

CULLEN FROST BANKERS INC

Form 10-Q

July 28, 2010

Table of Contents

**United States**  
**Securities and Exchange Commission**

Washington, D.C. 20549

**Form 10-Q**

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended: June 30, 2010

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: 001-13221

**Cullen/Frost Bankers, Inc.**

(Exact name of registrant as specified in its charter)

Texas	74-1751768
(State or other jurisdiction of	(I.R.S. Employer
incorporation or organization)	Identification No.)
100 W. Houston Street, San Antonio, Texas	78205
(Address of principal executive offices)	(Zip code)
(210) 220-4011	

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

## Edgar Filing: CULLEN FROST BANKERS INC - Form 10-Q

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

As of July 21, 2010, there were 60,677,936 shares of the registrant's Common Stock, \$.01 par value, outstanding.

---

**Table of Contents**

Cullen/Frost Bankers, Inc.

Quarterly Report on Form 10-Q

June 30, 2010

Table of Contents

	Page
<b><u>Part I - Financial Information</u></b>	
Item 1. <u>Financial Statements (Unaudited)</u>	
<u>Consolidated Statements of Income</u>	3
<u>Consolidated Balance Sheets</u>	4
<u>Consolidated Statements of Changes in Shareholders' Equity</u>	5
<u>Consolidated Statements of Cash Flows</u>	6
<u>Notes to Consolidated Financial Statements</u>	7
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	25
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	49
Item 4. <u>Controls and Procedures</u>	50
<b><u>Part II - Other Information</u></b>	
Item 1. <u>Legal Proceedings</u>	51
Item 1A. <u>Risk Factors</u>	51
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	51
Item 3. <u>Defaults Upon Senior Securities</u>	51
Item 5. <u>Other Information</u>	51
Item 6. <u>Exhibits</u>	51
<b><u>Signatures</u></b>	52

**Table of Contents****Part I. Financial Information****Item 1. Financial Statements (Unaudited)****Cullen/Frost Bankers, Inc.****Consolidated Statements of Income**

(Dollars in thousands, except per share amounts)

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
<b>Interest income:</b>				
Loans, including fees	\$ 102,512	\$ 109,512	\$ 205,024	\$ 217,804
Securities:				
Taxable	31,482	32,105	60,557	65,206
Tax-exempt	20,310	15,285	40,019	27,567
Interest-bearing deposits	989	261	1,844	523
Federal funds sold and resell agreements	21	62	31	181
<b>Total interest income</b>	<b>155,314</b>	<b>157,225</b>	<b>307,475</b>	<b>311,281</b>
<b>Interest expense:</b>				
Deposits	7,377	14,804	15,938	31,390
Federal funds purchased and repurchase agreements	116	298	174	685
Junior subordinated deferrable interest debentures	1,783	1,818	3,556	3,625
Other long-term borrowings	4,142	5,841	8,327	11,485
<b>Total interest expense</b>	<b>13,418</b>	<b>22,761</b>	<b>27,995</b>	<b>47,185</b>
<b>Net interest income</b>	<b>141,896</b>	<b>134,464</b>	<b>279,480</b>	<b>264,096</b>
Provision for possible loan losses	8,650	16,601	22,221	26,202
<b>Net interest income after provision for possible loan losses</b>	<b>133,246</b>	<b>117,863</b>	<b>257,259</b>	<b>237,894</b>
<b>Non-interest income:</b>				
Trust fees	17,037	16,875	34,000	32,844
Service charges on deposit accounts	24,925	25,152	49,734	50,062
Insurance commissions and fees	7,512	7,106	18,650	17,857
Other charges, commissions and fees	8,029	6,288	14,948	13,050
Net gain (loss) on securities transactions	1	49	6	49
Other	12,428	12,536	23,987	24,008
<b>Total non-interest income</b>	<b>69,932</b>	<b>68,006</b>	<b>141,325</b>	<b>137,870</b>
<b>Non-interest expense:</b>				
Salaries and wages	58,827	56,540	119,102	113,316
Employee benefits	12,675	13,783	27,196	29,023
Net occupancy	11,637	10,864	22,772	21,554
Furniture and equipment	11,662	10,662	23,151	21,025
Deposit insurance	5,429	11,667	10,872	16,043
Intangible amortization	1,299	1,719	2,632	3,500
Other	33,125	31,054	63,523	61,327
<b>Total non-interest expense</b>	<b>134,654</b>	<b>136,289</b>	<b>269,248</b>	<b>265,788</b>

Edgar Filing: CULLEN FROST BANKERS INC - Form 10-Q

<b>Income before income taxes</b>	68,524	49,580	129,336	109,976
Income taxes	15,624	11,721	28,618	27,135
<b>Net income</b>	<b>\$ 52,900</b>	<b>\$ 37,859</b>	<b>\$ 100,718</b>	<b>\$ 82,841</b>
<b>Earnings per common share:</b>				
Basic	\$ 0.87	\$ 0.64	\$ 1.67	\$ 1.39
Diluted	0.87	0.63	1.66	1.39
See Notes to Consolidated Financial Statements.				

**Table of Contents****Cullen/Frost Bankers, Inc.****Consolidated Balance Sheets**

(Dollars in thousands, except per share amounts)

	June 30, 2010	December 31, 2009	June 30, 2009
<b>Assets:</b>			
Cash and due from banks	\$ 491,747	\$ 558,490	\$ 653,497
Interest-bearing deposits	2,145,003	1,157,699	57,426
Federal funds sold and resell agreements	12,063	5,290	803,950
<b>Total cash and cash equivalents</b>	<b>2,648,813</b>	<b>1,721,479</b>	<b>1,514,873</b>
Securities held to maturity, at amortized cost	252,995	6,115	6,583
Securities available for sale, at estimated fair value	4,753,608	4,884,257	4,327,628
Trading account securities	15,833	16,126	15,514
Loans, net of unearned discounts	8,065,679	8,367,780	8,643,693
Less: Allowance for possible loan losses	(125,442)	(125,309)	(122,501)
<b>Net loans</b>	<b>7,940,237</b>	<b>8,242,471</b>	<b>8,521,192</b>
Premises and equipment, net	318,921	324,098	295,767
Goodwill	527,684	527,684	527,197
Other intangible assets, net	16,828	19,460	21,839
Cash surrender value of life insurance policies	127,579	125,405	123,579
Accrued interest receivable and other assets	457,381	420,943	430,640
<b>Total assets</b>	<b>\$ 17,059,879</b>	<b>\$ 16,288,038</b>	<b>\$ 15,784,812</b>
<b>Liabilities:</b>			
<b>Deposits:</b>			
Non-interest-bearing demand deposits	\$ 5,062,023	\$ 4,645,802	\$ 4,359,904
Interest-bearing deposits	8,890,137	8,667,508	8,136,833
<b>Total deposits</b>	<b>13,952,160</b>	<b>13,313,310</b>	<b>12,496,737</b>
Federal funds purchased and repurchase agreements	438,496	482,048	656,363
Junior subordinated deferrable interest debentures	136,084	136,084	136,084
Other long-term borrowings	250,054	256,562	486,571
Accrued interest payable and other liabilities	242,234	205,610	212,060
<b>Total liabilities</b>	<b>15,019,028</b>	<b>14,393,614</b>	<b>13,987,815</b>
<b>Shareholders Equity:</b>			
Preferred stock, par value \$0.01 per share; 10,000,000 shares authorized; none issued			
Junior participating preferred stock, par value \$0.01 per share; 250,000 shares authorized; none issued			
Common stock, par value \$0.01 per share; 210,000,000 shares authorized; 60,656,360 shares issued at June 30, 2010 and 60,236,862 shares issued at December 31, 2009 and June 30, 2009	606	602	602
Additional paid-in capital	628,227	600,355	596,076
Retained earnings	1,196,254	1,150,103	1,109,504
Accumulated other comprehensive income (loss), net of tax	215,764	154,205	122,017

Edgar Filing: CULLEN FROST BANKERS INC - Form 10-Q

Treasury stock, 198,586 shares at December 31,2009 and 584,304 shares, at June 30, 2009, at cost		(10,841)	(31,202)
Total shareholders equity	2,040,851	\$ 523.9	\$ 1,500.5
Service Layer Technologies	1,879.7	278.4	2,158.1
Service	802.3	(802.3)	
Total	\$ 3,658.6	\$	\$ 3,658.6

**Table of Contents****Purchased Intangible Assets**

The following table presents details of the Company's purchased intangible assets with definite lives (in millions):

	<b>Gross</b>	<b>Accumulated Amortization</b>	<b>Impairment</b>	<b>Net</b>
As of June 30, 2008:				
Technologies and patents	\$ 379.6	\$ (352.1)	\$ (4.3)	\$ 23.2
Other	68.9	(49.4)	(0.7)	18.8
<b>Total</b>	<b>\$ 448.5</b>	<b>\$ (401.5)</b>	<b>\$ (5.0)</b>	<b>\$ 42.0</b>
As of December 31, 2007:				
Technologies and patents	\$ 379.6	\$ (326.0)	\$	\$ 53.6
Other	68.9	(44.7)		24.2
<b>Total</b>	<b>\$ 448.5</b>	<b>\$ (370.7)</b>	<b>\$</b>	<b>\$ 77.8</b>

There were no additions to purchased intangible assets during the three and six months ended June 30, 2008, and 2007.

Amortization of purchased intangible assets of \$9.4 million and \$24.1 million were included in operating expenses and cost of product revenues for the three months ended June 30, 2008, and 2007, respectively, and \$35.9 million and \$48.2 million were included in operating expenses and cost of product revenues for the six months ended June 30, 2008, and 2007, respectively. There were no impairment charges in the three months ended June 30, 2008. In the six months ended June 30, 2008, the Company recorded an impairment charge of \$5.0 million, included in its amortization of purchased intangible assets, due to the phase out of its DX products. The estimated future amortization expense of purchased intangible assets with definite lives for future periods is as follows (in millions):

<b>Years Ending December 31,</b>	<b>Amount</b>
2008 (remaining six months)	\$ 13.2
2009	15.4
2010	3.9
2011	2.0
2012	1.2
Thereafter	6.3
<b>Total</b>	<b>\$ 42.0</b>

**Note 4. Other Financial Information****Restricted Cash**

As of June 30, 2008, and December 31, 2007, restricted cash of \$38.0 million and \$35.5 million, respectively, consisted of escrow accounts required by certain acquisitions completed in 2005, the India Gratuity Trust and the Directors & Officers ( D&O ) indemnification trust. During the six months ended June 30, 2008, the Company increased its restricted cash by \$0.8 million to fund the India Gratuity Trust, which covers statutory severance obligations in the event of termination of its India employees who have provided five or more years of continuous service. Juniper Networks established the D&O trust to secure its indemnification obligations to certain directors, officers, and other specified employees, arising from their activities as such, in the event that the Company does not provide or is financially incapable of providing indemnification. During the three and six months ended June 30, 2008, the Company also increased its restricted cash balance by \$3.1 million and \$1.8 million, respectively, in



connection with its D&O trust. During the three and six months ended June 30, 2008, the Company made no releases from restricted cash for escrow payments associated with past acquisitions.

***Minority Equity Investments***

As of June 30, 2008, and December 31, 2007, the carrying values of the Company's minority equity investments in privately held companies of \$23.8 million and \$23.3 million, respectively, were included in other long-term assets in the condensed consolidated balance sheets. The Company did not make any minority equity investments in the three months ended June 30, 2008. During the six months ended June 30, 2008, the Company invested a total of

**Table of Contents**

\$2.0 million in a privately-held company. During the three months ended June 30, 2008, the Company recognized a loss of \$1.5 million related to investments in privately-held companies.

The Company's minority equity investments in privately held companies are carried at cost as the Company does not have a controlling interest and does not have the ability to exercise significant influence over these companies. The Company adjusts its minority equity investments for any impairment if the fair value exceeds the carrying value of the respective assets.

**Other Long-Term Assets**

Details of the Company's other long-term assets are as follows (in millions):

	<b>June 30, 2008</b>	<b>As of December 31, 2007</b>
Deferred tax assets	\$ 65.8	\$ 59.0
Long-term assets	44.2	38.2
Total	\$ 110.0	\$ 97.2

**Warranties**

Changes in the Company's warranty reserve were as follows (in millions):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Beginning balance	\$ 41.3	\$ 35.3	\$ 37.5	\$ 34.8
Provisions made during the period, net	7.0	9.6	12.2	21.3
Actual costs incurred during the period	(6.5)	(9.2)	(7.9)	(20.4)
Ending balance (current)	\$ 41.8	\$ 35.7	\$ 41.8	\$ 35.7

**Deferred Revenue**

Amounts billed in excess of revenue recognized are included as deferred revenue and accounts receivable in the accompanying condensed consolidated balance sheets. Product deferred revenue, net of the related cost of revenue, includes shipments to end-users, value-add resellers, and distributors. The portion of deferred revenue that the Company anticipates will be recognized during the succeeding 12-month period is recorded as current deferred revenue, and the remaining portion is recorded as non-current deferred revenue. The Company may reclassify amounts between current and non-current deferred revenue based upon its assessment of when all revenue recognition criteria are expected to be met. Details of the Company's deferred revenue are as follows (in millions):

	<b>June 30, 2008</b>	<b>As of December 31, 2007</b>
Service	\$ 424.1	\$ 367.3
Product	168.7	146.0
Total	\$ 592.8	\$ 513.3

Reported as:

Current	\$ 467.1	\$	425.6
Non-Current	125.7		87.7
Total	\$ 592.8	\$	513.3

***Restructuring and Acquisition Related Reserves***

***Restructuring***

Restructuring charges were based on the Company's restructuring plans that were committed to by management. Any changes in the estimates of executing the approved plans will be reflected in the Company's results of operations.

