

CITRIX SYSTEMS INC  
Form 10-Q  
May 04, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**Form 10-Q**

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(Mark One)

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

For the quarterly period ended March 31, 2006

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number 0-27084

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**CITRIX SYSTEMS, INC.**

*(Exact name of registrant as specified in its charter)*

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

75-2275152  
*(IRS Employer  
Identification No.)*

33309

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**851 West Cypress Creek Road**  
**Fort Lauderdale, Florida**  
*(Address of principal executive offices)*

*(Zip Code)*

**Registrant's telephone number, including area code:**

**(954) 267-3000**

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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 is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

x Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer

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

As of April 28, 2006 there were 182,148,953 shares of the registrant's Common Stock, \$.001 par value per share, outstanding.

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**Form 10-Q**

**For the Quarterly Period Ended March 31, 2006**

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**Table of Contents****PART I: FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****CITRIX SYSTEMS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

	March 31, 2006 (unaudited) (In thousands, except par value)	December 31, 2005
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 423,192	\$ 484,035
Short-term investments	157,073	18,900
Accounts receivable, net of allowances of \$4,626 and \$4,382 at March 31, 2006 and December 31, 2005, respectively	116,418	142,015
Inventories, net	3,954	3,933
Prepaid expenses and other current assets	34,462	31,164
Current portion of deferred tax assets	46,363	46,410
Total current assets	781,462	726,457
Restricted cash equivalents and investments	63,737	63,728
Long-term investments	95,439	51,286
Property and equipment, net	76,293	73,727
Goodwill, net	591,593	591,994
Other intangible assets, net	129,196	137,333
Long-term portion of deferred tax assets, net	30,461	29,158
Other assets	8,678	7,973
	\$ 1,776,859	\$ 1,681,656
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 35,297	\$ 33,495
Accrued expenses	119,681	125,029
Income taxes payable		1,329
Current portion of deferred revenues	274,192	266,223
Total current liabilities	429,170	426,076
Long-term portion of deferred revenues	18,260	19,803
Long-term debt		31,000
Other liabilities	1,352	1,297
Commitments and contingencies		
Stockholders' equity:		
Preferred stock at \$.01 par value: 5,000 shares authorized, none issued and outstanding		
Common stock at \$.001 par value: 1,000,000 shares authorized; 231,348 and 226,573 shares issued and outstanding at March 31, 2006 and December 31, 2005, respectively	231	226
Additional paid-in capital	1,287,706	1,189,460
Deferred compensation		(18,873)
Retained earnings	989,305	944,626

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Accumulated other comprehensive loss	(2,637)	(4,463)
	<b>2,274,605</b>	2,110,976
Less common stock in treasury, at cost (51,361 and 49,965 shares at March 31, 2006 and December 31, 2005, respectively)	<b>(946,528)</b>	(907,496)
Total stockholders' equity	<b>1,328,077</b>	1,203,480
	<b>\$ 1,776,859</b>	\$ 1,681,656

See accompanying notes.

**Table of Contents****CITRIX SYSTEMS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(In thousands, except</b>	
	<b>per share information)</b>	
Revenues:		
Product licenses	\$ 114,185	\$ 90,062
License updates	93,871	77,175
Online services	31,638	20,365
Technical services	20,304	14,288
Total net revenues	259,998	201,890
Cost of revenues:		
Cost of license revenues	6,631	1,368
Cost of services revenues	10,390	4,515
Amortization of core and product technology	5,001	3,318
Total cost of revenues	22,022	9,201
Gross margin	237,976	192,689
Operating expenses:		
Research and development	33,660	25,065
Sales, marketing and support	108,937	94,394
General and administrative	38,618	27,411
Amortization of other intangible assets	4,032	2,177
Total operating expenses	185,247	149,047
Income from operations	52,729	43,642
Interest income	7,602	4,632
Interest expense	(438)	(8)
Other (expense) income, net	(708)	464
Income before income taxes	59,185	48,730
Income taxes	14,506	10,170
Net income	\$ 44,679	\$ 38,560
Earnings per share:		
Basic	\$ 0.25	\$ 0.23
Diluted	\$ 0.24	\$ 0.22
Weighted average shares outstanding:		
Basic	178,169	170,139

Diluted	<b>186,013</b>	175,913
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See accompanying notes.

**Table of Contents****CITRIX SYSTEMS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	Three Months Ended March 31,	
	2006	2005
	(In thousands)	
<b>Operating activities</b>		
Net income	\$ 44,679	\$ 38,560
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of intangible assets	9,033	5,495
Depreciation and amortization of property and equipment	6,221	4,886
Stock-based compensation expense	11,549	103
Provision (recovery) for doubtful accounts	587	(673)
Provision for product returns	1,179	990
Tax effect of stock-based compensation	14,452	4,509
Excess tax benefit from exercise of stock options	(14,454)	
Other non-cash items	134	(22)
Total adjustments to reconcile net income to net cash provided by operating activities	28,701	15,288
Changes in operating assets and liabilities:		
Accounts receivable	23,832	22,623
Inventories	(1)	(279)
Prepaid expenses and other current assets	(4,414)	3,378
Other assets	(706)	(1,144)
Deferred tax assets, net	(1,179)	(237)
Accounts payable	667	(2,358)
Accrued expenses	(1,339)	(7,764)
Income taxes payable	(1,330)	633
Deferred revenues	6,427	4,840
Other liabilities	4	(140)
Total changes in operating assets and liabilities	21,961	19,552
Net cash provided by operating activities	95,341	73,400
<b>Investing activities</b>		
Purchases of available-for-sale investments	(185,137)	(86,049)
Proceeds from sales of available-for-sale investments		76,015
Proceeds from maturities of available-for-sale investments	2,751	15,640
Purchases of property and equipment	(8,903)	(4,322)
Other	(465)	
Net cash (used in) provided by investing activities	(191,754)	1,284
<b>Financing activities</b>		
Proceeds from issuance of common stock	92,219	12,739
Excess tax benefit from exercise of stock options	14,454	
Cash paid under stock repurchase programs	(40,103)	(39,961)
Payments on term loan	(31,000)	
Net cash provided by (used in) financing activities	35,570	(27,222)
Change in cash and cash equivalents	(60,843)	47,462

