incident management, where the primary goal is to troubleshoot problems rapidly and definitively as they occur and restore services to their desired levels as quickly as possible. For this set of needs, NetScout advocates the *nGenius* InfiniStream data collection products, with their high capacity stream-to-disk capabilities for capturing continuous application service session packets, and our Sniffer Intelligence suite of advanced reconstructive analysis applications.

At the next level of process maturity is proactive problem management, where organizations are focusing on systemic reduction of performance problems and becoming proactive in assuring service quality. For this level of requirements, NetScout recommends incremental additions to our incident management solutions by deploying additional packet-flow instrumentation at key points of traffic aggregation across distributed networks, complemented by *nGenius* Performance Manager for real-time enterprise-wide visibility, rapid isolation of performance issues across geographies and domains, and business priority-driven capacity planning. We offer two types of instrumentation: *nGenius* Probes (real-time packet-based monitoring) and *nGenius* InfiniStream appliances (real-time packet-based monitoring plus packet stream-to-disk for retrospective detailed analysis). These high performance devices attach to the network in a non-intrusive, passive manner and monitor traffic

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patterns in real time. Through in-depth, on-the-fly analysis of traffic information, these devices are able to monitor error rates, usage levels and response times by application, by user and by server and are able to detect and alarm on unexpected conditions. By placing NetScout packet-flow instrumentation at strategic locations throughout a network, organizations gain network-wide visibility of their traffic flows so they can better understand and optimize application performance and delivery.

The most advanced maturity level toward which the industry is moving is called service-aware performance management, or Business Service Management (BSM), at which level organizations are ready to move to preventive approaches that can be linked to and prioritized by business criticality. Newly introduced during fiscal year 2008, NetScout's *nGenius* K2 product delivers service status views and intelligent early warning capabilities, and represents a service-aware approach which leverages all of the investments our customers have previously made in packet-flow instrumentation to achieve proactive performance management.

We continually enhance our instrumentation technology to ensure visibility into all types of network traffic and communications technologies. Our track record of innovation began with the introduction of Ethernet probes in 1992 and continues at an accelerated pace today. We have continued to advance instrumentation technology with the addition of more than 30 new instrumentation products over the past 10 years. We also continue to advance our solutions for integrated performance management using third party data sources. In parallel with our packet-based solutions, NetScout offers a full set of solutions for application-aware monitoring based on NetFlow and IPSLA data gathered from network infrastructure devices including routers and switches manufactured by Cisco, Juniper, Foundry, and others.

Strategy

Enhancing shareholder value through sustained growth and increased profitability based on market leadership is our continued objective. We intend to pursue growth by expanding our worldwide presence and customer base, establishing relationships with new technology partners, increasing our mindshare with strategic resellers and increasing our ongoing business with our established customers. We intend to extend our market leadership by continuing to expand the market's first strategic, integrated, network and application performance management platform that overlays the network, and to create the information needed to avoid service failures and performance degradations. Key elements of our strategy include:

Extend Technology Leadership. We intend to continue to invest significantly in research and development to expand and enhance our first-to-market, integrated platform for performance management solutions that capitalizes on our extensive experience with global organizations and their very large computer networks. Key aspects of our technology leadership include the ability to generate new statistics and information from network traffic, the ability to develop new and groundbreaking performance management techniques based on that information, the ability to deliver solutions across a multi-vendor environment, and our vision of emerging uses of communications technology and networked environments. As part of our strategy, we will endeavor to enter into strategic relationships with, and/or possibly acquire other companies to complement our technologies, such as our recent acquisition of Network General. We intend to incorporate new technologies and provide solutions that will enable businesses, service providers, and government agencies to manage and optimize the performance of their networks, network-delivered applications and network-based service offerings.

Expand Reporting and Analysis Software Solutions. We plan to enhance our analysis, presentation and reporting software to capitalize on growing demands for integrated performance management solutions and opportunities that have been created by changes and trends in networking and application technologies such as VoIP, telepresence, and Service Oriented Architecture, or SOA-based applications. We also plan to leverage the unique information generated by our instrumentation through enhanced integrated reporting and analysis tools.