**Table of Contents**

In the three and six months ended June 30, 2008, the Company paid \$0.2 million and \$0.4 million, respectively, for facility charges associated with its restructuring plans initiated in prior years. As of June 30, 2008, and December 31, 2007, the restructuring reserve of \$0.4 million and \$0.6 million, respectively, was related to future facility charges. Amounts related to the net facility charges are included in other accrued liabilities and will be paid over the remaining respective lease term through July 2008. The difference between the actual future rent payments and the net present value will be recorded as operating expenses when incurred. During the three and six months ended June 30, 2008 and 2007, the Company had no additional restructuring charges.

***Acquisition Related Restructuring Reserves***

Acquisition related reserves pertain to the restructuring reserves established in connection with the Company's past acquisitions. In conjunction with various acquisitions, the Company accrued for acquisition related restructuring charges primarily related to severance and facility charges.

The Company paid \$0.4 million and \$0.6 million for the three and six months ended June 30, 2008, respectively, and \$0.5 million and \$1.0 million for the three and six months ended June 30, 2007, respectively, primarily for facility related charges. The Company had no adjustments to its existing acquisition related restructuring reserves for the three and six months ended June 30, 2008, and recorded a \$0.3 million adjustment to its acquisition related restructuring reserves for facility related charges in the three and six months ended June 30, 2007. As of June 30, 2008, approximately \$0.9 million remained unpaid, of which \$0.4 million was recorded in other long-term liabilities in the condensed consolidated balance sheet. All remaining restructuring reserves were associated with future facility charges and will be paid over the remaining respective lease terms through March 2011. The difference between the actual future rent payments and the restructuring reserves will be recorded as operating expenses when incurred. During the three and six months ended June 30, 2008 and 2007, the Company had no new acquisition related restructuring charges. As of December 31, 2007, approximately \$1.6 million remained unpaid, of which \$0.6 million was recorded in other long-term liabilities in the condensed consolidated balance sheet.

***Derivatives***

Periodically, the Company uses derivatives to partially offset its market exposure to fluctuations in foreign currencies. The Company does not enter into derivatives for speculative or trading purposes. The Company uses foreign currency forward contracts to mitigate transaction gains and losses generated by certain foreign currency denominated monetary assets and liabilities. These derivatives are carried at fair value with changes recorded in other income (expense). Changes in the fair value of these derivatives are largely offset by re-measurement of the underlying assets and liabilities. Cash flows from such hedges are classified as operating activities. These foreign exchange forward contracts have maturities between one and two months.

The Company also uses foreign currency forward and/or option contracts to hedge certain forecasted foreign currency transactions relating to operating expenses. These derivatives are designated as cash flow hedges and have maturities of less than one year. The effective portion of the derivative's gain or loss is initially reported as a component of accumulated other comprehensive income, and upon occurrence of the forecasted transaction, is subsequently reclassified into the consolidated statements of operations line item to which the hedged transaction relates. The Company records ineffectiveness of the hedging instruments, which was immaterial during the three and six months ended June 30, 2008 and 2007, in other income (expense) on its condensed consolidated statements of operations. Cash flows from such hedges are classified as operating activities.

***Debt******Senior Convertible Notes***

In 2003, the Company received \$392.8 million of net proceeds from an offering of \$400.0 million aggregate principal amount of Zero Coupon Convertible Senior Notes due June 15, 2008 (the "Senior Notes") which were converted into shares of its common stock by the holders during the three months ended June 30, 2008. The Senior Notes were senior unsecured obligations, ranked on parity in right of payment with all of the Company's existing and future senior unsecured debt, and ranked senior to all of the Company's existing and future debt that expressly provided that it was subordinated to the notes. The Senior Notes bore no interest, but were convertible into shares of the Company's common stock, subject to certain conditions, at any time prior to maturity or their prior repurchase



**Table of Contents**

by the Company. The conversion rate was 49.6512 shares per each \$1,000 principal amount of convertible notes, subject to adjustment in certain circumstances. This was equivalent to a conversion price of approximately \$20.14 per share. The holders of Senior Notes with a face value of approximately \$0.5 million had converted these notes prior to maturity into shares of the Company's common stock as of December 31, 2007. As of June 16, 2008, holders of approximately \$399.2 million in aggregate principal amount of Senior Notes had converted these notes into approximately 19.8 million shares of the Company's common stock. The Company settled the remaining Senior Notes, with a face value of \$0.3 million principal amount at maturity, for cash. As of June 30, 2008, all of the Company's Senior Notes were retired.

The carrying amounts and fair values of the Company's Zero Coupon Convertible Senior Notes (Senior Notes) were (in millions):

	As of	
	June 30, 2008	December 31, 2007
Carrying amount	\$	\$ 399.5
Fair value	\$	\$ 659.2

*Distributor Financing Arrangement*

The Company recognized the sales of accounts receivable to a financing provider according to FASB Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of FASB Statement No. 125*. The Company introduced its distributor financing program in 2006 to strengthen its channel business by promoting greater distributor volume and improved customer service. The program does not, and is not intended to affect the timing of revenue recognition because the Company only recognizes revenue upon sell-through. Under the financing arrangements, the proceeds from the financing provider are due to the Company 30 days from the sale of the receivable. The Company pays the financing provider a financing fee based on the spread over LIBOR or SIBOR. In these transactions with a major financing provider, the Company has surrendered control over the transferred assets. The accounts receivable have been isolated from the Company and put beyond the reach of creditors, even in the event of bankruptcy. The purchaser of the accounts receivable balances has the right to pledge or exchange the assets transferred. The Company does not maintain effective control over the transferred assets through obligations or rights to redeem, transfer or repurchase the receivables after they have been transferred.

Pursuant to the receivable financing arrangements for the sale of receivables, the Company sold net receivables of \$108.2 million and \$20.0 million during the three months ended June 30, 2008, and 2007, respectively, and \$167.0 million and \$38.6 million during the six months ended June 30, 2008, and 2007, respectively. During the three months ended June 30, 2008, and 2007, the Company received cash proceeds, net of the financing fee, of \$77.8 million and \$18.1 million, respectively, and \$132.1 million and \$35.6 million during the six months ended June 30, 2008 and 2007, respectively. The amounts owing by the financing provider recorded as accounts receivable on the Company's condensed consolidated balance sheets as of June 30, 2008 and December 31, 2007, were \$70.2 million and \$40.4 million, respectively.

The Company has determined that the portion of the receivable financed that has not been recognized as revenue should be accounted for as a financing pursuant to FASB Emerging Issues Task Force Issue 88-18, *Sales of Future Revenues*. As of June 30, 2008 and December 31, 2007, the estimated amounts of cash received from the financing provider that has not been recognized as revenue from its distributors was \$12.7 million and \$10.0 million, respectively.

**Table of Contents****Comprehensive Income**

Comprehensive income consists of the following (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net income	\$ 120.4	\$ 86.2	\$ 230.8	\$ 152.8
Change in net unrealized gains (losses) on investments, net of tax of nil	(3.9)	4.4	(3.4)	5.7
Change in foreign currency translation adjustment, net of tax of nil	(1.6)	2.7	0.9	3.7
Total comprehensive income	\$ 114.9	\$ 93.3	\$ 228.3	\$ 162.2

**Accumulated Deficit**

The following table summarizes the activity in the Company's accumulated deficit account (in millions):

	Six Months Ended June 30, 2008
Balance, December 31, 2007	\$ (2,813.3)
Retirement of common stock (see Note 6)	(121.3)
Net income	230.8
Balance, June 30, 2008	\$ (2,703.8)

**Stock-Based Compensation Expense**

Amortization of stock-based compensation was included in the following cost and expense categories (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Cost of revenues - Product	\$ 0.7	\$ 0.5	\$ 1.5	\$ 1.0
Cost of revenues - Service	2.2	2.1	4.6	5.2
Research and development	12.0	8.3	22.2	19.3
Sales and marketing	9.1	7.7	15.8	15.3
General and administrative	3.3	2.9	6.0	6.6
Total	\$ 27.3	\$ 21.5	\$ 50.1	\$ 47.4

**Other Charges, Net**

Other charges recognized consisted of the following (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Restructuring adjustments	\$	\$ (0.3)	\$	\$ (0.3)
Acquisition related compensation charges		0.3		0.6
Stock option investigation costs		1.3		6.0

Tax related charges		0.3		7.9
Loss on litigation settlement	9.0		9.0	
Total	\$ 9.0	\$ 1.6	\$ 9.0	\$ 14.2

In the three months ended June 30, 2008, the Company accrued \$9.0 million for the potential settlement of its derivative lawsuits. See Note 9 Commitments and Contingencies under *Legal Proceedings*.

In conjunction with various acquisitions, the Company accrued for acquisition related restructuring charges primarily related to severance and facility charges. The Company had no adjustments to its existing acquisition related restructuring reserves for the three and six months ended June 30, 2008, and recorded a \$0.3 million adjustment to its acquisition related restructuring reserves for facility related charges in the three and six months ended June 30, 2007.

In connection with a past acquisition, the Company recorded bonus obligation of \$0.3 million and \$0.6 million for the three and six months ended June 30, 2007, respectively.



**Table of Contents**

In the three and six months ended June 30, 2007, the Company incurred \$1.3 million and \$6.0 million, respectively, in professional fees for the costs of external service providers used in the completion of its internal stock option investigation.

On March 12, 2007, the Company commenced a tender offer to amend certain options granted under the Juniper Networks, Inc. Amended & Restated 1996 Stock Plan and the Juniper Networks, Inc. 2000 Nonstatutory Stock Option Plan that had original exercise prices per share that were less than the fair market value per share of the common stock underlying the option on the option's grant date, as determined by the Company for financial accounting purposes. Under this tender offer, employees subject to taxation in the United States and Canada had the opportunity to increase their strike price on affected options to the appropriate fair market value per share on the date of grant so as to avoid unfavorable tax consequences under United States Internal Revenue Code Section 409A or applicable Canadian tax laws and regulations. In exchange for increasing the strike price of these options, the Company committed to make a cash payment to employees participating in the offer so as to make employees whole for the incremental strike price as compared to their original option exercise price. In connection with the offer, the Company amended options to purchase 4.3 million shares of the Company's common stock and committed to make aggregate cash payments of \$7.6 million to offer participants. The Company accrued nil and \$7.6 million in the three and six months ended June 30, 2007, respectively.

In addition, the Company entered into a separate agreement with two executives in the three months ended June 30, 2007, to amend their unexercised stock options covering 0.1 million shares of the Company's common stock in order to cure the 409A issue associated with such options. As a result, the Company committed to make aggregate cash payments of approximately \$0.4 million and recorded this payment liability in operating expense for the three and six months ended June 30, 2007.

**Interest and Other Income, Net**

Interest and other income, net, consist of the following (in millions):

	Three Months Ended June		Six Months Ended June	
	2008	2007	2008	2007
Interest income and expense, net	\$ 13.5	\$ 26.6	\$ 31.8	\$ 59.5
Other income and expense, net	(0.3)	(1.1)	(1.0)	(1.1)
Total interest and other income, net	\$ 13.2	\$ 25.5	\$ 30.8	\$ 58.4

**Note 5. Net Income per Share**

The following table presents the calculation of basic and diluted net income per share (in millions, except per share amounts):

	Three Months Ended June		Six Months Ended June	
	2008	2007	2008	2007
Numerator:				
Net income	\$ 120.4	\$ 86.2	\$ 230.8	\$ 152.8
Denominator:				
Denominator for basic net income per share	529.0	544.2	526.4	556.8
Shares issuable upon conversion of the Senior Notes	15.6	19.9	17.8	19.9
Employee stock awards	14.7	16.6	17.4	15.6
Denominator for diluted net income per share	559.3	580.7	561.6	592.3

Net income per share:

Basic	\$ 0.23	\$ 0.16	\$ 0.44	\$ 0.27
Diluted	\$ 0.22	\$ 0.15	\$ 0.41	\$ 0.26

Employee stock awards for approximately 22.9 million shares and 18.7 million shares of the Company's common stock in the three and six months ended June 30, 2008, respectively, were outstanding, but were not included in the computation of diluted earnings per share because their effect would have been anti-dilutive. For the three and six

**Table of Contents**

months ended June 30, 2007, approximately 37.0 million and 50.4 million shares of the Company's common stock equivalents, respectively, were not included in the computation of diluted earnings per share because their effect would have been anti-dilutive.

**Note 6. Stockholders' Equity*****Stock Repurchase Activities***

During the six months ended June 30, 2008, the Company repurchased \$121.3 million, or 4.7 million shares of its common stock via open market purchases under two stock repurchase programs that were authorized by its Board of Directors.

Under the \$2.0 billion stock repurchase program approved in 2006 and 2007 (the 2006 Stock Repurchase Program), the Company repurchased approximately 2.2 million shares of its common stock at an average price of \$24.61 per share for a total purchase price of \$53.1 million during the three months ended March 31, 2008. No shares were repurchased under this program during the second quarter of 2008. As of June 30, 2008, the Company has repurchased and retired approximately 71.6 million shares of its common stock under the 2006 Stock Repurchase Program at an average price of \$23.41 per share, and the program had remaining authorized funds of \$323.8 million.

The Board of Directors approved another \$1.0 billion stock repurchase program in March 2008 (the 2008 Stock Repurchase Program). Under this program, the Company repurchased approximately 2.5 million shares of its common stock at an average price of \$26.84 per share for a total purchase price of \$68.2 million during the three and six months ended June 30, 2008. As of June 30, 2008, the 2008 Stock Repurchase Program had remaining authorized funds of \$931.8 million.

All shares of common stock purchased under the 2006 and 2008 Stock Repurchase Programs have been retired. Share repurchases under the Company's stock repurchase programs will be subject to a review of the circumstances in place at the time and will be made from time to time in private transactions or open market purchases as permitted by securities laws and other legal requirements. These programs may be discontinued at any time.

***Stock Option Plans******2006 Equity Incentive Plan***

On May 18, 2006, the Company's stockholders adopted the Company's 2006 Equity Incentive Plan (the 2006 Plan) to enable the granting of incentive stock options, nonstatutory stock options, RSUs, restricted stock, stock appreciation rights, performance shares, performance units, deferred stock units and dividend equivalents to the employees and consultants of the Company. The 2006 Plan also provides for the automatic, non-discretionary award of nonstatutory stock options to the Company's non-employee members of the Board.