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Cash and cash equivalents at beginning of period	<b>484,035</b>	73,485
Cash and cash equivalents at end of period	<b>\$ 423,192</b>	<b>\$ 120,947</b>
<b>Supplemental non-cash investing activity:</b>		
Increase (decrease) in restricted cash equivalents and investments	<b>\$ 9</b>	<b>\$ (1,875)</b>

See accompanying notes.

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**CITRIX SYSTEMS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**March 31, 2006**

**1. BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. All adjustments, which, in the opinion of management, are considered necessary for a fair presentation of the results of operations for the periods shown, are of a normal recurring nature and have been reflected in the condensed consolidated financial statements. The results of operations for the periods presented are not necessarily indicative of the results expected for the full year or for any future period partially because of the seasonality of the Company's business. Historically, the Company's fourth quarter revenue in any year is typically higher than the first quarter of the subsequent year. The information included in these condensed consolidated financial statements should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations contained in this report and the consolidated financial statements and accompanying notes included in the Citrix Systems, Inc. (the "Company") Form 10-K for the year ended December 31, 2005.

Certain reclassifications have been made for consistent presentation.

**2. SIGNIFICANT ACCOUNTING POLICIES**

*Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. While the Company believes that such estimates are fair when considered in conjunction with the condensed consolidated financial statements and accompanying notes, the actual amount of such estimates, when known, will vary from these estimates.

*Investments*

Short and long-term investments at March 31, 2006 and December 31, 2005 primarily consist of corporate securities, government securities and municipal securities. Investments classified as available-for-sale are stated at fair value with unrealized gains and losses, net of taxes, reported in accumulated other comprehensive income (loss). In accordance with Statement of Financial Accounting Standards (SFAS) No. 95, *Statement of Cash Flows*, the Company classifies available-for-sale securities, including its investments in auction rate securities that are available to meet the Company's current operational needs as short-term. The Company does not recognize changes in the fair value of its investments in income unless a decline in value is considered other-than-temporary.

The Company minimizes its credit risk associated with investments by investing primarily in investment grade, highly liquid securities. The Company's policy is designed to limit exposure to any one issuer depending on credit quality. Periodic evaluations of the relative credit standing of those issuers are considered in the Company's investment strategy. The Company uses information provided by third parties to adjust the carrying value of certain of its investments and derivative instruments to fair value at the end of each period. Fair values are based on valuation models that use market quotes and, for certain investments, assumptions as to the creditworthiness of the entities issuing those underlying investments.

*Inventory*

Inventories are consistently stated at the lower of cost or market on a first-in, first-out basis and primarily consist of finished goods. When necessary, a provision has been made to reduce obsolete or excess inventories to market.

*Revenue Recognition*

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The Company markets and licenses products primarily through multiple channels such as value-added resellers, channel distributors, system integrators, independent software vendors, its websites and original equipment manufacturers. The Company's product licenses are generally perpetual. The Company also separately sells license updates and services, which may include product training, technical support and consulting services, as well as online services.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**March 31, 2006**

The Company's software products are purchased by medium and small-sized businesses, with a minimal number of locations, and larger business enterprises with more complex multiserver environments that deploy the Company's software products on a department or enterprise-wide basis. Once the Company receives a product license agreement and purchase order, software activation keys that enable the feature configuration ordered by the end-user are delivered. Products may be delivered indirectly by a channel distributor, original equipment manufacturers or directly to the end-user by the Company via packaged product or download from the Company's website. The Company's appliance products are integrated with software that is essential to the functionality of the equipment. The Company provides unspecified software upgrades and enhancements related to the appliances through its maintenance contracts. Accordingly, for these appliances, the Company accounts for revenue in accordance with SOP No. 97-2, *Software Revenue Recognition, (as amended by SOP 98-4 and SOP 98-9)* and all related interpretations, as described in detail below.

Revenue is recognized when it is earned. The Company's revenue recognition policies are in compliance with SOP 97-2 and related amendments and interpretations. In addition, the Company's online services revenue is recognized in accordance with Emerging Issues Task Force (EITF) No. 00-3, *Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware*. The Company recognizes revenue when all of the following criteria are met: persuasive evidence of the arrangement exists; delivery has occurred and the Company has no remaining obligations; the fee is fixed or determinable; and collectibility is probable. The Company defines these four criteria as follows:

Persuasive evidence of the arrangement exists. The Company recognizes revenue on packaged products and appliances upon shipment to distributors and resellers. For packaged product and appliance sales, it is the Company's customary practice to require a purchase order from distributors and resellers who have previously negotiated a master packaged product distribution or resale agreement. For electronic and paper license arrangements, the Company typically requires a purchase order from the distributor, reseller or end-user (depending on the arrangement) and an executed product license agreement from the end-user. For technical support, product training and consulting services, the Company requires a purchase order and an executed agreement. For online services, the Company requires the customer or the reseller to electronically accept the terms of an online services agreement or execute a contract and generally submit a purchase order.