Extend Instrumentation Family. We plan to continue the expansion of our instrumentation line of products, including our *nGenius* Probes and our *nGenius* InfiniStream products, extending our monitoring capabilities to

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meet emerging network environment demands including higher speeds, new types of traffic, new communications architectures and technologies and new network topologies. To ensure that our customers are able to achieve comprehensive oversight of their networks, we typically maintain our support for older technologies while regularly introducing product versions for newer ones. Our instrumentation family covers technologies for both domestic and international markets.

Expand Our Installed-Base. With the acquisition of Network General, we have more than doubled our active customer base. Our combined customer set now includes 70% of the Fortune 500 and 40% of the Fortune Global 2000. The *nGenius* System currently is only lightly penetrated in the large majority of our new customers resulting from the Network General acquisition, and there is a significant opportunity to provide *nGenius* functionality to these customers. We have initiated steps to target Network General customers and existing *nGenius* users with marketing and sales programs designed to promote more extensive use of our performance management solutions. Customers can purchase products through our reseller partners or directly from us. In both cases (reseller or direct sales), we believe in a high-touch selling model to assure customer satisfaction. In this model, our worldwide field sales force maintains a very high presence with customers and prospects, consulting in both direct and reseller sales opportunities to meet customers' needs.

Target Market Opportunities. We target our products at markets that we believe have the potential for growth. The key characteristic of companies that have strong demand for our solution is their reliance on their IT infrastructure for critical, time-sensitive services that have a high financial or mission impact. We have identified the following markets as having the potential for increasingly strong demand for our integrated products:

Global enterprises;

Federal, state and local governments;

Global communications service providers, including IP-based wireless and wireline carriers, Internet Service Providers (ISPs), Managed Service Providers (MSPs), and outsourcers; and

Financial services companies.

Expand Distribution Channels. We plan to maintain our direct field sales presence during fiscal year 2009 because we believe the sales force, which more than doubled in size after the Network General acquisition, is appropriately sized for our business in 2009. We expect to resume expansion of the sales force as our business grows. We also seek to develop additional indirect distribution channels with systems integrators, resellers and service providers. Our channel relationships include: World Wide Technology, Force 3 and Verizon. During this past year we completed several new channel agreements. These channel partners facilitate the worldwide distribution, support and market acceptance of our solutions. We also anticipate that possible strategic relationships may result in some form of go to market relationship.

Facilitate Development of Complementary Third-Party Products and Vendor Relationships. Our instrumentation generates rich performance information that can enhance the value of third-party software products and helps increase demand for our products as part of an integrated network monitoring solution. For instance, *nGenius* Performance Manager can be used with Hewlett-Packard's Network Node Manager. NetScout became a Platinum Business Partner in HP's Enterprise Management Alliance Program, and we integrated *nGenius* Performance Manager with HP Software's Network Node Manager and Business Availability Center (then part of Mercury Interactive) during fiscal year 2005. We have maintained and enhanced that integration with the more recent releases of HP products. During fiscal year 2008, NetScout and HP announced a deeper, jointly-developed product integration whereby unique functionality will be made available to our common customers with the expectation that the success of the integration will lead to a form of joint marketing and sales effort. We also completed and certified an integration solution with IBM/Tivoli's Netcool platform during fiscal year 2008.

Sales and Marketing

NetScout targets commercial businesses, government agencies, and communications service providers with large, mission-critical networks through a combination of direct and indirect sales channels. We emphasize hiring

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practices and orientation which ensure our sales personnel are highly experienced, talented and well trained. We provide programs for our direct sales force, as well as channel partners, throughout the year, for in-depth product and technical training. We sponsor joint initiatives involving both the sales teams of NetScout and our partners.

NetScout's sales force uses a direct high-touch sales model that consists of meetings with customers to understand and identify their unique business requirements. Our sales teams then translate those requirements into tailored business solutions that allow the customer to maximize the performance of its infrastructure. Due to the complexity of the systems and the capital expenditure involved, our sales cycle takes typically three to 12 months. We build strategic relationships with our customers by continually enhancing our solution, based on their expressed needs, to help them solve their evolving infrastructure management problems. Therefore, a major element of our business model is to provide software enhancements, including major revisions, to our customers as part of their maintenance contracts with us. These enhancements are designed to provide additional value from customers with existing installations of our solution and to promote their expansion of the deployment of our products. This is a significant part of our ongoing business opportunity with existing customers that is also driven by expansion and change in their networks as they add new infrastructure topologies, new types of traffic and new applications. Our sales model is designed to capitalize on this opportunity.