The maximum aggregate number of shares authorized under the 2006 Plan is 64,500,000 shares of common stock, plus the addition of any shares subject to outstanding options under the Company's Amended and Restated 1996 Stock Plan (the 1996 Plan) and the Company's 2000 Nonstatutory Stock Option Plan (the 2000 Plan) that subsequently expired unexercised after May 18, 2006 up to a maximum of 75,000,000 additional shares of the common stock.

Options granted under the 2006 Plan have a maximum term of five to seven years from the grant date, and generally vest and become exercisable over a four-year period. Restricted stock, performance shares, RSUs or deferred stock units that vest solely based on continuing employment or provision of services will vest in full no earlier than the three-year anniversary of the grant date. In the event vesting is based on factors other than continued future provision of services, such awards will vest in full no earlier than the one-year anniversary of the grant date.

The 2006 Plan provides each non-employee director an automatic grant of an option to purchase 50,000 shares of common stock upon the date on which such individual first becomes a director, whether through election by the stockholders of the Company or appointment by the Board to fill a vacancy (the First Option). In addition, at each

**Table of Contents**

of the Company's annual stockholder meetings (i) each non-employee director who was a non-employee director on the date of the prior year's annual stockholder meeting shall be automatically granted an option to purchase 20,000 shares of common stock, and (ii) each non-employee director who was not a non-employee director on the date of the prior year's annual stockholder meeting shall receive an option to purchase a pro-rata portion of the 20,000 shares of the common stock determined by the time elapsed since the individual's First Option grant (the Annual Option). The First Option vests monthly over approximately three years from the grant date subject to the non-employee director's continuous service on the Board. The Annual Option shall vest monthly over approximately one year from the grant date subject to the non-employee director's continuous service on the Board. Under the 2006 Plan, options granted to non-employee directors have a maximum term of seven years.

*2000 Nonstatutory Stock Option Plan*

In July 2000, the Board adopted the Juniper Networks 2000 Plan. The 2000 Plan provided for the granting of nonstatutory stock options to employees, directors and consultants. Options granted under the 2000 Plan generally become exercisable over a four-year period beginning on the date of grant and have a maximum term of ten years. The Company had authorized 90,901,437 shares of common stock for issuance under the 2000 Plan. Effective May 18, 2006, additional equity awards under the 2000 Plan have been discontinued and new equity awards are being granted under the 2006 Plan. Remaining authorized shares under the 2000 Plan that were not subject to outstanding awards as of May 18, 2006, were canceled on May 18, 2006. The 2000 Plan will remain in effect as to outstanding equity awards granted under the plan prior to May 18, 2006.

*Amended and Restated 1996 Stock Plan*

The 1996 Plan provided for the granting of incentive stock options to employees and nonstatutory stock options to employees, directors and consultants. On November 3, 2005, the Board adopted an amendment to the 1996 Plan to add the ability to issue RSUs under the 1996 Plan. Options granted under the 1996 Plan generally become exercisable over a four-year period beginning on the date of grant and have a maximum term of ten years. The Company had authorized 164,623,039 shares of common stock for issuance under the 1996 Plan. Effective May 18, 2006, additional equity awards under the 1996 Plan have been discontinued and new equity awards are being granted under the 2006 Plan. Remaining authorized shares under the 1996 Plan that were not subject to outstanding awards as of May 18, 2006 were canceled on May 18, 2006. The 1996 Plan will remain in effect as to outstanding equity awards granted under the plan prior to May 18, 2006.

*Plans Assumed Upon Acquisition*

In connection with past acquisitions, the Company assumed options and restricted stock under the stock plans of the acquired companies. The Company exchanged those options and restricted stock for Juniper Networks' options and restricted stock and, in the case of the options, authorized the appropriate number of shares of common stock for issuance pursuant to those options. As of June 30, 2008, there were approximately 3.2 million common shares subject to outstanding awards under plans assumed through past acquisitions. There was no restricted stock subject to repurchase as of June 30, 2008 and December 31, 2007. There were no restricted stock repurchases during the three and six months ended June 30, 2008 and 2007.

*Equity Award Activities*

In the three and six months ended June 30, 2008, the Company granted RSUs covering 0.1 million shares and 0.9 million shares, respectively, of common stock to its employees under the 2006 Plan. The Company also granted performance share awards to eligible executives covering up to 0.1 million and 0.6 million shares of common stock in the three and six months ended June 30, 2008, respectively, that vest in March 2011 provided certain annual performance targets and other vesting criteria are met. RSUs generally vest over a period of three or four years from the date of grant. Until vested, RSUs and performance share awards do not have the voting rights of common stock and the shares underlying the awards are not considered issued and outstanding. No restricted stock was issued in the same periods during 2008. The Company expenses the cost of the RSUs, which is determined to be the fair market value of the shares of the Company's common stock at the date of grant, ratably over the period during which the restrictions lapse. The Company estimated the stock compensation expense for its performance share awards based on the vesting criteria and only recognized stock compensation expense for the portions of such



**Table of Contents**

awards for which annual targets have been set. The Company accrued stock compensation expense of \$0.5 million for the three and six months ended June 30, 2008, and \$0.1 million and \$0.2 million for the three and six months ended June 30, 2007, respectively, in connection with such performance shares. In addition to RSUs and performance share awards, the Company also granted stock options covering 1.9 million shares and 8.3 million shares of common stock under the 2006 Plan in the three and six months ended June 30, 2008, respectively.

Net income for the three and six months ended June 30, 2008, included pre-tax stock-based compensation expense of \$27.3 million and \$50.1 million, respectively, related to stock options, RSUs, performance share awards and employee stock purchases under the Company's 1999 Employee Stock Purchase Plan reflecting the fair value recognition provisions under SFAS 123R. Net income for the three and six months ended June 30, 2007, included pre-tax stock-based compensation expense of \$21.5 million and \$47.4 million, respectively, related to stock options, RSUs, performance share awards, and employee stock purchases reflecting the fair value recognition provisions under SFAS 123R.

A summary of the Company's equity award activity and related information for the six months ended June 30, 2008, is set forth in the following table:

	<b>Shares Available For Grant(1) (In thousands)</b>	<b>Number of Shares (In thousands)</b>	<b>Weighted- Average Exercise Price (In dollars)</b>	<b>Outstanding Options(4) Weighted Average Remaining Contractual Term (In years)</b>	<b>Aggregate Intrinsic Value (In thousands)</b>
Balance at January 1, 2008	46,022	66,928	\$20.36		
RSUs and performance share awards granted (2)	(3,202)				
Options granted	(8,296)	8,296	25.37		
RSUs canceled (2)	824				
Options canceled (3)	1,318	(1,326)	20.39		
Options exercised		(3,901)	15.10		
Options expired (3)	516	(527)	29.02		
Balance at June 30, 2008 (4)	37,182	69,470	\$21.19	5.2	\$ 262,648

(1) Shares available for grant under the 2006 Plan.

(2) RSUs and performance share awards with a per share or unit purchase price lower than 100% of the fair market value of the Company's

common stock on the day of the grant under the 2006 Plan are counted against shares authorized under the plan as two and one-tenth shares of common stock for each share subject to such award. The Company granted RSUs and performance share awards covering approximately 0.1 million and 1.5 million shares of common stock in the three and six months ended June 30, 2008, respectively.

- (3) Canceled or expired options under the 1996 Plan and the 2000 Plan and the stock plans of the acquired companies are no longer available for future grant under such plans, except for shares subject to outstanding options under the 1996 Plan and the 2000 Plan that subsequently

expired  
unexercised  
after May 18,  
2006, up to a  
maximum of  
75,000,000  
additional  
shares of  
common stock,  
become  
available for  
grant under the  
2006 Plan.

- (4) Outstanding  
options covering  
69.5 million  
shares of  
common stock  
do not include  
RSUs and  
performance  
share awards  
outstanding as  
of June 30,  
2008. See  
details under  
*Restricted Stock  
Units and  
Performance  
Share Awards  
Activities* below.



**Table of Contents**

A summary of the Company's vested or expected-to-vest options and exercisable options as of June 30, 2008, is set forth in the following table:

	<b>Number of</b>	<b>Weighted- Average Exercise</b>	<b>Weighted Average Remaining Contractual</b>	<b>Aggregate Intrinsic Value</b>
	<b>Shares</b>	<b>Price</b>	<b>Term</b>	<b>Value</b>
	<b>(In</b>	<b>(In</b>	<b>(In years)</b>	<b>(In</b>
	<b>thousands)</b>	<b>dollars)</b>		<b>thousands)</b>
Vested or expected-to-vest options	63,058	\$21.06	5.1	\$ 248,385
Exercisable options	45,478	20.20	4.8	215,832

As of June 30, 2008, options covering approximately 45.5 million shares of common stock were exercisable at a weighted-average exercise price of \$20.20 per share. As of December 31, 2007, options covering approximately 44.8 million shares of common stock were exercisable at a weighted-average exercise price of \$20.01 per share.

Aggregate intrinsic value represents the difference between the Company's closing stock price on the last trading day of the fiscal period, which was \$22.18 as of June 30, 2008, and the exercise price multiplied by the number of related options. The pre-tax intrinsic value of options exercised, representing the difference between the fair market value of the Company's common stock on the date of the exercise and the exercise price of each option, was \$27.0 million and \$47.5 million for the three and six months ended June 30, 2008, respectively.

Total fair value of options vested for the three and six months ended June 30, 2008, was \$14.0 million and \$37.1 million, respectively. As of June 30, 2008, approximately \$146.7 million of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock options is expected to be recognized over a weighted-average period of approximately 3 years.

*Restricted Stock Units and Performance Share Awards Activities*

The following schedule summarizes information about the Company's RSUs and performance share awards for the six months ended June 30, 2008:

	<b>Outstanding RSUs and Performance Share Awards</b>			
	<b>Number of</b>	<b>Weighted- Average Grant Date</b>	<b>Weighted Average Remaining Contractual</b>	<b>Aggregate Intrinsic Value</b>
	<b>Shares</b>	<b>Fair Value</b>	<b>Term</b>	<b>Value</b>
	<b>(In</b>	<b>(In</b>	<b>(In years)</b>	<b>(In</b>
	<b>thousands)</b>	<b>dollars)</b>		<b>thousands)</b>
Balance at January 1, 2008	6,284	\$22.40		
RSUs and performance share awards granted	1,525	25.19		
RSUs and performance share awards vested	(1,448)	18.81		
RSUs and performance share awards canceled	(445)	20.21		
Balance at June 30, 2008	5,916	\$24.16	1.7	\$ 131,206

The weighted-average grant date fair value of RSUs granted during the three and six months ended June 30, 2008, was \$24.79 per share and \$25.24 per share, respectively, and was \$21.36 per share and \$18.50 per share for the three and six months ended June 30, 2007, respectively. The weighted-average grant date fair value of performance share awards granted during the three and six months ended June 30, 2008, was \$24.48 per share and \$25.10 per share,

respectively, and was \$18.27 per share for the three and six months ended June 30, 2007, respectively. As of June 30, 2008, approximately \$74.1 million of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested RSUs and non-vested performance share awards is expected to be recognized over a weighted-average period of approximately 2.5 years.

**Table of Contents**

The following schedule summarizes information about the Company's RSUs and performance share awards as of June 30, 2008:

	Number of Shares (In thousands)	Weighted- Average Exercise Price (In dollars)	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Shares subject to outstanding RSUs and performance share awards	5,916	\$	1.7	\$ 131,206
Vested and expected-to-vest RSUs and performance share awards	4,157		1.7	92,213

Approximately 0.1 million RSUs and 1.4 million RSUs, respectively, became vested and exercisable during the three and six months ended June 30, 2008, respectively. There were no RSUs vested during the three and six months ended June 30, 2007.

***Employee Stock Purchase Plan***

In April 1999, the Board of Directors approved the adoption of Juniper Networks 1999 Employee Stock Purchase Plan (the 1999 Purchase Plan). The 1999 Purchase Plan permits eligible employees to acquire shares of the Company's common stock through periodic payroll deductions of up to 10% of base compensation. Each employee may purchase no more than 6,000 shares in any twelve-month period, and in no event may an employee purchase more than \$25,000 worth of stock, determined at the fair market value of the shares at the time such option is granted, in one calendar year. The 1999 Purchase Plan is implemented in a series of offering periods, each six months in duration, or a shorter period as determined by the Board. The price at which the common stock may be purchased is 85% of the lesser of the fair market value of the Company's common stock on the first or last trading day of the applicable offering period. Employees purchased approximately 0.7 million shares of common stock through the 1999 Purchase Plan at an average price of \$23.08 per share in the six months ended June 30, 2008. There were no employee purchases under the 1999 Purchase Plan due to the suspension of the Purchase Plan from August 2006 through March 2007. In connection with the 1999 Purchase Plan, compensation expense of \$3.1 million and \$6.6 million was recorded in operating expenses for the three and six months ended June 30, 2008, and \$2.3 million for the three and six months ended June 30, 2007. No compensation expense was recorded in the first quarter of 2007 due to the temporary suspension of the 1999 Purchase Plan. As of June 30, 2008, approximately 7.9 million shares had been issued since inception and the 13.1 million shares remained available for future issuance under the 1999 Purchase Plan. The 1999 Purchase Plan will be discontinued effective February 1, 2009.

In May 2008, the Company's stockholders approved the adoption of Juniper Networks 2008 Employee Stock Purchase Plan (the 2008 Purchase Plan). The 2008 Purchase Plan was adopted to replace the 1999 Purchase Plan, which will be terminated immediately following the conclusion of the offering period ending January 30, 2009. The Board has reserved an aggregate of 12,000,000 shares of the Company's common stock for issuance under the 2008 Purchase Plan. The 2008 Purchase Plan is generally similar to the 1999 Purchase Plan, except that under the 2008 Purchase Plan any increases to the number of shares reserved for issuance must be approved by the Company's stockholders. The first offering period of the 2008 Purchase Plan will commence on the first trading day on or after February 1, 2009.