Delivery has occurred and the Company has no remaining obligations. For product license and appliance sales, the Company's standard delivery method is free-on-board shipping point. Consequently, it considers delivery of packaged products and appliances to have occurred when the products are shipped pursuant to an agreement and purchase order. The Company considers delivery of licenses under electronic licensing agreements to have occurred when the related products are shipped and the end-user has been electronically provided the software activation keys that allow the end-user to take immediate possession of the product. For product training and consulting services, the Company fulfills its obligation when the services are performed. For license updates, technical support and online services, the Company assumes that its obligation is satisfied ratably over the respective terms of the agreements, which are typically 12 to 24 months.

The fee is fixed or determinable. In the normal course of business, the Company does not provide customers the right to a refund of any portion of their license fees or extended payment terms. The Company sells license updates and services, which includes technical support, product training and consulting services, and online services separately and it determines vendor specific objective evidence (VSOE) of fair value by the price charged for each product when sold separately or applicable renewal rates.

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Collectibility is probable. The Company determines collectibility on a customer-by-customer basis and generally does not require collateral. The Company typically sells product licenses and license updates to distributors or resellers for whom there are histories of successful collection. New customers are subject to a credit review process that evaluates their financial position and ultimately their ability to pay. Customers are also subject to an ongoing credit review process. If the Company determines from the outset of an arrangement that collectibility is not probable, revenue recognition is deferred until customer payment is received and the other parameters of revenue recognition described above have been achieved. Management's judgment is required in assessing the probability of collection, which is generally based on evaluation of customer specific information, historical experience and economic market conditions.

Net revenues include the following categories: Product Licenses, License Updates, Online Services and Technical Services. Product Licenses primarily represent fees related to the licensing of the Company's products. These revenues are reflected net of sales allowances and provisions for stock balancing return rights. License Updates consist of fees related to the Subscription Advantage program that are recognized ratably over the term of the contract, which is typically 12-24

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**(Unaudited)**

**March 31, 2006**

months. Subscription Advantage is a renewable program that provides subscribers with automatic delivery of software upgrades, enhancements and maintenance releases when and if they become available during the term of subscription. Online Services revenues consist primarily of fees related to online service agreements and are recognized ratably over the contract term. Technical Services revenues are comprised of fees from technical support services which are recognized ratably over the contract term as well as revenues from product training and certification, and consulting services revenue related to implementation of the Company's products, which is recognized as the services are provided.

The Company licenses most its products bundled with an initial subscription for license updates that provide the end-user with free enhancements and upgrades to the licensed product on a when and if available basis. Customers may also elect to purchase subscriptions for license updates, when not bundled with the initial product purchase, technical support, product training or consulting services. The Company allocates revenue to license updates and any other undelivered elements of the arrangement based on VSOE of fair value of each element and such amounts are deferred until the applicable delivery criteria and other revenue recognition criteria described above have been met. The balance of the revenue, net of any discounts inherent in the arrangement, is allocated to the delivered product using the residual method and recognized at the outset of the arrangement as the product licenses are delivered. If management cannot objectively determine the fair value of each undelivered element based on VSOE, revenue recognition is deferred until all elements are delivered, all services have been performed, or until fair value can be objectively determined.

In the normal course of business, the Company does not permit product returns, but it does provide most of its distributors with stock balancing and price protection rights. Stock balancing rights permit distributors to return products to the Company by the forty-fifth day of the fiscal quarter, subject to ordering an equal dollar amount of the Company's other products prior to the last day of the same fiscal quarter. Price protection rights require that the Company grant retroactive price adjustments for inventories of products held by distributors if it lowers prices for such products. The Company establishes provisions for estimated returns for stock balancing and price protection rights, as well as other sales allowances, concurrently with the recognition of revenue. The provisions are established based upon consideration of a variety of factors, including, among other things, recent and historical return rates for both, specific products and distributors, estimated distributor inventory levels by product, the impact of any new product releases and projected economic conditions. Actual product returns for stock balancing and price protection provisions incurred are, however, dependent upon future events, including the amount of stock balancing activity by distributors and the level of distributor inventories at the time of any price adjustments. The Company continually monitors the factors that influence the pricing of its products and distributor inventory levels and makes adjustments to these provisions when it believes actual returns and other allowances could differ from established reserves. The Company's ability to recognize revenue upon shipment to distributors is predicated on its ability to reliably estimate future stock balancing returns. If actual experience or changes in market condition impairs the Company's ability to estimate returns, it would be required to defer the recognition of revenue until the delivery of the product to the end-user. Allowances for estimated product returns amounted to approximately \$2.3 million at March 31, 2006 and December 31, 2005. The Company has not reduced and has no current plans to reduce its prices for inventory currently held by distributors. Accordingly, there were no reserves required for price protection at March 31, 2006 and December 31, 2005. The Company also records estimated reductions to revenue for customer programs and incentive offerings including volume-based incentives. If market conditions were to decline, the Company could take actions to increase its customer incentive offerings, which could result in an incremental reduction to revenue at the time the incentive is offered.