Our channel partners include original equipment manufacturers, distributors, resellers, service providers and systems integrators. Total revenue from indirect distribution channels represented 65%, 61% and 61% of total revenue for the fiscal years ended March 31, 2008, 2007 and 2006, respectively.

Our sales force is organized into five main geographic teams covering sales around the globe. Revenue from sales outside the United States represented 27%, 24% and 26% of our total revenue in the fiscal years ended March 31, 2008, 2007 and 2006, respectively. Sales outside the United States are primarily export sales to channel partners, who are generally responsible for selling products and providing consulting, technical support and service to customers within their territory. Our reported international revenue does not include any revenue from sales to customers outside the United States that are shipped to any of our United States-based indirect channel partners. These domestic resellers may sell NetScout products to international locations; however, NetScout reports these shipments as United States revenue since NetScout ships the products to a United States location. We expect revenue from sales outside the United States to continue to account for a significant portion of our revenue in the future. For more information on the geographic distribution of our revenue, see Note 16 to the attached consolidated financial statements.

We manufacture our products based upon near term demand resulting from detailed sales forecasts. Due to the fact that these forecasts have a high degree of variability because of such factors as time of year, overall economic conditions and employee incentives we maintain inventory levels in advance of receipt of firm orders to try and ensure that we have sufficient stock to satisfy all incoming orders.

We configure our products to customer specifications and generally deliver the final products to the customer within a relatively short time after receipt of the purchase order. These orders also often include service engagements and technical support coverage. Customers may reschedule or cancel orders prior to shipment with little or no penalty. Because of the relatively short time between order receipt and shipment and due to the fact that customers may reschedule or cancel the orders during this interim period, we believe that our backlog as of any particular date does not determine near term revenue and is not indicative of future order bookings levels.

As of March 31, 2008, our North American field sales organization consisted of 181 employees. Our international field sales organization consisted of 86 employees with offices in the United Kingdom, Hong Kong, Germany, France, Singapore, Korea, Taiwan, Australia, China, Malaysia and Japan. In addition, we had 19 employees responsible for providing telesales and sales and administrative support located in the United States and abroad.

As of March 31, 2008, our marketing organization consisted of 18 employees. Our marketing organization produces and manages a variety of programs such as advertising, trade shows, public relations, direct mail,

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seminars, sales promotions, and web marketing to promote the sale and acceptance of our solutions and to build the NetScout *nGenius* and Sniffer brand names in the marketplace. Key elements of our marketing strategy focus on market education, reputation management, demand generation, and acceleration of strategic selling relationships with local and global resellers, systems integrators, and our technology alliance partners.

Support Services

Customer satisfaction is a key driver of NetScout's success. NetScout MasterCare support programs offer customers various levels of high quality support services to assist in the deployment and use of our solutions. NetScout offers 24/7 toll-free telephone support to its MasterCare customers. We have support personnel located in the United States and abroad with some of the support provided by qualified third party support partners. In addition many of our certified resellers provide first line support to NetScout customers. This is especially prevalent in international locations where time zones and language, among other factors, make it more efficient for the customer to have the reseller provide initial support functions. MasterCare support also includes updates to our software and firmware at no additional charge, if and when such updates are developed and made generally available to our commercial customer base. If ordered, MasterCare support commences upon expiration of the standard warranty for software. For software, which also includes firmware, the standard warranty commences upon shipment and expires 90 days thereafter. With regard to hardware, the standard warranty commences upon shipment and expires 12 months thereafter. We believe our warranties are consistent with commonly accepted industry standards.

NetScout issues a monthly support newsletter, MasterCare News, which informs our MasterCare customers of new releases, patches, technical tips and documentation tips. MasterCare customers receive the benefits of comprehensive customer support website that provides an on-line database of product and usability information and the latest downloadable patches as well as an on-line trouble ticketing system. NetScout continues to make new investments in call center infrastructure to further improve our ability to service our customers. As of March 31, 2008, our support services organization consisted of 87 employees located in the United States and India.