***Common Stock Reserved for Future Issuance***

As of June 30, 2008, the Company had reserved an aggregate of approximately 125.7 million shares of common stock for future issuance under its stock option plans and the 1999 Purchase Plan.

***Valuation of Stock-Based Compensation***

SFAS 123R requires the use of a valuation technique, such as an option-pricing model, to calculate the fair value of stock-based awards. The Company has elected to use the Black-Scholes-Merton option-pricing model, which

incorporates various assumptions including volatility, expected life, and risk-free interest rates. The expected volatility is based on the implied volatility of market traded options on the Company's common stock, adjusted for

21

---

**Table of Contents**

other relevant factors including historical volatility of the Company's common stock over the most recent period commensurate with the estimated expected life of the Company's stock options. The expected life of an award is based on historical experience and on the terms and conditions of the stock awards granted to employees, as well as the potential effect from options that had not been exercised at the time.

Since 2006, the Company has granted stock option awards that have a maximum contractual life of seven years from the date of grant. Prior to 2006, stock option awards generally had a ten-year contractual life from the date of grant. In 2007, the government of India implemented a new fringe benefit tax that applies to equity awards granted to India taxpayers. This fringe benefit tax is payable by the issuer of the equity awards; however, the law allows an issuer to recover from individual award holders the fringe benefit taxes the issuer paid on their applicable equity awards. Beginning in January 2008, the Company amended its equity award agreements for future grants made to its employees in India to provide for the Company to be reimbursed for fringe benefit taxes paid in relation to applicable equity awards. The Company has elected to use a Black-Scholes-Merton option-pricing model that incorporates a Monte Carlo simulation to calculate the fair value of stock-based awards issued under the amended equity award agreements. The assumptions used in this valuation are included below.

The assumptions used and the resulting estimates of fair value or weighted-average fair value per share of awards granted and employee stock purchases under the Purchase Plan during those periods were:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Employee Stock Options:				
Volatility factor	43% - 46%	34% - 35%	43% - 48%	34% - 40%
Risk-free interest rate	1.7% - 4.0%	4.6% - 5.1%	1.7% - 4.4%	4.5% - 5.1%
Expected life (years)	3.6 - 5.7	3.6	3.6 - 5.7	3.6 - 3.7
Dividend yield				
Fair value per share	\$ 8.32 - \$10.60	\$ 6.67 - \$8.37	\$ 8.32 - \$10.88	\$ 6.42 - \$8.37
Employee Stock Purchase Plan:				
Volatility factor	48%	38%	48%	38%
Risk-free interest rate	2.2%	5.1%	2.2%	5.1%
Expected life (years)	0.5	0.3	0.5	0.3
Dividend yield				
Weighted-average fair value per share	\$ 7.83	\$ 4.75	\$ 7.83	\$ 4.75

**Note 7. Segments**

The Company's chief operating decision maker ( CODM ) allocates resources and assesses performance based on financial information by the Company's business groups. In the first quarter of 2008, the Company realigned its organizational structure to include its Service business as a component of the related Infrastructure or SLT business groups. Accordingly, the previously reported Service segment has been combined into the Company's two reportable segments as follows: Infrastructure and SLT. The Infrastructure segment includes products from the E-, M-, MX-, and T-series router product families, EX-series switching products, as well as the circuit-to-packet products. The SLT segment consists primarily of Firewall virtual private network ( Firewall ) systems and appliances, secure sockets layer virtual private network ( SSL ) appliances, intrusion detection and prevention appliances ( IDP ), the J-series router product family and wide area network ( WAN ) optimization platforms.

The primary financial measure used by the CODM in assessing performance of the segments is segment operating income, which includes certain cost of revenues, research and development expenses, sales and marketing expenses, and general and administrative expenses. In the three and six months ended June 30, 2008, the CODM did not allocate certain miscellaneous expenses to its segments even though such expenses were included in the Company's management operating income.

For arrangements with both Infrastructure and SLT products and services, revenue is attributed to the segment based on the underlying purchase order, contract or sell-through report. Direct costs and operating expenses, such as standard costs, research and development and product marketing expenses, are generally applied to each segment. Indirect costs, such as manufacturing overhead and other cost of sales, are allocated based on standard costs. Indirect

**Table of Contents**

operating expenses, such as sales, marketing, business development, and general and administrative expenses are generally allocated to each segment based on factors including headcount, usage and revenue. The CODM does not allocate stock-based compensation, amortization of purchased intangible assets, impairment, gain or loss on minority equity investments, interest income and expense, other income and expense, income taxes, as well as certain other charges to the segments.

Further changes to this organizational structure may result in changes to the segments disclosed. The Company has restated the previously reported segment revenues and segment operating results to reflect the changes in its segments. Financial information for each segment used by the CODM is summarized as follows (in millions):

	Three Months Ended June		Six Months Ended June	
	2008	30, 2007 (1)	2008	30, 2007 (1)
Net revenues:				
Infrastructure:				
Product	\$ 575.9	\$ 402.9	\$ 1,104.6	\$ 788.1
Service	96.5	78.0	189.7	153.6
Total Infrastructure revenues	672.4	480.9	1,294.3	941.7
Service Layer Technologies:				
Product	148.0	138.8	293.5	263.4
Service	58.6	45.2	114.1	86.8
Total Service Layer Technologies revenues	206.6	184.0	407.6	350.2
Total net revenues	879.0	664.9	1,701.9	1,291.9
Operating income:				
Infrastructure	195.1	133.5	386.6	259.4
Service Layer Technologies	12.3	2.0	18.5	(0.8)
Total segment operating income	207.4	135.5	405.1	258.6
Other corporate (2)			(4.7)	
Total management operating income	207.4	135.5	400.4	258.6
Amortization of purchased intangible assets	(9.4)	(24.1)	(35.9)	(48.2)
Stock-based compensation expense	(27.3)	(21.5)	(50.1)	(47.4)
Stock-based payroll tax expense	(1.2)	(2.1)	(2.3)	(2.1)
Other charges, net	(9.0)	(1.6)	(9.0)	(14.2)
Total operating income	160.5	86.2	303.1	146.7
Interest and other income, net	11.6	32.3	29.3	65.2
Income before income taxes	\$ 172.1	\$ 118.5	\$ 332.4	\$ 211.9

(1) Prior period amounts have been reclassified to reflect the 2008 segment

structure, which now includes service revenue and operating results in the Infrastructure and SLT segments.

- (2) Other corporate represents miscellaneous expenses that have not been allocated to segment operating results.

Depreciation expense allocated to the Infrastructure segment was \$21.4 million and \$41.6 million, in the three and six months ended June 30, 2008, respectively, and \$17.7 million and \$33.3 million, in the three and six months ended June 30, 2007, respectively. The depreciation expense allocated to the SLT segment was \$9.6 million and \$18.3 million in the three and six months ended June 30, 2008, respectively, and \$7.1 million and \$13.7 million in the three and six months ended June 30, 2007, respectively.



**Table of Contents**

The Company attributes sales to geographic region based on the customer's ship-to location. The following table shows net revenues by geographic region (in millions):

	Three Months Ended June		Six Months Ended June	
	30, 2008	2007	30, 2008	2007
Americas:				
United States	\$ 325.3	\$ 289.7	\$ 713.4	\$ 569.2
Other	63.3	25.5	93.2	41.4
Total Americas	388.6	315.2	806.6	610.6
Europe, Middle East and Africa	285.6	197.8	525.7	407.2
Asia Pacific	204.8	151.9	369.6	274.1
Total	\$ 879.0	\$ 664.9	\$ 1,701.9	\$ 1,291.9

Nokia Siemens Networks B.V. ( NSN ) accounted for 10.4% of the Company's net revenues for the three months ended June 30, 2008, and no single customer accounted for 10.0% or more of the Company's net revenues for the six months ended June 30, 2008. NSN accounted for 17.7% of the Company's net revenues for the three months ended June 30, 2007, and NSN and Verizon Communications, Inc. ( Verizon ) individually accounted for 14.7% and 10.7%, respectively, of the Company's net revenues for the six months ended June 30, 2007. The revenue attributed to each significant customer was derived from the sale of products and services in both segments.

The Company tracks assets by physical location. The majority of the Company's assets, including property and equipment, were attributable to its U.S. operations as of June 30, 2008, and December 31, 2007. Although management reviews asset information on a corporate level and allocates depreciation expense by segment, the CODM does not review asset information on a segment basis.

**Note 8. Income Taxes**

The Company recorded tax provisions of \$51.7 million and \$32.3 million for the three months ended June 30, 2008 and 2007, or effective tax rates of 30% and 27%, respectively. The Company recorded tax provisions of \$101.7 million and \$59.1 million for the six months ended June 30, 2008 and 2007, or effective tax rates of 31% and 28%, respectively. The effective tax rates for the three and six months ended June 30, 2008, differ from the federal statutory rate of 35% and the rate for the same periods in 2007 primarily due to earnings in foreign jurisdictions which are subject to lower rates and a reduced benefit from tax credits due to the expiration of the federal research and development credit law at December 31, 2007. The Company's income taxes payable for federal and state purposes were reduced by the tax benefit from employee stock option transactions. This benefit totaled \$14.6 million and \$19.1 million for the three and six months ended June 30, 2008, respectively, and was reflected as an increase to additional paid-in capital.

The Company is currently under examination by the Internal Revenue Service (IRS) for the 2004 tax year, the German tax authorities for the 2005 tax year, and the Indian authorities for the 2004 and 2005 tax years. Additionally, the Company has not reached final resolution with the IRS on an adjustment it proposed for the 1999 and 2000 tax years. The Company was not under examination by any other major jurisdictions in which the Company files its income tax returns as of June 30, 2008. Although the timing of the resolution and/or closure of any audits is highly uncertain, it is reasonably possible that the balance of gross unrecognized tax benefits could significantly change in the next 12 months. However, given the number of years remaining subject to examination and the number of matters being examined, the Company is unable to estimate the range of possible adjustments to the balance of gross unrecognized tax benefits.

The gross unrecognized tax benefits increased by approximately \$6.2 million for the six months ended June 30, 2008, of which \$5.2 million, if recognized, would affect the effective tax rate. Interest and penalties accrued for the same period were immaterial.



**Table of Contents****Note 9. Commitments and Contingencies****Commitments**

The following table summarizes the Company's principal contractual obligations as of June 30, 2008 (in millions):

	<b>Total</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>Thereafter</b>	<b>Other</b>
Operating leases	\$ 227.8	\$ 28.1	\$ 50.1	\$ 46.0	\$ 38.8	\$ 32.6	\$ 32.2	\$
Sublease rental income	(2.2)	(0.8)	(0.8)	(0.6)				
Purchase commitments	113.0	113.0						
Tax liabilities	79.3							79.3
Other contractual obligations	65.7	19.3	25.2	9.1	5.3	5.1	1.7	
<b>Total</b>	<b>\$ 483.6</b>	<b>\$ 159.6</b>	<b>\$ 74.5</b>	<b>\$ 54.5</b>	<b>\$ 44.1</b>	<b>\$ 37.7</b>	<b>\$ 33.9</b>	<b>\$ 79.3</b>

**Operating Leases**

Juniper Networks leases its facilities under operating leases that expire at various times, the longest of which expires in January 2017. Future minimum payments under the non-cancelable operating leases, net of committed sublease income, totaled \$225.6 million as of June 30, 2008. Rent expense for the three months ended June 30, 2008 and 2007 was \$14.7 million and \$11.3 million, respectively, and \$28.9 million and \$22.0 million for the six months ended June 30, 2008 and 2007, respectively.

**Senior Notes**

As of June 16, 2008, holders of approximately \$399.2 million in aggregate principal amount of Senior Notes converted these notes into approximately 19.8 million shares of the Company's common stock. The Company settled the remaining Senior Notes with a face value of \$0.3 million principal amount at maturity for cash. As of June 30, 2008, the Company's Senior Notes were retired.

**Purchase Commitments**

In order to reduce manufacturing lead times and ensure adequate component supply, contract manufacturers utilized by the Company place non-cancelable, non-returnable ( NCNR ) orders for components based on the Company's build forecasts. As of June 30, 2008, there were NCNR component orders placed by the contract manufacturers with a value of \$113.0 million. The contract manufacturers use the components to build products based on the Company's forecasts and on purchase orders the Company has received from customers. Generally, the Company does not own the components and title to the products transfers from the contract manufacturers to the Company and immediately to the Company's customers upon delivery at a designated shipment location. If the components go unused or the products go unsold for specified periods of time, the Company may incur carrying charges or obsolete materials charges for components that the contract manufacturers purchased to build products to meet the Company's forecast or customer orders. As of June 30, 2008, the Company had accrued \$26.2 million based on its estimate of such charges.

**Tax Liabilities**

As of June 30, 2008, the company had \$79.3 million included in long-term liabilities in the condensed consolidated balance sheet for unrecognized tax positions. At this time, the Company is unable to make a reasonably reliable estimate of the timing of payments in individual years beyond 12 months due to uncertainties in the timing of tax audit outcomes.

**Table of Contents***Other Contractual Obligations*

As of June 30, 2008, other contractual obligations consisted primarily of an indemnity-related escrow amount of \$2.3 million, a software subscription requiring payments of \$5.0 million in January 2009, and a joint development agreement for \$24.5 million with quarterly payments of \$3.5 million through January 2010. Additionally, in the second quarter of 2008, the Company entered into a five year, \$34.0 million data center hosting agreement requiring payments of \$8.4 million in the third quarter of 2008. The remaining commitment under this agreement is expected to be paid through the end of April 2013. As of June 30, 2008, \$34.0 million remained unpaid under the data center hosting agreement.