*Accounting for Stock-Based Compensation*

The Company's stock-based compensation program is a broad based, long-term retention program that is intended to attract and reward talented employees and align stockholder and employee interest. As of March 31, 2006, the Company had two stock-based compensation plans under which it was granting stock options and shares of non-vested stock. The Company is currently granting stock-based awards from its 2005 Equity Incentive Plan (the "2005 Plan") and 2005 Employee Stock Purchase Plan (the "2005 ESPP"). The Company's Board of Directors has provided that no new awards will be granted under the Company's previous stock plans, including the Company's Amended and Restated 1995 Stock Plan, Second Amended and Restated 2000 Director and Officer Stock Option and Incentive Plan, Second Amended and Restated 1995 Non-Employee Director Stock Option Plan and Third Amended and Restated 1995 Employee Stock Purchase Plan (the "1995 ESPP"). Awards previously granted under these plans and still outstanding, however, typically expire ten years from the date of grant and will continue to be subject to all the terms and conditions of such plans, as applicable. In the future, in addition to stock options and non-vested stock, the Company plans to begin using

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non-vested stock, non-vested stock units and stock options with performance measures as part of its overall compensation program.

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**(Unaudited)**

**March 31, 2006**

The 2005 Plan was originally adopted by the Board of Directors on March 24, 2005 and approved by the Company's stockholders in May 2005. Under the terms of the 2005 Plan, the Company is authorized to grant incentive stock options (ISOs), non-qualified stock options (NSOs), non-vested stock, non-vested stock units, stock appreciation rights (SARs), performance units and to make stock-based awards to full and part-time employees of the Company and its subsidiaries or affiliates, where legally eligible to participate, as well as consultants and non-employee directors of the Company. The 2005 Plan provides for the issuance of a maximum of 10,100,000 shares of common stock. In addition, in February 2006, the Company's Board of Directors approved an amendment to increase the shares of common stock authorized for issuance by 5,400,000. The Company has submitted this amendment to its stockholders for approval in May 2006. Under the 2005 Plan, ISOs must be granted at exercise prices no less than fair market value on the date of grant, except for ISOs granted to employees who own more than 10% of the Company's combined voting power, for which the exercise prices must be no less than 110% of the market value at the date of grant. NSOs and SARs must be granted at no less than market value on the date of grant, or in the case of SARs in tandem with options, at the exercise price of the related option. Non-vested stock awards may be granted for such consideration in cash, other property or services, or a combination thereof, as determined by the Compensation Committee of the Board of Directors of the Company. All stock-based awards are exercisable upon vesting. Typically, under the 2005 Plan, the Company grants five year options that vest over three years at a rate of 33.3% of the shares underlying the option one year from date of grant and at a rate of 2.78% monthly thereafter. As of March 31, 2006, there were 36,785,527 shares of common stock reserved for issuance pursuant to the Company's stock-based compensation plans and the Company had authorization under its 2005 Plan to grant 7,036,872 additional stock-based awards at March 31, 2006.

As part of the Company's acquisition of NetScaler, Inc., and Teros, Inc., it assumed 25,179 shares of non-vested stock held by certain employees of the acquired companies. The non-vested stock assumed vests monthly based on service through October 2007 dependent upon the remaining vesting period at the time of the acquisition. As part of an overall retention program, the Company also assumed \$2.8 million worth of non-vested stock units and granted 60,000 shares of non-vested stock to certain employees retained from the acquisitions of NetScaler, Inc., and Teros, Inc. Of the non-vested stock granted, 45,000 shares vest 50% on the first anniversary of the grant date and 50% on the second anniversary of the grant date, the remaining 15,000 non-vested shares granted, vest 50% on the first anniversary of the grant date and 50% eighteen months from the grant date. The non-vested stock units vest 33.33% six, twelve and eighteen months from the date of grant. The number of shares that will be issued on each vest date is dependent upon the Company's stock price over the five consecutive trading days prior to the vesting date; provided, however that the number of shares issued pursuant to the non-vested stock units will not exceed 280,000 shares. The Company's policy is to recognize compensation cost for awards with only service conditions and a graded vesting schedule on a straight line basis over the requisite service period for the entire award.

The 2005 ESPP was originally adopted by the Board on March 24, 2005 and approved by the Company's stockholders in May 2005. The 2005 ESPP replaced the Company's 1995 ESPP under which no more shares may be granted. Under the 2005 ESPP, all full-time and certain part-time employees of the Company are eligible to receive options to purchase common stock of the Company twice per year at the end of a six month payment period (a Payment Period). During each Payment Period, eligible employees who so elect may authorize payroll deductions in an amount no less than 1% nor greater than 10% of his or her base pay for each payroll period in the Payment Period. At the end of each Payment Period, the accumulated deductions are used to purchase shares of common stock from the Company up to a maximum of 12,000 shares for any one employee during a Payment Period. Shares are purchased at a price equal to 85% of the fair market value of the Company's common stock on the last business day of a Payment Period. Employees who, after exercising their rights to purchase shares of common stock under the 2005 ESPP, would own shares of 5% or more of the voting power of the Company's common stock, are ineligible to participate under the 2005 ESPP. The 2005 ESPP provides for the issuance of a maximum of 10,000,000 shares of common stock. As of March 31, 2006, 150,743 shares had been issued under the 2005 ESPP.