Research and Development

Our continued success depends significantly on our ability to anticipate and create solutions that will meet emerging customer requirements. We have extensive experience in market development in conjunction with pioneering next generation network performance management technologies. We believe that our core technology for monitoring and troubleshooting network and applications performance remains positioned at the forefront of a growing market. Our *nGenius* Solution integrates the principal functions of network and application performance management: real-time network monitoring, applications monitoring, troubleshooting, proactive alarming, capacity planning and service level management. Our plans are to continue to leverage the comprehensive benefits of this integrated solution into emerging, growth-oriented markets.

As of March 31, 2008, our research and development organization consisted of 258 employees located in the United States and India. In addition, we occasionally contract with independent third parties to perform specific development projects.

We predominantly develop our products internally, with some third party contracting. We have also acquired developed technology through business acquisitions. To promote industry standards and manifest technology leadership, we participate in and support the activities and recommendations of industry standards bodies, such as the Internet Engineering Task Force, or IETF, the 3rd Generation Partnership Project, or 3GPP, and we also engage in close and regular dialogue with our key customers and alliance partners. These activities provide early insight into the direction of network and applications performance requirements for current and emerging technologies.

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Manufacturing

Our manufacturing operations consist primarily of final product assembly, configuration and testing. We purchase components and subassemblies from suppliers and construct our hardware products in accordance with NetScout standard specifications. We inspect, test and use process control to ensure the quality and reliability of our products. In February 1998, we obtained ISO 9001 quality systems registration, a certification showing that our corporate procedures and manufacturing facilities comply with standards for quality assurance and process control. In July 2003, we obtained ISO 9001:2000 quality systems registration, a certification showing that our corporate procedures comply with standards for continuous improvement and customer satisfaction. We are scheduled for renewal in August 2009. As of March 31, 2008, our manufacturing organization consisted of 30 employees.

Although we generally use standard parts and components for our products, which are available from various suppliers, each of the computer network interface cards used in our probes is currently available only from separate single source suppliers. We have generally been able to obtain adequate supplies of components in a timely manner from current suppliers. While currently we purchase from specific suppliers, we believe that, in most cases, alternate suppliers can be identified if current suppliers are unable to fulfill our needs. Our reliance on single source suppliers is further described in Item 1A Risk Factors.

Customers

We sell our products to large corporations, government agencies, communications service providers and other organizations with large- and medium-sized high-speed computer networks. Our enterprise customers cover a wide variety of industries, such as financial services, technology, telecommunications, manufacturing, healthcare and retail.

Channels

During the fiscal year ended March 31, 2008, we implemented reseller specific programs to improve revenue fulfillment and sourcing of new revenue through channel partners. We also integrated the channel partner programs of NetScout and Network General and continued to put emphasis on growing our international business through partners.

Seasonality

We have experienced, and expect to continue to experience, quarterly variations in our booking of orders as a result of a number of factors, including the length of the sales cycle, new product introductions and their market acceptance and seasonal factors in sales quota and sales compensation management. Bookings seasonality is also affected by customer buying patterns. Due to these factors, we historically experience stronger bookings during our fiscal third and fourth quarters. Net revenue can also be affected by delays in product shipments and product quality control difficulties.

Competition

The market for our products is rapidly evolving, and we expect it to become increasingly competitive as current competitors expand their product offerings and merge their businesses and new companies enter the market. Our principal competitors include several companies who offer alternative solutions for portions of our product lines. For example, we compete not only with vendors of portable network traffic analyzers and probes, such as Nixsun and Network Instruments but also with a growing number of smaller vendors of software-only network management suites, such as NetQoS and Solar Winds. We also compete in the telecommunications service provider marketplace with vendors that provide operational intelligence based on signaling data, such as

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Tektronix. In addition, we compete with some leading network equipment providers who currently offer their own limited solutions but could provide enhanced solutions in the future. We believe that the principal competitive factors in the network and applications performance management solutions market include product performance, functionality, price, name and reputation of vendor, distribution strength, and alliances with industry partners. Competitive factors in our industry are further described in Item 1A Risk Factors.