*Guarantees*

The Company enters into agreements with customers that contain indemnification provisions relating to potential situations where claims could be alleged that the Company's products infringe the intellectual property rights of a third party. Other guarantees or indemnification arrangements include guarantees of product and service performance and standby letters of credit for certain lease facilities. The Company has not recorded a liability related to these guarantee and indemnification provisions and these guarantees and indemnification arrangements have not had any significant impact on the Company's financial position, results of operations, or cash flows.

*Legal Proceedings*

The Company is subject to legal claims and litigation arising in the ordinary course of business, such as employment or intellectual property claims, including the matters described below. The outcome of any such matters is currently not determinable. Although the Company does not expect that any such legal claims or litigation will ultimately have a material adverse effect on its consolidated financial position, results of operations or cash flows, an adverse result in one or more matters could negatively affect the Company's results in the period in which they occur.

*Federal Derivative Lawsuits*

Between May 24, 2006 and August 17, 2006, seven purported shareholder derivative actions were filed in the United States District Court for the Northern District of California against the Company and certain of its current and former officers and directors. The lawsuits allege that the Company's officers and directors either participated in illegal back-dating of stock option grants or allowed it to happen. On October 19, 2006, the Court ordered the consolidation of these actions as *In Re Juniper Derivative Actions*, No. 06-03396, and appointed as the lead plaintiffs Timothy Hill, Employer-Teamsters Local Nos. 175 & 505 Pension Trust Fund, and Indiana State District Council of Laborers and HOD Carriers Pension Fund. Lead plaintiffs filed a consolidated complaint on April 11, 2007. The consolidated complaint asserts causes of action for violations of federal securities laws, violations of California securities laws, breaches of fiduciary duty, aiding and abetting breaches of fiduciary duty, abuse of control, corporate waste, breach of contract, unjust enrichment, gross mismanagement, and insider selling and misappropriation of information. The consolidated complaint also demands an accounting and rescission of allegedly improper stock option grants. The Company formed a Special Litigation Committee, consisting of directors Michael Rose and Michael Lawrie, to determine whether it is in the best interest of Juniper Networks and its shareholders to pursue any of the claims asserted in the derivative litigation. The plaintiffs and the Company have agreed in principle on a settlement of the federal derivative litigation and the state derivative litigation discussed below, and any such settlements would require approval of the court. The Company has accrued a \$9 million expense in connection with these potential settlements. The Special Litigation Committee is authorized to pursue, settle, or release such claims.

*State Derivative Lawsuits - California*

On May 24 and June 2, 2006, two purported shareholder derivative actions were filed in the Santa Clara County Superior Court in the State of California against the Company and certain of its current and former officers and directors. These two actions were consolidated as *In re Juniper Networks Derivative Litigation*, No. 1:06CV064294, by order dated June 20, 2006. An amended consolidated complaint was filed on April 9, 2007. The amended consolidated complaint alleges that certain of the Company's current and former officers and directors either participated in illegal back-dating of stock options or allowed it to happen. The complaint asserts causes of action

**Table of Contents**

for unjust enrichment, breach of fiduciary duties, abuse of control, gross mismanagement, waste of corporate assets, insider selling and misappropriation of information, and violations of California securities laws. Plaintiffs also demand an accounting and rescission of allegedly improper stock options grants, and a constructive trust of proceeds derived from allegedly illicit stock options. The Company formed a Special Litigation Committee, consisting of directors Michael Rose and Michael Lawrie, to determine whether it is in the best interest of Juniper Networks and its shareholders to pursue any of the claims asserted in the derivative litigation. The plaintiffs and the Company have agreed in principle on a settlement of the federal derivative litigation discussed above and the state derivative litigation and any such settlements would require approval of the court. The Company has accrued a \$9 million expense in connection with these potential settlements. The Special Litigation Committee is authorized to pursue, settle, or release such claims.

*Federal Securities Class Action*

On July 14, 2006 and August 29, 2006, two purported class actions were filed in the Northern District of California against the Company and certain of the Company's current and former officers and directors. On November 20, 2006, the Court consolidated the two actions as *In re Juniper Networks, Inc. Securities Litigation*, No. C06-04327-JW, and appointed the New York City Pension Funds as lead plaintiffs. The lead plaintiffs filed a Consolidated Class Action Complaint on January 12, 2007, and filed an Amended Consolidated Class Action Complaint on April 9, 2007. The Amended Consolidated Complaint alleges that the defendants violated federal securities laws by manipulating stock option grant dates to coincide with low stock prices and issuing false and misleading statements including, among others, incorrect financial statements due to the improper accounting of stock option grants. The Amended Consolidated Complaint asserts claims for violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 on behalf of all persons who purchased or otherwise acquired Juniper Networks' publicly traded securities from July 12, 2001, through and including August 10, 2006. On June 7, 2007, the defendants filed a motion to dismiss certain of the claims, and a hearing was held on September 10, 2007. On March 31, 2008, the Court issued an order granting in part and denying in part the defendants' motion to dismiss. The order dismissed with prejudice plaintiffs' section 10(b) claim to the extent it was based on challenged statements made before July 14, 2001. The order also dismissed, with leave to amend plaintiffs' section 10(b) claim against Pradeep Sindhu. The order upheld all of plaintiffs' remaining claims. The order gave plaintiffs until May 1, 2008, to file an amended complaint. Plaintiffs chose not to amend their complaint. Defendants filed their answer on June 23, 2008.

*Calamore Proxy Statement Action*

On March 28, 2007, an action titled *Jeanne M. Calamore v. Juniper Networks, Inc., et al.*, No. C-07-1772-JW, was filed by Jeanne M. Calamore in the Northern District of California against the Company and certain of the Company's current and former officers and directors. The complaint alleges that the proxy statement for the Company's 2006 Annual Meeting of Stockholders contained various false and misleading statements in that it failed to disclose stock option backdating information. As a result, plaintiff seeks preliminary and permanent injunctive relief with respect to the Company's 2006 Equity Incentive Plan, including seeking to invalidate the plan and all equity awards granted and grantable thereunder. On May 21, 2007, the Company filed a motion to dismiss and plaintiff filed a motion for preliminary injunction. On July 19, 2007, the Court issued an order denying plaintiff's motion for a preliminary injunction and dismissing the complaint in its entirety with leave to amend. Plaintiff filed an amended complaint on August 27, 2007, and the defendants filed a motion to dismiss on October 9, 2007. Plaintiff filed her opposition on December 21, 2007, and defendants filed their reply on January 25, 2008. A hearing was held on February 11, 2008. The Court has not yet issued a ruling.

*IPO Allocation Case*

In December 2001, a class action complaint was filed in the United States District Court for the Southern District of New York against the Goldman Sachs Group, Inc., Credit Suisse First Boston Corporation, FleetBoston Robertson Stephens, Inc., Royal Bank of Canada (Dain Rauscher Wessels), SG Cowen Securities Corporation, UBS Warburg LLC (Warburg Dillon Read LLC), Chase (Hambrecht & Quist LLC), J.P. Morgan Chase & Co., Lehman Brothers, Inc., Salomon Smith Barney, Inc., Merrill Lynch, Pierce, Fenner & Smith, Incorporated (collectively, the Underwriters), Juniper Networks and certain of Juniper Networks' officers. This action was brought on behalf of purchasers of the Company's common stock in its initial public offering in June 1999 and the Company's secondary

offering in September 1999.

**Table of Contents**

Specifically, among other things, this complaint alleged that the prospectus pursuant to which shares of common stock were sold in the Company's initial public offering and the Company's subsequent secondary offering contained certain false and misleading statements or omissions regarding the practices of the Underwriters with respect to their allocation of shares of common stock in these offerings and their receipt of commissions from customers related to such allocations. Various plaintiffs have filed actions asserting similar allegations concerning the initial public offerings of approximately 300 other issuers. These various cases pending in the Southern District of New York have been coordinated for pretrial proceedings as *In re Initial Public Offering Securities Litigation*, 21 MC 92. In April 2002, plaintiffs filed a consolidated amended complaint in the action against the Company, alleging violations of the Securities Act of 1933 and the Securities Exchange Act of 1934. Defendants in the coordinated proceeding filed motions to dismiss. In October 2002, the Company's officers were dismissed from the case without prejudice pursuant to a stipulation. On February 19, 2003, the court granted in part and denied in part the motion to dismiss, but declined to dismiss the claims against the Company.

In June 2004, a stipulation of settlement and release of claims against the issuer defendants, including the Company, was submitted to the court for approval. On August 31, 2005, the court preliminarily approved the settlement. In December 2006, the appellate court overturned the certification of classes in the six test cases that were selected by the underwriter defendants and plaintiffs in the coordinated proceedings (the action involving the Company is not one of the six test cases). Because class certification was a condition of the settlement, it was unlikely that the settlement would receive final Court approval. On June 25, 2007, the Court entered an order terminating the proposed settlement based upon a stipulation among the parties to the settlement. Plaintiffs have filed amended master allegations and amended complaints and moved for class certification in the six focus cases, which the defendants in those cases have opposed. On March 26, 2008, the Court largely denied the defendants' motion to dismiss the amended complaints in the six test cases.

**16(b) Demand**

On October 3, 2007, a purported Juniper Networks shareholder filed a complaint for violation of Section 16(b) of the Securities Exchange Act of 1934, which prohibits short-swing trading, against the Company's IPO underwriters. The complaint, *Vanessa Simmonds v. The Goldman Sachs Group, et al.*, Case No. C07-015777, in District Court for the Western District of Washington, seeks the recovery of short-swing profits. The Company is named as a nominal defendant. No recovery is sought from the Company in this matter.

**IRS Notices of Proposed Adjustments**

The IRS has concluded an audit of the Company's federal income tax returns for fiscal years 1999 and 2000. During 2004, the Company received a Notice of Proposed Adjustment (NOPA) from the IRS. While the final resolution of the issues raised in the NOPA is uncertain, the Company does not believe that the outcome of this matter will have a material adverse effect on the Company's consolidated financial position or results of operations. The Company is also under routine examination by certain state and non-US tax authorities. The Company believes that it has adequately provided for any reasonably foreseeable outcome related to these audits.

In 2007, the IRS opened an examination of the Company's U.S. federal income tax and employment tax returns for the 2004 fiscal year. Subsequently, the IRS extended their examination of the Company's employment tax returns to include fiscal years 2005 and 2006. The Company has not yet received any NOPAs related to these audits.

**Note 10. Related Party Transactions**

The Company reimburses its CEO, Mr. Scott Kriens, for ordinary operating costs relating to his use of a personal aircraft for business purposes up to a maximum amount per year. The Company incurred \$0.1 million in related expenses for the three and six months ended June 30, 2008, and \$0.1 million and \$0.2 million in the three and six months ended June 30, 2007, respectively.

**Table of Contents**

**Note 11. Subsequent Event**

***Stock Repurchases***

Subsequent to June 30, 2008, through the filing of this report, the Company repurchased and retired approximately 1.5 million shares of its common stock for approximately \$35.2 million under the 2008 Stock Repurchase Program at an average purchase price of \$23.40 per share. The Company's 2008 Stock Repurchase Program had remaining authorized funds of \$896.6 million as of the report filing date. Purchases under the Company's stock repurchase programs are subject to a review of the circumstances in place at the time and will be made from time to time as permitted by securities laws and other legal requirements.

29

---



**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Forward-Looking Statements**

*This Quarterly Report on Form 10-Q ( Report ), including the Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements regarding future events and the future results of the Company that are based on current expectations, estimates, forecasts, and projections about the industry in which the Company operates and the beliefs and assumptions of the management of the Company. Words such as expects, anticipates, targets, goals, projects, intends, plans, believes, seeks, estimates, variations of such words, and similar expressions are intended to identify such forward-looking statements. These forward-looking statements are only predictions and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in this Report under the section entitled Risk Factors in Item 1A of Part II and elsewhere, and in other reports the Company files with the Securities and Exchange Commission ( SEC ), specifically the most recent Annual Report on Form 10-K. The Company undertakes no obligation to revise or update publicly any forward-looking statements for any reason.*

The following discussion is based upon our unaudited Condensed Consolidated Financial Statements included elsewhere in this report, which have been prepared in accordance with U.S. generally accepted accounting principles. In the course of operating our business, we routinely make decisions as to the timing of the payment of invoices, the collection of receivables, the manufacturing and shipment of products, the fulfillment of orders, the purchase of supplies, and the building of inventory and spare parts, among other matters. Each of these decisions has some impact on the financial results for any given period. In making these decisions, we consider various factors including contractual obligations, customer satisfaction, competition, internal and external financial targets and expectations, and financial planning objectives. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingencies. On an on-going basis, we evaluate our estimates, including those related to sales returns, pricing credits, warranty costs, allowance for doubtful accounts, impairment of long-term assets, especially goodwill and intangible assets, contract manufacturer exposures for carrying and obsolete material charges, assumptions used in the valuation of stock-based compensation, and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

**Overview of the Results of Operations****Executive Overview**

To aid readers of our financial statements in understanding our operating results, we have provided below an executive overview of the significant events that affected the most recent quarter and the first half of our fiscal 2008 and a discussion of the nature of our operating expenses.

(In millions, except per share amounts and percentages)

**Three months ended June 30, 2008**

	<b>Total</b>	<b>Segments</b>	
	<b>Consolidated</b>	<b>Infrastructure</b>	<b>SLT</b>
Net revenues	\$ 879.0	\$ 672.4	\$ 206.6
Year-over-year net revenues increase	32%	40%	12%
Segment operating income (1)	\$ 207.4	\$ 195.1	\$ 12.3
Year-over-year segment operating income increase	53%	46%	N/M(2)
Operating income (1)	\$ 160.5		
Year-over-year operating income increase	86%		
Net income	\$ 120.4		
Year-over-year net income increase	40%		
Net income per share:			
Basic	\$ 0.23		

Diluted

\$ 0.22

30

---

**Table of Contents****(In millions, except per share amounts and percentages)****Six months ended June 30, 2008**

	<b>Total</b>	<b>Segments</b>	
	<b>Consolidated</b>	<b>Infrastructure</b>	<b>SLT</b>
Net revenues	\$ 1,701.9	\$ 1,294.3	\$ 407.6
Year-over-year net revenues increase	32%	37%	16%
Segment operating income (1)	\$ 405.1	\$ 386.6	\$ 18.5
Year-over-year segment operating income increase	57%	49%	N/M(2)
Operating income (1)	\$ 303.1		
Year-over-year operating income increase	107%		
Net income	\$ 230.8		
Year-over-year net income increase	51%		
Net income per share:			
Basic	\$ 0.44		
Diluted	\$ 0.41		

(1) Segment operating income excludes expenses for amortization of intangible assets, stock-based compensation expense, stock-based payroll tax expense, and other charges, net; however, these expenses are included in operating income.