*Adoption of SFAS No. 123R and Transition*

Prior to January 1, 2006, the Company accounted for its stock-based compensation plans under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations, as permitted by SFAS No. 123, *Accounting for Stock-Based Compensation*. The Company did not recognize compensation cost related to stock options granted to its employees and non-employee directors that had an exercise price equal to or above the market value of the underlying common stock on

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the date of grant in its condensed consolidated statement of income prior to January 1, 2006. Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123R, *Share-Based Payment*, and related interpretations using the modified-

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prospective transition method. Under that method, compensation cost recognized in the first quarter of 2006 includes (a) compensation cost for all stock-based awards granted prior to, but not yet vested as of January 1, 2006 based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 and (b) compensation cost for all stock-based awards granted on or subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R. Results for prior periods have not been restated.

As a result of adopting SFAS No. 123R on January 1, 2006, the Company's operating income, income before income taxes and net income for the three months ended March 31, 2006, are \$8.6 million, \$8.6 million and \$6.5 million lower, respectively, than if the Company had continued to account for stock-based compensation under APB Opinion No. 25. Basic and diluted earnings per share for the three months ended March 31, 2006 would have been \$0.29 and \$0.27, respectively, if the Company had not adopted SFAS No. 123R, compared to reported basic and diluted earnings per share of \$0.25 and \$0.24, respectively.

Prior to the adoption of SFAS No. 123R, the Company presented all tax benefits from deductions resulting from the exercise of stock options as operating cash flows in its statement of cash flows. SFAS No. 123R requires that the portion of benefits resulting from tax deductions in excess of recognized compensation (the excess tax benefits) be presented as financing cash flows. The excess tax benefits were approximately \$14.5 million for the first quarter of 2006 and would have been presented as an operating cash inflow prior to the adoption SFAS No. 123R. In addition, the Company previously presented deferred compensation as a separate component of stockholders' equity. In accordance with the provisions of SFAS No. 123R, upon adoption, the Company also reclassified the balance in deferred compensation to additional paid-in capital on its accompanying condensed consolidated balance sheet.

In November 2005, the Financial Accounting Standards Board (the FASB), issued FASB Staff Position FAS123(R)-3, *Transition Election to Accounting for the Tax Effects of Share-Based Payment Awards*, (FSP). This FSP requires an entity to follow either the transition guidance for the additional-paid-in-capital pool as prescribed in SFAS No. 123R or the alternative transition method as described in the FSP. An entity that adopts SFAS No. 123R using the modified prospective method may make a one-time election to adopt the transition method described in this FSP. An entity may take up to one year from the later of its initial adoption of SFAS No. 123R or the effective date of this FSP to evaluate its available transition alternatives and make its one-time election. This FSP became effective in November 2005. The Company is still evaluating whether it will adopt the alternative method for calculating its additional-paid-in-capital pool described in the FSP.

*Pro Forma Information Under SFAS No. 123 for Periods Prior to January 1, 2006*

The following table illustrates the effect on net earnings and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based awards in the first quarter of 2005 (in thousands, except per share information):

	<b>Three Months Ended</b>
	<b>March 31, 2005</b>
Net income:	
As reported	\$ 38,560
Add: Total stock-based employee compensation included in net income as reported, net of related tax effects	82
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(10,014)

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Pro forma	\$	28,628
Basic earnings per share:		
As reported	\$	0.23
Pro forma	\$	0.17
Diluted earnings per share:		
As reported	\$	0.22
Pro forma	\$	0.16

**Table of Contents****CITRIX SYSTEMS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****March 31, 2006**

For purposes of the pro forma calculations, the fair value of each option was estimated on the date of the grant using the Black-Scholes option-pricing model, assuming no expected dividends, and the following assumptions:

	<b>March 31, 2005</b>
Expected volatility factor	0.35
Approximate risk free interest rate	3.8%
Expected term	3.32 years

The Company estimated the expected volatility factor based upon implied and historical data. The approximate risk free interest rate was based on the implied yield available on U.S. Treasury zero-coupon issues with remaining terms equivalent to the Company's expected term. The expected term of the Company's stock options was based on the historical exercise patterns considering changes in vesting periods and contractual terms. The weighted average fair value of stock-based awards granted during the first quarter of 2005 was \$6.93. The total intrinsic value of stock options exercised during the first quarter of 2005 was \$6.6 million. Forfeitures were recognized as they occurred.

For purposes of the pro forma calculations, the fair value of each stock-based award related to the 1995 ESPP was estimated using the Black-Scholes option-pricing model, assuming no expected dividends, and the following assumptions:

	<b>March 31, 2005</b>
Expected volatility factor	0.33
Approximate risk free interest rate	2.5%
Expected term	6 months

The Company estimated the expected volatility factor based on historical data. The approximate risk free interest rate was based on the implied yield available on U.S. Treasury zero-coupon issues with remaining term equivalent to the Company's expected term. The expected term for the 1995 ESPP is the six month Payment Period. The weighted average fair value of the shares purchased under the 1995 ESPP during the first quarter of 2005 was \$21.96.