Intellectual Property Rights

We rely on patent, copyright, trademark, and trade secret laws and contract rights to establish and maintain our rights in our technology and products. While our intellectual property rights are an important element in our success, our business as a whole does not depend on any one particular patent, trademark, copyright, trade secret, license, or other intellectual property right.

NetScout uses contracts, statutory laws, domestic and foreign intellectual property registration processes, and international intellectual property treaties to police and protect its intellectual property portfolio and rights from infringement. From a contractual perspective, NetScout uses license agreements and non-disclosure agreements to limit the use of NetScout's intellectual property and protect NetScout's trade secrets from unauthorized use and disclosure. In addition to license agreements, NetScout relies on U.S. and international copyright law and registration to protect against unauthorized copying of software programs, in the U.S. and abroad. NetScout has obtained U.S. and foreign trademark registrations to preserve and protect certain trademarks and trade names. NetScout has also filed and obtained U.S. patents to protect certain unique NetScout inventions from being unlawfully exploited by other parties. However, there is no assurance that pending or future patent applications will be granted, that we will be able to obtain patents covering all of our products, or that we will be able to license, if needed, patents from other companies on favorable terms or at all. Our proprietary rights are subject to other risks and uncertainties described under Item 1A Risk Factors.

Employees

As of March 31, 2008, we had 790 employees, 580 of whom are employed in the United States. Of the total, 291 were in sales, 18 were in marketing, 87 were in support services, 258 were in research and development, 30 were in manufacturing, and 106 were in general and administrative functions. None of our employees are represented by a collective bargaining agreement.

Available Information

NetScout's internet address is <http://www.netscout.com>. NetScout makes available, free of charge, on our website our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission.

Item 1A. Risk Factors

In addition to the other information in this report, the following discussion should be considered carefully in evaluating NetScout and our business. This Annual Report on Form 10-K contains forward-looking statements. These statements relate to future events or our future financial performance and are identified by terminology such as may, will, could, should, expects, plans, intends, seeks, anticipates, believe, potential or continue, or the negative of such terms or other comparable terminology. These statements are only predictions. You should not place undue reliance on these forward-looking statements. Actual events or results may differ materially. Factors that may cause such differences include, but are not limited to, the factors discussed below and in our other filings with the Securities and Exchange Commission, or SEC. These factors may cause our actual results to differ materially from any forward-looking statement.

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Our operating results and financial condition have varied in the past and may in the future vary significantly depending on a number of factors. Except for the historical information in this report, the matters contained in this report include forward-looking statements that involve risk and uncertainties. The following factors are among many that could cause actual results to differ materially from those contained in or implied by forward-looking statements made in this report. These statements involve the risks and uncertainties identified below as well as additional risks and uncertainties that are not yet identified or that we currently think are immaterial may also impact our business operations. Such factors are among many that may have a material adverse impact upon our business, results of operations and financial condition.

Our quarterly operating results may fluctuate. Our quarterly revenue and operating results are difficult to predict and may fluctuate significantly from quarter to quarter. Most of our expenses, such as employee compensation, benefits and rent, are relatively fixed in the short term. Moreover, our expense levels are based, in part, on our expectations regarding future revenue levels. As a result, if revenue for a particular quarter is below our expectations, we may not be able to reduce operating expenses proportionately for that quarter, and, therefore, this revenue shortfall would have a disproportionately negative impact on our operating results for that quarter.

Our quarterly revenue may fluctuate as a result of a variety of factors, many of which are outside of our control, including the following:

technology spending by current and potential customers;

uneven demand for application and network management solutions;

the timing, size and receipt of orders from customers, especially in light of our lengthy sales cycle;

the timing and market acceptance of new products or product enhancements by us or our competitors;

changes in the distribution channels through which our products are sold;

the timing of hiring sales personnel and the speed at which such personnel become productive;

our ability to anticipate or adapt effectively to developing markets and rapidly changing technologies;

changes in the number and size of our competitors;

the timing and impact of threat outbreaks (e.g., worms and viruses);

customer difficulty in implementing our products;

changes in foreign currency exchange rates;

attrition affecting key employees;

changes in our prices or the prices of our competitors' products; and

economic slowdowns or the occurrence of unforeseeable events, such as terrorist attacks, which contribute to such slowdowns.