(2) N/M Not meaningful

*Net revenues:* Our net revenues for the three and six months ended June 30, 2008, increased 32% from the same periods in 2007. We experienced growth in both Infrastructure and Service Layer Technologies ( SLT ) revenues, which represented 76.5% and 23.5% of net revenues, respectively, for the three months ended June 30, 2008, and 76.1% and 23.9% of net revenues, respectively, for the six months ended June 30, 2008. Our Infrastructure revenues increased 40% and 37% and SLT revenues increased 12% and 16%, in the three and six months ended June 30, 2008, respectively, in each case compared to the same periods in 2007. Our increases in Infrastructure revenues were attributable to the growing acceptance of our router products and services, including our MX-, T-, and M-series product families, in the service provider and enterprise markets. We also experienced growth in our SLT products and services, including firewall virtual private network ( Firewall ) and J-series product families, in the enterprise and service provider markets, partially offset by declines in revenue from WX and DX products.

*Operating Margin:* Our operating income increased \$74.2 million and \$156.4 million, or 86% and 107%, in the three and six months ended June 30, 2008, to \$160.5 million and \$303.1 million, respectively, compared to the same periods in 2007. Operating margin percentage was 18.3% and 17.8% for the three and six months ended June 30, 2008, as compared to 13.0% and 11.4% from the same periods in 2007. This change was, in large part, due to a decrease in operating expense as a percentage of net revenues due to our efforts to manage expenses and improve efficiencies in the three and six months ended June 30, 2008, compared to the same periods in the prior year.

*Net Income and Net Income Per Share:* Net income was \$120.4 million and \$230.8 million, or \$0.22 per share and \$0.41 per share on a diluted basis in the three and six months ended June 30, 2008, respectively, compared to \$86.2 million and \$152.8 million, or \$0.15 per share and \$0.26 per share on a diluted basis from the same periods in 2007. The increase was primarily due to the revenue growth and the reduction in operating expenses, which were partially offset by lower net interest and other income along with higher income tax expense in the 2008 period.

*Other Financial Highlights:* Total deferred revenue increased \$79.5 million in the six months ended June 30, 2008, primarily due to the renewal of annual maintenance arrangements. During the six months ended June 30, 2008, we generated \$324.3 million resulting from cash provided by our operating activities, which was partially offset by cash used in investing activities and financing activities, which included the repurchase of \$121.3 million of our common stock.

**Table of Contents****Significant Events*****Business and Market Environment***

We design, develop and sell products and services that together provide our customers with high-performance network infrastructure that creates responsive and trusted environments for accelerating the deployment of services and applications over a single Internet Protocol ( IP )-based network. We serve the high-performance networking requirements of global service providers, enterprises, governments and research and education institutions that view the network as critical to their success. High-performance networking is designed to provide fast, reliable and secure access to applications and services. We offer a high-performance network infrastructure that includes best-in-class IP routing, Ethernet switching, security and application acceleration solutions, as well as partnerships designed to extend the value of the network and worldwide services and support designed to optimize customer investments.

In the first half of our fiscal 2008, we continued to deliver innovative, high-performance network infrastructure solutions. For the service provider market, we announced an advanced mobile IP/MPLS solution portfolio with the new BX 7000 multi-access gateway router for the cell site, M-series circuit emulation physical interface cards for the aggregation site and a suite of software features designed to simplify deployment, provisioning and management of mobile backhaul networks. We also introduced the JCS 1200, a high-performance control plane scaling platform. In addition, we announced three new line card families for the MX-series Ethernet Services Routers. These cards known as Dense Port Concentrators or ( DPC ) provide physical interfaces for the MX-series. These cards allow customers greater flexibility in network design with the MX-series by providing connections to lower speed Ethernet platforms (10mb & 100mb), copper based infrastructures and by combining a wide range of Ethernet speeds in a single chassis slot. For the enterprise market, we introduced the EX-series, a family of Ethernet switches that leverage the operational simplicity and carrier-class reliability of our JUNOS software. We also announced a new family of Intrusion Detection and Prevention (IDP) appliances that deliver up to 10 Gbps real-world throughput and performance to enable Intrusion Prevention System (IPS) appliance deployments in the network core, the integration of services, including Firewall and chassis clustering into JUNOS software for implementation on the J-series services router and the Security Threat Response Manager (STRM), a platform capable of providing businesses with a centralized scalable and effective way to log and manage a rapidly evolving threat landscape.

***Changes to Segments***

Beginning in January 2008, we realigned our reporting structure which resulted in two segments: Infrastructure and SLT. The previously reported Service segment has been combined into the following two segments:

*Infrastructure:* Our Infrastructure segment includes products and services related to the E-, M-, MX- and T-series router product families, EX-series switching products, as well as the circuit-to-packet products.

*SLT:* Our SLT segment consists primarily of products and services related to our Firewall systems and appliances, secure sockets layer virtual private network ( SSL ) appliances, intrusion detection and prevention appliances ( IDP ), the J-series router product family and wide area network ( WAN ) optimization platforms.

***Stock Repurchase Activity***

During the six months ended June 30, 2008, we repurchased \$121.3 million or 4.7 million shares of our common stock via open market purchases under two stock repurchase programs that were authorized by our Board of Directors. Under the \$2.0 billion stock repurchase program approved in 2006 and 2007 (the 2006 Stock Repurchase Program ), we repurchased approximately 2.2 million shares of our common stock at an average price of \$24.61 per share for a total purchase price of \$53.1 million during the three months ended March 31, 2008. No shares were repurchased under this program during the second quarter of 2008. As of June 30, 2008, we have repurchased and retired approximately 71.6 million shares of our common stock under the 2006 Stock Repurchase Program at an average price of \$23.41 per share, and the program had remaining authorized funds of \$323.8 million

## **Table of Contents**

The Board of Directors approved another \$1.0 billion stock repurchase program in March 2008 (the 2008 Stock Repurchase Program ). Under this program, we repurchased approximately 2.5 million shares of our common stock at an average price of \$26.84 per share for a total purchase price of \$68.2 million during the three and six months ended June 30, 2008. As of June 30, 2008, the 2008 Stock Repurchase Program had remaining authorized funds of \$931.8 million.

Subsequent to June 30, 2008, through the filing of this report, we have repurchased and retired approximately 1.5 million shares of our common stock for approximately \$35.2 million under the 2008 Stock Repurchase Program at an average price of \$23.40 per share. The 2008 Stock Repurchase Program had remaining authorized funds of \$896.6 million as of the report filing date.

All shares of common stock purchased under the 2006 and 2008 Stock Repurchase Programs have been retired. Share repurchases under our stock repurchase programs will be subject to a review of the circumstances in place at the time and will be made from time to time in private transactions or open market purchases as permitted by securities laws and other legal requirements. These programs may be discontinued at any time.

### **Backlog**

Our sales are made primarily pursuant to purchase orders under framework agreements with our customers. At any given time, we have orders for products that have not been shipped and for services that have not yet been performed for various reasons. Because we believe industry practice would allow customers to cancel or change orders with limited advance notice prior to shipment or performance, as well as our own history of allowing such changes and cancellations, we do not consider this backlog to be firm and do not believe our backlog information is necessarily indicative of future revenue.

### **Manufacturing**

Most of our manufacturing, repair and supply chain operations are outsourced to independent contract manufacturers. Accordingly, most of our costs of revenues consist of payments to our independent contract manufacturers for product costs. The independent contract manufacturers produce our products using design specifications, quality assurance programs and standards that we establish. Our independent contract manufacturers manufacture our products primarily in Canada, China, Malaysia, and the United States. We have employees in our manufacturing and operations organization who manage relationships with our contract manufacturers, manage our supply chain, and monitor product testing and quality. We generally do not own the components and title to products transfers from the contract manufacturers to us and immediately to our customers upon shipment.

The contract manufacturers procure components based on our build forecasts. If actual component usage is lower than our forecasts, we may be and have been in the past, liable for carrying or obsolete material charges.

In recent years, an increasing amount of our product has been manufactured in Asia, and we anticipate that a larger percentage of our products will be produced outside the United States and Canada in the future. Our contracts generally provide for passage of title and risk of loss at the designated point of shipment to the customer. The manufacturing of products in Asia for shipment to customers in EMEA and the Americas resulted in additional shipment logistics, freight and timing issues for us and those customers. In an ongoing effort to balance our and the customers' needs, we have made changes on occasion to the payment of freight and the point of shipment with respect to products shipped from Asia. These changes impact shipping costs and the timing of revenue recognition of the affected shipments.

### **Nature of Expenses**

Employee related costs have historically been the primary driver of our operating expenses and we expect this trend to continue. These costs include items such as wages, commissions, bonuses, vacation, benefits, stock-based compensation, and travel. We increased our headcount by 20% to 6,531 employees as of June 30, 2008, from 5,435 employees as of June 30, 2007, primarily in the research and development, sales, and customer service organizations.

**Table of Contents**

Stock-based compensation and related payroll tax expense was \$28.6 million and \$52.4 million in the three and six months ended June 30, 2008, respectively, and \$23.6 million and \$49.5 million in the three and six months ended June 30, 2007, respectively. As of June 30, 2008, approximately \$146.7 million of unrecognized stock-based compensation cost, adjusted for estimated forfeitures, related to non-vested stock options is expected to be recognized over a weighted-average period of approximately 3 years. In addition, approximately \$74.1 million of unrecognized stock-based compensation cost, adjusted for estimated forfeitures, related to non-vested RSUs and non-vested performance share awards is expected to be recognized over a weighted-average period of approximately 2.5 years. Facility and information technology departmental costs are allocated to other departments based on usage and headcount, respectively. Facility and information technology related cost increased by \$16.0 million and \$37.2 million in the three and six months ended June 30, 2008, respectively, compared to the same periods in 2007 due to an increase in headcount and the continued build-out of our domestic and international development and test centers and applications to support our internal operations. Facility and information technology related headcount was 256 employees as of June 30, 2008, compared to 213 employees as of June 30, 2007. We expect to further invest in our company-wide information technology infrastructure as we implement our operational excellence initiatives. Although our revenue transactions are primarily denominated in U.S. dollars, operating expenses are denominated in U.S. dollars as well as other foreign currencies including the British Pound, the Euro, Indian Rupee, and Japanese Yen. Changes in related currency exchange rates may affect our operating results. Periodically, we use foreign currency forward and/or option contracts to hedge certain forecasted foreign currency transactions relating to operating expenses. The effective portion of the derivative's gain or loss is initially reported as a component of accumulated other comprehensive income and, upon occurrence of the forecasted transaction, is subsequently reclassified into the condensed consolidated statements of operations line item to which the hedged transaction relates. Any ineffectiveness of the hedging instruments is reported in other income (expense) on our condensed consolidated statements of operations. The increase in expenses including cost of revenues, research and development, sales and marketing, and general and administrative expenses, due to foreign currency fluctuation, was approximately 3% in the three and six months ended June 30, 2008, compared with the same periods in 2007.

**Critical Accounting Policies and Estimates**

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities and equity at the date of the financial statements and the reported amounts of net revenues, costs and expenses in the reporting period. We regularly evaluate our estimates and assumptions. We base our estimates and assumptions on current facts, historical experience and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Our actual results may differ materially and adversely from management's estimates. To the extent there are material differences between our estimates and the actual results, our future operating results will be affected.

We believe the following critical accounting policies require us to make significant judgments and estimates in the preparation of our condensed consolidated financial statements:

*Revenue Recognition;*

*Contract Manufacturer Liabilities;*

*Warranty Reserve;*

*Goodwill and Purchased Intangible Assets;*

*Stock-Based Compensation;*

*Income Taxes; and*

*Loss Contingencies.*



**Table of Contents****Fair Value Accounting**

In February 2007, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standard No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115* ("SFAS 159"). SFAS 159 expands the use of fair value accounting to eligible financial assets and liabilities. SFAS 159 is effective beginning on January 1, 2008. We evaluated our existing financial instruments and elected not to adopt the fair value option on our financial instruments. As a result, SFAS 159 did not have any impact on our financial condition or results of operations as of and for the three and six months ended June 30, 2008. However, because the SFAS 159 election is based on an instrument-by-instrument election at the time we first recognize an eligible item or enter into an eligible firm commitment, we may decide to exercise the option on new items when business reasons support doing so in the future which may have a significant impact on our operating results.

Management believes that there have been no significant changes during the three and six months ended June 30, 2008, to the items that we disclosed as our critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2007.

**Recent Accounting Pronouncements**

See Note 1 - Summary of Significant Accounting Policies in the Notes to Condensed Consolidated Financial Statements in Item 1, Part I of this Form 10-Q for a full description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on results of operations and financial condition, which is incorporated herein by reference.