*Valuation and Expense Information under SFAS No. 123R*

The Company recorded stock-based compensation costs of \$11.5 million and recognized a tax benefit related to stock-based compensation of \$14.5 million in the first quarter of 2006. As required by SFAS No. 123R, the Company estimates forfeitures of employee stock options and recognizes compensation cost only for those awards expected to vest. Forfeiture rates are determined based on historical experience. Estimated forfeitures are adjusted to actual forfeiture experience as needed.

Total stock-based compensation and related income tax benefit recognized in the Company's consolidated statement of income for the three months ended March 31, 2006 is \$11.5 million and \$1.5 million, respectively. A detail of the total stock-based compensation recognized by income statement classification is as follows (in thousands):

<b>Income Statement Classifications</b>	
Cost of services revenues	<b>\$ 360</b>

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Research and development	3,657
Sales, marketing and support	4,775
General and administrative	2,757
Total	\$ 11,549

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## CITRIX SYSTEMS, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

March 31, 2006

In connection with the adoption of SFAS No. 123R, the Company estimated the fair value of each stock option on the date of grant using the Black-Scholes option-pricing model, applying the following assumptions and amortizing that value to expense over the option's vesting period using the ratable approach:

	March 31, 2006
Expected volatility factor	0.30
Approximate risk free interest rate	4.55
Expected term	3.0 years
Expected dividend yield	0%

For purposes of determining the expected volatility factor, the Company considered implied volatility in two-year market-traded options of the Company's common stock based on third party volatility quotes in accordance with the provisions of Staff Accounting Bulletin, (SAB) No. 107. The Company's decision to use implied volatility was based upon the availability of actively traded options on the Company's common stock and its assessment that implied volatility is more representative of future stock price trends than historical volatility. The approximate risk free interest rate was based on the implied yield available on U.S. Treasury zero-coupon issues with remaining terms equivalent to the Company's expected term on its options. The expected term of the Company's stock options was based on the historical employee exercise patterns considering changes in vesting periods and contractual terms. The Company also analyzed its historical pattern of option exercises based on certain demographic characteristics and determined that there were no meaningful differences in option exercise activity based on the demographic characteristics. The Company does not intend to pay dividends on its common stock in the foreseeable future. Accordingly, the Company used a dividend yield of zero in its option pricing model. The weighted average fair value of stock options granted during the first quarter of 2006 was \$7.77.

A summary of the status and activity of the Company's fixed option awards is as follows:

		Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Life	Aggregate Intrinsic Value
Options	Number of Options			(in thousands)
Outstanding at December 31, 2005	34,305,837	\$ 25.86	4.79	
Granted	499,375	29.92		
Exercised	(4,626,283)	19.07		
Forfeited or expired	(430,272)	26.67		
Outstanding at March 31, 2006	29,748,657	26.98	4.31	\$ 430,158
Vested or expected to vest at March 31, 2006	27,746,784	27.39	4.30	396,813

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Exercisable at March 31, 2006	21,050,854	29.82	4.16	275,367
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The following table summarizes the Company's non-vested stock activity as of March 31, 2006:

	Number of	Weighted- Average Fair Value
	Shares	at Grant Date
Non-vested at December 31, 2005	85,179	\$ 26.52
Granted		
Vested	9,090	23.46
Forfeited or expired	2,600	27.87
Non-vested at March 31, 2006	73,489	26.85
Exercisable at March 31, 2006	9,090	23.46

**Table of Contents****CITRIX SYSTEMS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****March 31, 2006**

The total intrinsic value of stock-based awards exercised during the first quarter of 2006 was \$62.0 million. As of March 31, 2006, there was \$57.7 million of total unrecognized compensation cost related to the stock options, non-vested stock and restricted stock units. That cost is expected to be recognized over a weighted-average period of 1.84 years.

The Company estimated the fair value of the stock-based compensation related to the 2005 ESPP using the Black-Scholes option pricing model, applying the following assumptions and amortizing that value to expense over the vesting period:

	<b>March 31, 2006</b>
Expected volatility factor	<b>0.27</b>
Approximate risk free interest rate	<b>4.45%</b>
Expected term	<b>6 months</b>
Expected dividend yield	<b>0%</b>

The Company estimated the expected volatility factor based on implied volatility in market traded options with remaining terms similar to the expected term of the ESPP options. The approximate risk free interest rate was based on the implied yield available on U.S. Treasury zero-coupon issues with remaining term equivalent to the expected term of the 2005 ESPP options. The expected term for the 2005 ESPP options is the six month Payment Period. The weighted average fair value of the shares purchased under the 2005 ESPP during the first quarter of 2006 was \$31.14.

**3. EARNINGS PER SHARE**

Basic earnings per share is calculated by dividing income available to stockholders by the weighted-average number of common shares outstanding during each period. Diluted earnings per share is computed using the weighted average number of common and dilutive common share equivalents outstanding during the period. Dilutive common share equivalents consist of shares issuable upon the exercise of stock awards (calculated using the treasury stock method) during the period they were outstanding.