We may not successfully integrate Network General's business into our operations, which could adversely affect our operating results.

On November 1, 2007, we acquired Network General and embarked upon an aggressive integration program designed to merge our organizations and highly complementary products and technologies. This activity continues to demand a significant financial and resource investment and substantial management time and entails the acquisition integration risks and difficulties discussed elsewhere in this section. If we are unable to successfully integrate the two companies into one combined operating company, our operating results could be materially adversely affected. This acquisition and our related integration efforts are also subject to the risks described in the following risk factor.

We may not successfully complete acquisitions or integrate acquisitions we do make, such as our recent acquisition of Network General, which could impair our ability to compete and could harm our operating results. We may need to acquire complementary businesses, products or technologies to remain

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competitive or expand our business such as our recent acquisition of Network General in November 2007. We actively investigate and evaluate potential acquisitions of complementary businesses, products and technologies in the ordinary course of business. We may compete for acquisition opportunities with entities having significantly greater resources than us. As a result, we may not succeed in acquiring some or all businesses, products or technologies that we seek to acquire. Our inability to effectively consummate acquisitions on favorable terms could significantly impact our ability to effectively compete in our targeted markets and could negatively affect our results of operations.

Acquisitions that we do complete could adversely impact our business. The potential adverse consequences from acquisitions include:

the potentially dilutive issuance of common stock or other equity instruments;

the incurrence of debt and amortization expenses related to goodwill and acquired intangible assets;

the potentially costly and disruptive impact of assuming pre-existing contractual relationships of acquired companies that we would not have otherwise entered into, and potentially exiting or modifying such relationships;

the potential litigation or other claims in connection with, or inheritance of claims or litigation risk as a result of, an acquisition including claims from terminated employees, customers or third parties;

the incurrence of significant costs and expenses; and

the potentially dilutive impact on our earnings per share.

Acquisition transactions also involve numerous business risks. These risks from acquisitions include:

difficulties in assimilating the acquired operations, technologies, personnel and products;

difficulties in managing geographically dispersed operations;

difficulties in assimilating diverse financial reporting and management information systems;

difficulties in maintaining uniform standards, controls, procedures and policies;

the diversion of management's attention from other business concerns;

use of cash to pay for acquisitions may limit other potential uses of our cash, including stock repurchases and retirement of outstanding indebtedness;

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substantial accounting charges for restructuring and related expenses, write-off of in-process research and development, impairment of goodwill, amortization or impairment of intangible assets and share-based compensation expense;

the potential disruption of our business;

the potential loss of key employees, customers, distributors or suppliers; and

the inability to generate sufficient revenue to offset acquisition or investment costs; and

the potential for delays in customer purchases due to uncertainty and the inability to maintain relationships with customers of the acquired businesses.

We have a significant amount of debt. If we fail to generate sufficient cash as our debt becomes due or are unable to renew our revolving credit facility prior to its expiration, this may adversely affect our business, financial condition, and operating results. On December 21, 2007, we entered into a credit agreement for a \$100 million five-year term loan and a \$10 million revolving credit facility. The proceeds of the term loan were used to redeem all of the outstanding senior secured floating rate notes due in 2012 issued in conjunction with the acquisition of Network General. We expect that existing cash, cash equivalents, marketable securities, cash provided from operations and our revolving credit facility will be sufficient to meet ongoing cash requirements. However, failure to generate sufficient cash as our debt becomes due or to renew our revolving

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credit facility prior to its expiration could adversely affect our business, financial condition, operating results and cash flows. In addition, as discussed in the risk factor below a portion of our marketable securities portfolio at March 31, 2008 is currently held in auction rate securities. These securities are currently undergoing liquidity difficulties due to the underlying credit environment and we are currently unable to access this cash in the short term. If this illiquidity in the auction rate security market continues, we may not be able to use these funds, if needed, to make debt payments. If this illiquidity in the auction rate security market continues, and should we need to access these assets for operations, this result could have a negative effect