**Results of Operations**

The following table shows product and service net revenues (in millions, except percentages):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2008	2007	\$ Change	%Change	2008	2007	\$ Change	%Change
Net revenues:								
Product	\$723.9	\$541.7	\$ 182.2	34%	\$1,398.1	\$1,051.5	\$ 346.6	33%
<i>Percentage of net revenues</i>	82.3%	81.5%			82.2%	81.4%		
Service	155.1	123.2	31.9	26%	303.8	240.4	63.4	26%
<i>Percentage of net revenues</i>	17.7%	18.5%			17.8%	18.6%		
Total net revenues	\$879.0	\$664.9	\$ 214.1	32%	\$1,701.9	\$1,291.9	\$ 410.0	32%

Our net revenues increased in the three and six months ended June 30, 2008, compared to the same periods in 2007 primarily as a result of increased sales of both Infrastructure and SLT solutions to the service provider and enterprise markets. In particular, we had success in selling our Infrastructure products to service providers who are adopting next generation networking ("NGN") IP networks, which are designed for higher capacity and efficiency to help reduce total operating costs and to be able to offer multiple services over a single network. In the second quarter of 2008, we also experienced increased revenue from the enterprise market primarily due to the sales of infrastructure product solutions. In addition, during the three and six months ended June 30, 2008, our new product releases and further expansion into emerging markets contributed to the increase in total net revenues for those periods.

**Table of Contents****Infrastructure Segment Revenues**

The following table shows net Infrastructure segment revenues and net Infrastructure segment revenues as a percentage of total net revenues by product and service categories (in millions, except percentages):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2008	2007 (1)	\$ Change	% Change	2008	2007 (1)	\$ Change	% Change
Net Infrastructure segment revenues:								
Infrastructure product revenue	\$575.9	\$402.9	\$ 173.0	43%	\$1,104.6	\$788.1	\$ 316.5	40%
<i>Percentage of net revenues</i>	<i>65.5%</i>	<i>60.6%</i>			<i>64.9%</i>	<i>61.0%</i>		
Infrastructure service revenue	96.5	78.0	18.5	24%	189.7	153.6	36.1	24%
<i>Percentage of net revenues</i>	<i>11.0%</i>	<i>11.7%</i>			<i>11.2%</i>	<i>11.9%</i>		
Total Infrastructure segment revenues (1)	\$672.4	\$480.9	\$ 191.5	40%	\$1,294.3	\$941.7	\$ 352.6	37%
<i>Percentage of net revenues</i>	<i>76.5%</i>	<i>72.3%</i>			<i>76.1%</i>	<i>72.9%</i>		

(1) Prior period amounts have been reclassified to reflect the 2008 segment structure, which now includes service revenue in the Infrastructure and SLT segments.

**Infrastructure Product**

For the three months ended June 30, 2008, the increase in Infrastructure product revenue was primarily attributable to revenue growth from our MX- and T-series product families in both the service provider and enterprise markets due to our customers' increased demand for network infrastructure solutions. To a lesser extent, our EX-series products also contributed to the revenue growth in the second quarter of 2008. For the six months ended June 30, 2008, the increase was primarily due to growth from MX-, M- and T-series product families as both our service provider and enterprise customers continued to build out their networks as their bandwidth requirements increased. E-series product revenue increased in the second quarter of 2008, but decreased in the first six months of 2008, primarily as a result of the timing of revenue recognition compared to revenue recognized in the same period in 2007 for prior year shipments. From a geographical perspective, during the second quarter of 2008, we experienced growth in all three regions, with particular strength in EMEA. In the first six months of 2008, we experienced strength in all regions.

We track Infrastructure chassis revenue units and ports shipped to analyze customer trends and indicate areas of potential network growth. Our Infrastructure product platforms are generally modular, with the chassis serving as the base of the platform. Each chassis has a certain number of slots that are available to be populated with components we refer to as modules or interfaces. The modules are the components through which the router receives incoming packets of data from a variety of transmission media. The physical connection between a transmission medium and a module is referred to as a port. The number of ports on a module varies widely depending on the functionality and throughput offered by the module. Chassis revenue units represent the number of chassis on which revenue was recognized during the period. The following table shows Infrastructure revenue units and ports shipped:

	Three Months Ended June30,				Six Months Ended June 30,			
	2008	2007	Unit Change	%	Change	2008	2007	Unit Change
Infrastructure chassis revenue units (1)	3,387	2,458	929	38%	6,392	4,948	1,444	29%
Infrastructure ports shipped (1)	94,284	51,824	42,460	82%	172,933	93,431	79,502	85%

(1) Excludes fixed configuration Ethernet switching products.

Chassis revenue units increased in the three and six months ended June 30, 2008, respectively, compared to the same periods in 2007. The increases in chassis units and port shipments were driven by bandwidth demand as customers are seeking to expand capabilities in their networks and to offer differentiating feature-rich multi-play services that allow them to generate new revenue sources. The port shipments also increased in the three and six months ended June 30, 2008, compared to the same periods in 2007, primarily due to the increase in the overall number of chassis revenue units from richly configured T- and M-series router products during the 2008 periods.

**Table of Contents****Infrastructure Service**

The increase in Infrastructure service revenue for the three and six months ended June 30, 2008, was primarily due to an increase in our installed base of equipment being serviced. A majority of our service revenue is earned from customers that purchase our products and enter into service contracts for support service. We also experienced increased professional service revenue due to consulting projects.

**SLT Segment Revenues**

The following table shows net SLT segment revenues and net SLT segment revenues as a percentage of total net revenues by product and service categories (in millions, except percentages):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2008	2007 (1)	\$ Change	% Change	2008	2007 (1)	\$ Change	% Change
Net SLT segment revenues:								
SLT product revenue	148.0	138.8	9.2	7%	293.5	263.4	30.1	11%
<i>Percentage of net revenues</i>	<i>16.8%</i>	<i>20.9%</i>			<i>17.2%</i>	<i>20.4%</i>		
SLT service revenue	58.6	45.2	13.4	30%	114.1	86.8	27.3	31%
<i>Percentage of net revenues</i>	<i>6.7%</i>	<i>6.8%</i>			<i>6.7%</i>	<i>6.7%</i>		
Total SLT segment revenues (1)	\$206.6	\$184.0	\$ 22.6	12%	\$407.6	\$350.2	\$ 57.4	16%
<i>Percentage of net revenues</i>	<i>23.5%</i>	<i>27.7%</i>			<i>23.9%</i>	<i>27.1%</i>		

(1) Prior period amounts have been reclassified to reflect the 2008 segment structure, which now includes service revenue in the Infrastructure and SLT segments.

**SLT Product**

We experienced increases in SLT product revenue from Firewall products, which include branch and high-end Firewall products, and J-series products in the three and six months ended June 30, 2008, compared to the same periods a year ago, partially offset by a decline in revenues from DX and WX products. The integrated systems introduced prior to 2007, such as the SSG Firewall products, gained further traction in the market place with revenue from these product lines growing in the three and six months ended June 30, 2008, compared to same periods in 2007. In the second quarter of 2008, we experienced sales growth primarily in the enterprise market and in the first half of 2008; we experienced sales growth both in the service provider and enterprise markets. Geographically, revenues

increased in EMEA and APAC, for the three months ended June 30, 2008. We experienced revenue increases in the EMEA and APAC, which were partially offset by a decrease in the Americas regions in the six months ended June 30, 2008.

The following table shows SLT revenue units recognized:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2008	2007	Unit Change	% Change	2008	2007	Unit Change	% Change
Service Layer Technologies revenue units	60,857	56,046	4,811	9%	120,137	112,306	7,831	7%

The increase in SLT revenue units of 9% was consistent with the 7% growth in SLT product revenue in the three months ended June 30, 2008. In the six months ended June 30, 2008, SLT revenue units increased by 7% compared to the 11% growth in SLT product revenue which was primarily due to the product mix that favored higher margin products as compared to the same period in 2007.

In January 2008, we announced a plan to phase out our DX product line. These products will be supported until 2013. We do not expect this plan to have a material impact on our condensed consolidated results of operations, cash flows, and financial condition.

#### ***SLT Service***

The increase in SLT service revenue was primarily due to an increase in our installed base of equipment being serviced. A majority of our service revenue is earned from customers that purchase our products and enter into service contracts for support.

**Table of Contents****Net Revenues by Geographic Region**

The following table shows the total net revenues by geographic region (in millions, except percentages):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2008	2007	\$ Change	% Change	2008	2007	\$ Change	% Change
Americas:								
United States	\$ 325.3	\$ 289.7	\$ 35.6	12%	\$ 713.4	\$ 569.2	\$ 144.2	25%
Other	63.3	25.5	37.8	148%	93.2	41.4	51.8	125%
Total Americas	388.6	315.2	73.4	23%	806.6	610.6	196.0	32%
<i>Percentage of net revenues</i>	<i>44.2%</i>	<i>47.4%</i>			<i>47.4%</i>	<i>47.3%</i>		
Europe, Middle East, and Africa	285.6	197.8	87.8	44%	525.7	407.2	118.5	29%
<i>Percentage of net revenues</i>	<i>32.5%</i>	<i>29.7%</i>			<i>30.9%</i>	<i>31.5%</i>		
Asia Pacific	204.8	151.9	52.9	35%	369.6	274.1	95.5	35%
<i>Percentage of net revenues</i>	<i>23.3%</i>	<i>22.9%</i>			<i>21.7%</i>	<i>21.2%</i>		
Total	\$ 879.0	\$ 664.9	\$ 214.1	32%	\$ 1,701.9	\$ 1,291.9	\$ 410.0	32%

Net revenues in the Americas region increased in absolute dollars in the second quarter of 2008 compared to the same period in 2007 primarily due to growth in revenue from both service provider and enterprise customers. In the United States, revenue increased in the service provider market as well as the enterprise market, particularly from federal government customers. Net revenues in the Americas region increased in absolute dollars in the first half of 2008 compared to the same period in 2007 primarily due to increased sales of our core routers to the service provider market in the United States as our customers continued to focus on increasing network performance, reliability and scale. Net revenues in the Americas region as a percentage of total net revenue decreased in the three months ended June 30, 2008, primarily due to the relative strength of sales in EMEA and APAC. During the six months ended June 30, 2008, net revenues in the Americas region as a percentage of total net revenues slightly increased primarily due to increased sales of our core routers to the service provider and enterprise markets particularly in the United States, compared to the same period in 2007, respectively.

Net revenues in EMEA increased in the three and six months ended June 30, 2008, compared to the same periods in 2007 primarily due to revenue growth in emerging markets in Eastern Europe, Middle East, and Africa which was driven by service provider network build-outs as a result of bandwidth demand and growth in the enterprise market. Net revenue in EMEA as a percentage of total net revenue increased in the three months ended June 30, 2008, primarily due to strength in the service provider market and decreased in the six months ended June 30, 2008, primarily due to relative strength of the Americas and APAC regions, compared to the same periods in 2007, respectively.

Net revenues in APAC increased, in absolute dollars and as a percentage of total net revenues, in the three and six months ended June 30, 2008, compared to the same periods in 2007, primarily due to strength in Japan, China and the Association of Southeast Asian Nations ( ASEAN ) countries, which was driven by bandwidth demand as well as our customers' deployment of routing platforms for their next-generation network. Increased sales in these countries were partially offset by a decrease in revenue from Australia.

**Net Revenues by Markets and Customers**

We sell our high-performance network products and service offerings from both the Infrastructure and SLT segments to two primary markets — service providers and enterprise. The service provider market includes wireline, wireless, and

cable operators as well as major internet content and application providers. The enterprise market represents businesses; federal, state and local governments; and research and education institutions. During the three and six months ended June 30, 2008, the service provider market accounted for 72.6% and 73.2%, respectively, of our net revenues, and the enterprise market accounted for 27.4% and 26.8%, respectively, of our net revenues. During the three and six months ended June 30, 2007, the service provider market accounted for 71.9% and 71.8%, respectively, of our net revenues, and the enterprise market accounted for 28.1% and 28.2%, respectively, of our net revenues. Net revenues to the service provider market increased by 33% and 34% during the three and six months ended June 30, 2008, respectively, compared to the same periods in 2007. Net revenues to the enterprise market increased by 29% and 25% during the three and six months ended June 30, 2008, compared to the same periods in 2007. NSN accounted for 10.4% of our net revenues in the three months ended June 30, 2008, and no single customer accounted for greater than 10.0% of our net revenues during the six months ended June 30, 2008. NSN and Verizon each accounted for greater than 10.0% of our net revenues during the same periods in 2007.

**Table of Contents****Cost of Revenues**

The following table shows cost of product and service revenues and the related gross margin ( GM ) percentages (in millions, except percentages):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2008	2007	\$ Change	% Change	2008	2007	\$ Change	% Change
Cost of revenues:								
Product	\$215.1	\$159.9	\$ 55.2	35%	\$406.9	\$314.8	\$ 92.1	29%
<i>GM as a percentage of product revenues</i>	70.3%	70.5%			70.9%	70.1%		
Service	74.2	60.9	13.3	22%	147.2	118.1	29.1	25%
<i>GM as a percentage of service revenues</i>	52.2%	50.6%			51.6%	50.9%		
Total cost of revenues	\$289.3	\$220.8	\$ 68.5	31%	\$554.1	\$432.9	\$ 121.2	28%
<i>GM as a percentage of net revenues</i>	67.1%	66.8%			67.4%	66.5%		

Cost of product revenues increased in the three and six months ended June 30, 2008, compared to the same periods in 2007, while product gross margin slightly decreased in the three months ended June 30, 2008, and increased in the six months ended June 30, 2008, compared to the same periods of 2007.

The increase in cost of product revenues in absolute dollars was primarily due to our increase in product revenues, which resulted in higher product costs. The slight decrease in product gross margin as a percentage of product revenues in the three months ended June 30, 2008, compared to same period in 2007, is primarily attributable to changes in the geography mix within our Infrastructure segment, and, particularly with a higher percentage of total product revenue experienced outside of the Americas. This overall decrease in product gross margin was partially offset by increased product gross margin within our SLT segment primarily due to increased sales of the higher margin Firewall and J-series products in the 2008 periods. The increase in product gross margin as a percentage of product revenues in the six months ended June 30, 2008, compared to same period in 2007, was primarily attributable to revenue growth from Infrastructure products across the higher-margin T- and M-series product families.