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

		<b>Three Months Ended March 31,</b>	<b>2006</b>	<b>2005</b>
<b>Numerator:</b>				
Net income		<b>\$ 44,679</b>	<b>\$</b>	38,560
<b>Denominator:</b>				
Denominator for basic earnings per share	weighted-average shares outstanding	<b>178,169</b>		170,139
Effect of dilutive employee stock awards		<b>7,844</b>		5,774
Denominator for diluted earnings per share	weighted-average shares outstanding	<b>186,013</b>		175,913
Basic earnings per share		<b>\$ 0.25</b>	<b>\$</b>	0.23

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Diluted earnings per share	\$	<b>0.24</b>	\$	0.22
Anti-dilutive weighted-average shares		<b>21,839</b>		30,537

### 4. ACQUISITIONS

#### *2005 Acquisitions*

During 2005, the Company acquired all of the issued and outstanding capital stock of two privately held companies, NetScaler, Inc. and Teros, Inc., (the 2005 Acquisitions ) for a total of \$172.8 million in cash, approximately 6.6 million shares of the Company's common stock valued at approximately \$154.8 million and estimated direct transaction costs of \$6.4 million. The Company also assumed approximately \$20.6 million in non-vested stock-based compensation upon the closing

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**CITRIX SYSTEMS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**March 31, 2006**

of the NetScaler transaction that was accounted for in accordance with FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation (an Interpretation of APB Opinion No. 2)* and was recorded as deferred compensation in the accompanying 2005 consolidated balance sheet. The assumed awards had an excess of fair value over intrinsic value of approximately \$0.5 million, which is reflected in the total consideration for the transaction. The 2005 Acquisitions are intended to further extend the Company's position in application delivery solutions. The results of operations of the acquired companies are included as part of the Company's results beginning after their respective dates of acquisition and revenues from the acquired products are included in the Company's Product License revenue and Technical Services revenue in the accompanying consolidated statements of income. In connection with the 2005 Acquisitions, the Company allocated \$234.3 million to goodwill, \$40.2 million to core technology and \$35.8 million to other intangible assets. The Company assigned all of the goodwill to its Americas segment.

*2004 Acquisitions*

During 2004, the Company acquired all of the issued and outstanding capital stock of two privately held companies Net6, Inc, a leader in providing secure access gateways and Expertcity.com, Inc., a leader in Web-based desktop access as well as a leader in Web-based meeting and customer assistance services (the 2004 Acquisitions). The consideration for the 2004 Acquisitions was approximately \$291.0 million comprised of approximately \$161.8 million in cash, \$6.1 million of direct transaction costs and approximately 5.8 million shares of the Company's common stock valued at approximately \$124.8 million. In connection with the 2004 Acquisitions, the Company allocated \$195.1 million to goodwill, \$38.7 million to core and product technology and \$32.4 million to other intangible assets. The Company assigned \$31.7 million of the goodwill to its Americas segment and \$163.4 million of the goodwill to its Online Services division.

*Purchase Accounting for Acquisitions*

The fair values used in determining the purchase price allocation for certain intangible assets for the Company's acquisitions were based on estimated discounted future cash flows, royalty rates and historical data, among other information. Purchased in-process research and development (IPR&D) of \$7.0 million was expensed in the third quarter of 2005 immediately upon the closing of the NetScaler, Inc. acquisition and a total \$19.1 million was expensed upon closing of the 2004 Acquisitions in accordance with FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*, due to the fact that it pertains to technology that was not currently technologically feasible, meaning it had not reached the working model stage, did not contain all of the major functions planned for the product, was not ready for initial customer testing and had no alternative future use. The fair value assigned to in-process research and development was determined using the income approach, which includes estimating the revenue and expenses associated with a project's sales cycle and by estimating the amount of after-tax cash flows attributable to the projects. The future cash flows were discounted to present value utilizing an appropriate risk-adjusted rate of return, which ranged from 17% to 25%. The rate of return included a factor that takes into account the uncertainty surrounding the successful development of the IPR&D.

**5. GOODWILL AND OTHER INTANGIBLE ASSETS**

*Goodwill*

The Company had \$591.6 and \$592.0 million of goodwill as of March 31, 2006 and December 31, 2005, respectively. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, the Company reviews its goodwill periodically for impairment. The Company completed its annual goodwill impairment test during the fourth quarter of 2005 and determined that the carrying amount of goodwill was not impaired. Substantially all of the Company's goodwill at March 31, 2006 and December 31, 2005 was associated with the Americas and Online Services reportable segments. See Note 7 for segment information.



**Table of Contents****CITRIX SYSTEMS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****March 31, 2006***Intangible Assets*

Intangible assets are recorded at cost, less accumulated amortization. Amortization is computed over the estimated useful lives of the respective assets, generally three to seven years, except for patents, which are amortized over their remaining life or 10 years. Intangible assets consist of the following (in thousands):

	March 31, 2006		December 31, 2005	
	Gross Carrying	Accumulated	Gross Carrying	Accumulated
	Amount	Amortization	Amount	Amortization
Core and product technologies	\$ 166,200	\$ 89,256	\$ 165,975	\$ 84,255
Other	81,925	29,674	81,254	25,641
<b>Total</b>	<b>\$ 248,125</b>	<b>\$ 118,930</b>	<b>\$ 247,229</b>	<b>\$ 109,896</b>

Amortization of core and product technology was \$5.0 million and \$3.3 million for the three months ended March 31, 2006 and 2005, respectively, and is classified as a component of cost of revenues on the accompanying condensed consolidated statements of income. Amortization of other intangible assets, which consists primarily of customer relationships, tradenames, covenants not to compete, and patents, was \$4.0 million and \$2.2 million for the three months ended March 31, 2006 and 2005, respectively, and is classified as a component of operating expenses on the accompanying condensed consolidated statements of income. Estimated future amortization expense is as follows (in thousands):

Year ending December 31,	
2006	\$ 33,802
2007	28,744
2008	25,730
2009	21,118
2010	18,056

**6. LONG-TERM DEBT***Credit Facility*

Effective on August 9, 2005, the Company entered into a Credit Facility with a group of financial institutions (the "Lenders"). The Credit Facility provides for a five year revolving line of credit in the aggregate amount of \$100.0 million, subject to continued covenant compliance. A portion of the revolving line of credit (i) in the aggregate amount of \$25.0 million may be available for issuances of letters of credit and (ii) in the aggregate amount of \$15.0 million may be available for swing line loans. The Credit Facility currently bears interest at LIBOR plus 0.5% and adjusts in the range of 0.5% to 1.25% above LIBOR based on the level of the Company's total debt and its adjusted earnings before interest, taxes, depreciation and amortization ("EBITDA") as defined in the agreement. In addition, the Company is required to pay a quarterly facility fee ranging from 0.125% to 0.25% based on the aggregate amount available under the Credit Facility and the level of the Company's total debt and its adjusted EBITDA. Borrowings under the Credit Facility are guaranteed by the Company and certain of the Company's United States and foreign subsidiaries, which guarantees are secured by a pledge of shares of certain foreign subsidiaries. During 2005, the Company borrowed

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and repaid \$75 million under the Credit Facility. As of March 31, 2006, there were no amounts outstanding under the Credit Facility.

### *Term Loan*

Effective on August 9, 2005, a subsidiary of the Company entered into a term loan facility (the "Term Loan") with the Lenders. The Term Loan provided for an eighteen-month single-draw term loan facility in the aggregate amount of \$100.0 million. The Term Loan's interest rate was LIBOR plus 0.5% and adjusted in the range of 0.5% to 1.25% above LIBOR based on the level of the subsidiary's total debt and its adjusted EBITDA, as described in the agreement. Borrowings under the Term Loan were guaranteed by the Company and certain of its United States and foreign subsidiaries, which guarantees were secured by a pledge of shares of certain foreign subsidiaries. In addition, the Company was required to pay a quarterly facility fee ranging from 0.125% to 0.25% based on the aggregate amount of the Term Loan and the level of the Company's total debt and its adjusted EBITDA. The Term Loan was paid in full in February 2006. The weighted average interest rate on the Term Loan for the period that it was outstanding in 2006 was 4.59%.

The Company incurred \$0.2 million in interest expense on its borrowings in 2006. The Credit Facility contains customary default provisions, and the Company must comply with various financial and non-financial covenants. The financial covenants consist of a minimum interest coverage ratio and a maximum consolidated leverage ratio. The primary non-financial covenants limit the Company's ability to pay dividends (other than pursuant to the Dividend Reinvestment Plan executed under the American Jobs Creation Act), conduct certain mergers or acquisitions, make certain investments and

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loans, incur future indebtedness or liens, alter the Company's capital structure or sell stock or assets, subject to certain limits. As of March 31, 2006, the Company was in compliance with all covenants under the Credit Facility.

**7. SEGMENT INFORMATION**

The Company operates in a single market consisting of the design, development, marketing, sales and support of access infrastructure software and services for applications and online services. The Company's revenues are derived from sales of its Access Management products, Application Networking products, Application Gateway products and related services in the Americas, EMEA and Asia-Pacific regions and from online services sold by its Online Services division. These three geographic regions and the Online Services division constitute the Company's four reportable segments.

The Company does not engage in intercompany revenue transfers between segments. The Company's management evaluates performance based primarily on revenues in the geographic locations in which the Company operates and separately evaluates revenues from the Online Services division. Segment profit for each segment includes certain sales, marketing, general and administrative expenses directly attributable to the segment, including research and development costs in the Online Services division and excludes certain expenses that are managed outside the reportable segments. Costs excluded from segment profit primarily consist of research and development costs associated with the Access Management products, Application Networking products, Application Gateway products, amortization of core and product technology, amortization of other intangible assets, interest, corporate expenses and income taxes, as well as, charges for in-process research and development. Corporate expenses are comprised primarily of corporate marketing costs, operations and certain general and administrative expenses, which are separately managed. Accounting policies of the segments are the same as the Company's consolidated accounting policies.

Net revenues and segment profit, classified by the Company's four reportable segments are as follows (in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
Net revenues:		
Americas (1)	\$ 109,628	\$ 86,165
EMEA (2)	97,606	77,432
Asia-Pacific	21,126	17,928
Online Services division	31,638	20,365
Consolidated	\$ 259,998	\$ 201,890
Segment profit:		
Americas (1)	\$ 51,857	\$ 47,940
EMEA (2)	65,626	46,434
Asia-Pacific	7,756	4,021
Online Services division	8,156	3,508
Unallocated expenses (3):		
Amortization of intangible assets	(9,033)	(5,495)
Research and development	(30,871)	(22,603)
Net interest and other income	6,456	5,088
Other corporate expenses	(40,762)	(30,163)

Consolidated income before income taxes	\$	59,185	\$	48,730
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