As of June 30, 2008, and 2007, we had 214 and 173 employees, respectively, in our manufacturing and operations organization that primarily manage relationships with our contract manufacturers, manage our supply chain, and monitor and manage product testing and quality.

The increases in cost of service revenues and service gross margin were commensurate with the growth in revenue in absolute dollars and the timing of our spares components purchases. Personnel related charges, consisting of salaries, bonus, fringe benefits expenses, stock-based compensation expenses, and other employee-related expenses increased \$6.9 million and \$12.4 million in the three and six months ended June 30, 2008, respectively, primarily due to a 12% increase in headcount, from 691 to 773 employees, in the customer service organization to build our world-wide operations. Our outside service expense also increased in the 2008 periods. Additionally, facilities and information technology expenses related to cost of service revenues increased in connection with the growth of service business as a portion of our overall operations.

**Operating Expenses**

The following table shows operating expenses (in millions, except percentages):



	Three Months Ended June 30,				Six Months Ended June 30,			
	2008	2007	\$ Change	% Change	2008	2007	\$ Change	% Change
Research and development	\$ 186.4	\$ 148.7	\$ 37.7	25%	\$ 357.0	\$ 289.8	\$ 67.2	23%
Sales and marketing	190.3	156.9	33.4	21%	376.3	307.5	68.8	22%
General and administrative	35.6	28.0	7.6	27%	69.3	55.3	14.0	25%
Amortization of purchased intangible assets	8.0	22.7	(14.7)	(65%)	33.1	45.5	(12.4)	(27%)
Other charges, net	9.0	1.6	7.4	463%	9.0	14.2	(5.2)	(37%)
Total operating expenses	\$ 429.3	\$ 357.9	\$ 71.4	20%	\$ 844.7	\$ 712.3	\$ 132.4	19%
Operating income	\$ 160.5	\$ 86.2	\$ 74.3	86%	\$ 303.1	\$ 146.7	\$ 156.4	107%

**Table of Contents**

The following table highlights our operating expenses as a percentage of net revenues:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Research and development	21.2%	22.4%	21.0%	22.4%
Sales and marketing	21.6%	23.6%	22.1%	23.8%
General and administrative	4.1%	4.2%	4.1%	4.3%
Amortization of purchased intangible assets	0.9%	3.4%	1.9%	3.5%
Other charges, net	1.0%	0.2%	0.5%	1.1%
<b>Total operating expenses</b>	<b>48.8%</b>	<b>53.8%</b>	<b>49.6%</b>	<b>55.1%</b>
Operating income	18.3%	13.0%	17.8%	11.4%

The increase in research and development expenses for the three and six months ended June 30, 2008, was primarily due to strategic initiatives to expand our product portfolio and maintain our technological advantage over competitors. Research and development expenses primarily consist of personnel related expenses and new product development costs. Personnel related charges, consisting of salaries, bonus, fringe benefits expenses, stock-based compensation expenses, and other employee-related expenses increased \$23.1 million and \$38.5 million in the three and six months ended June 30, 2008, respectively, primarily due to a 23% increase in headcount, from 2,354 to 2,898 employees in the engineering organization to support product innovation intended to capture anticipated future network infrastructure growth and opportunities. Outside consulting and other development expense also increased to support our product innovation initiatives. Additionally, facilities and information technology expenses related to research and development expenses increased to support these engineering efforts.

The increase in sales and marketing expenses was primarily due to increases in personnel related expenses and marketing expenses. Personnel related charges, consisting of salaries, commissions, bonus, fringe benefits, stock-based compensation expenses, and other employee-related expenses increased \$20.7 million and \$35.7 million for the three and six months ended June 30, 2008, respectively, primarily due to a 19% increase in headcount from 1,733 to 2,068 employees in our worldwide sales and marketing organizations. Included in the personnel charges was an increase in commission expense of \$2.7 million for the six months ended June 30, 2008, compared to the same period in 2007, due to our higher net revenues. We also increased our investment in corporate and channel marketing efforts from the prior year. As our sales force grew, we also increased facilities and information technology expense related to the sales and marketing organizations in the three months and six months ended June 30, 2008, compared to the same 2007 periods.

The increase in general and administrative expenses was primarily due to an increase in personnel related expenses and outside professional services. Personnel related charges, consisting of salaries, bonus, fringe benefits, stock-based compensation expenses, and other employee-related expenses increased \$4.6 million and \$6.6 million in the three and six months ended June 30, 2008, respectively, compared to the same 2007 periods, primarily due to a 19% increase in headcount in our worldwide general and administrative functions from 271 to 322 employees to support the overall growth of the business. Outside professional service fees increased in the three and six months ended June 30, 2008, compared to the same 2007 periods as a result of increased legal fees and business processes re-engineering costs. Additionally, facilities and information technology related to general and administrative expenses increased to support our growing business.

Research and development, sales and marketing and general and administrative expenses each decreased as a percentage of net revenues in the three and six months ended June 30, 2008, compared to the same 2007 periods, primarily due to our focused execution and cost control initiatives.

Amortization of purchased intangible assets decreased \$14.7 million and \$12.4 million in the three and six months ended June 30, 2008, respectively, compared to the same 2007 periods, primarily due to a decrease in amortization

expense as certain purchased intangible assets became fully amortized during the second quarter of 2008. This decrease was partially offset by the inclusion of an impairment charge of \$5.0 million, for the six months ended June 30, 2008, as a result of the phase out of our DX products.

Other charges, net, increased \$7.4 million in the three months ended June 30, 2008, primarily due to a \$9.0 million legal settlement expense and decreased \$5.2 million in the six months ended June 30, 2008, primarily due to the absence of stock investigation and tax related charges that were incurred in the same periods a year ago. See Note 4 Other Financial Information under *Other Charges, Net* in Notes to Condensed Consolidated Financial Statements in Item I of this Form 10-Q, for more information.

**Table of Contents****Interest and Other Income, Net, Gain or (Loss) on Minority Equity Investments, and Income Tax Provision**

The following table shows net interest and other income and income tax provision (in millions, except percentages):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2008	2007	\$ Change	% Change	2008	2007	\$ Change	% Change
Interest and other income, net	\$13.2	\$25.5	\$ (12.3)	(48%)	\$ 30.8	\$58.4	\$ (27.6)	(47%)
<i>Percentage of net revenues</i>	<i>1.5%</i>	<i>3.8%</i>			<i>1.8%</i>	<i>4.5%</i>		
(Loss) gain on minority equity investments	(1.5)	6.7	(8.2)	(122%)	(1.5)	6.7	(8.2)	(122%)
<i>Percentage of net revenues</i>	<i>(0.2%)</i>	<i>1.0%</i>			<i>N/M*</i>	<i>(0.5%)</i>		
Income tax provision	51.7	32.3	19.4	60%	101.7	59.1	42.6	72%
<i>Percentage of net revenues</i>	<i>5.9%</i>	<i>4.9%</i>			<i>6.0</i>	<i>4.6%</i>		

\*N/M Not meaningful

The decrease in interest and other income, net, was primarily due to lower interest rates in the 2008 period as compared to a year ago.

The gain (loss) on minority equity investments decreased by \$8.2 million in the three and six months ended June 30, 2008, compared to the same periods in 2007. In the three and six months ended June 30, 2008, we recorded a loss on two of our minority equity investments. In the three and six months ended June 30, 2007, we realized a gain from one of our minority equity investments that completed an initial public offering.

We recorded tax provisions of \$51.7 million and \$32.3 million for the three months ended June 30, 2008 and 2007, or effective tax rates of 30% and 27%, respectively. We recorded tax provisions of \$101.7 million and \$59.1 million for the six months ended June 30, 2008 and 2007, or effective tax rates of 31% and 28%, respectively. The effective tax rates for the three and six months ended June 30, 2008, differ from the federal statutory rate of 35% and the rate for the same periods in 2007 primarily due to earnings in foreign jurisdictions which are subject to lower rates and a reduced benefit from tax credits due to the expiration of the federal research and development credit law at December 31, 2007. Our income taxes payable for federal and state purposes was reduced by the tax benefit from employee stock option transactions. This benefit totaled \$14.6 million and \$19.1 million for the three and six months ended June 30, 2008, respectively, and was reflected as an increase to additional paid-in capital.

Our future effective tax rates could be subject to volatility or adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated earnings in countries where we have higher statutory rates; by changes in the valuation of our deferred tax assets and liabilities; by expiration of or lapses in the R&D tax credit laws; by transfer pricing adjustments related to certain acquisitions including the license of acquired intangibles under our intercompany R&D cost sharing arrangement; by tax effects of stock-based compensation; by costs related to intercompany restructurings; or by changes in tax laws, regulations, accounting principles, or interpretations thereof. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse effect on our operating results and financial condition.

**Table of Contents****Segment Information**

For a description of the products and services for each segment; See Note 7 Segments in Notes to Condensed Consolidated Financial Statement in Item I of this Form 10-Q.

Financial information for each segment used by management to make financial decisions and allocate resources is as follows (in millions, except percentages):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2008	2007 (1)	\$ Change	% Change	2008	2007 (1)	\$ Change	% Change
Net Revenues:								
Infrastructure:								
Product	\$575.9	\$402.9	\$ 173.0	43%	\$1,104.6	\$ 788.1	\$ 316.5	40%
Service	96.5	78.0	18.5	24%	189.7	153.6	36.1	24%
Total Infrastructure revenues	672.4	480.9	191.5	40%	1,294.3	941.7	352.6	37%
Service Layer Technologies:								
Product	148.0	138.8	9.2	7%	293.5	263.4	30.1	11%
Service	58.6	45.2	13.4	30%	114.1	86.8	27.3	31%
Total Service Layer Technologies revenues	206.6	184.0	22.6	12%	407.6	350.2	57.4	16%
Total net revenues	879.0	664.9	214.1	32%	1,701.9	1,291.9	410.0	32%
Operating income:								
Infrastructure	195.1	133.5	61.6	46%	386.6	259.4	127.2	49%
Service Layer Technologies	12.3	2.0	10.3	N/M	18.5	(0.8)	19.3	N/M
Total segment operating income	207.4	135.5	71.9	53%	405.1	258.6	146.5	57%
Other corporate (2)					(4.7)		(4.7)	N/M
Total management operating income	207.4	135.5	71.9	53%	400.4	258.6	141.8	55%
Amortization of purchased intangible assets	(9.4)	(24.1)	14.7	61%	(35.9)	(48.2)	12.3	26%
Stock-based compensation expense	(27.3)	(21.5)	(5.8)	(27%)	(50.1)	(47.4)	(2.7)	(6%)
Stock-based payroll tax expense	(1.2)	(2.1)	0.9	43%	(2.3)	(2.1)	(0.2)	(10%)
Other charges, net	(9.0)	(1.6)	(7.4)	N/M	(9.0)	(14.2)	5.2	37%
Total operating income	160.5	86.2	74.3	86%	303.1	146.7	156.4	107%
	11.6	32.3	(20.7)	(64%)	29.3	65.2	(35.9)	(55%)

Interest and other  
income, net

Income before income  
taxes

\$172.1	\$118.5	\$ 53.6	45%	\$ 332.4	\$ 211.9	\$ 120.5	57%
---------	---------	---------	-----	----------	----------	----------	-----

(1) Prior period amounts have been reclassified to reflect the 2008 segment structure, which now includes service revenue and operating results in the Infrastructure and SLT segments.

(2) Other corporate represents miscellaneous expenses that have not been allocated to segment operating results.

N/M - Not meaningful.

**Table of Contents**

The following table shows financial information for each segment as a percentage of total net revenues:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007 (1)</b>	<b>2008</b>	<b>2007 (1)</b>
Net Revenues:				
Infrastructure:				
Product	65.5%	60.6%	64.9%	61.0%
Service	11.0%	11.7%	11.2%	11.9%
Total Infrastructure revenues	76.5%	72.3%	76.1%	72.9%
Service Layer Technologies:				
Product	16.8%	20.9%	17.2%	20.4%
Service	6.7%	6.8%	6.7%	6.7%
Total Service Layer Technologies revenues	23.5%	27.7%	23.9%	27.1%
Total net revenues	100.0%	100.0%	100.0%	100.0%
Operating income:				
Infrastructure	22.2%	20.1%	22.7%	20.1%
Service Layer Technologies	1.4%	0.3%	1.1%	(0.1%)
Total segment operating income	23.6%	20.4%	23.8%	20.0%
Other corporate (2)			(0.3%)	
Total management operating income	23.6%	20.4%	23.5%	20.0%
Amortization of purchased intangible assets	(1.1%)	(3.6%)	(2.2%)	(3.7%)
Stock-based compensation expense	(3.1%)	(3.2%)	(2.9%)	(3.7%)
Stock-based payroll tax expense	(0.1%)	(0.3%)	(0.1%)	(0.2%)
Other charges, net	(1.0%)	(0.3%)	(0.5%)	(1.0%)
Total operating income	18.3%	13.0%	17.8%	11.4%
Interest and other income, net	1.3%	4.8%	1.7%	5.0%
Income before income taxes	19.6%	17.8%	19.5%	16.4%

(1) Prior period amounts have been reclassified to reflect the 2008 segment structure, which now includes service revenue and operating results in the Infrastructure

and SLT  
segments.

- (2) Other corporate  
represents  
miscellaneous  
expenses that  
have not been  
allocated to  
segment  
operating  
results.

***Infrastructure Segment***

An analysis of the change in revenue for the Infrastructure segment, and the change in units, can be found above in the section titled *Net Revenues*.

Infrastructure segment operating income increased in the three and six months ended June 30, 2008, compared to the same periods in 2007, due to revenue growth outpacing expense growth. Infrastructure product gross margin increased in absolute dollars in the three months ended June 30, 2008, compared to the year ago period primarily due to revenue growth in the T- and M-series product families which generally have higher margins. The Infrastructure gross margin percentage decreased slightly in the second quarter of 2008, compared to the same 2007 period, primarily as a result of geographical mix during the period discussed in *Net Revenue by Geographic Region* above. For the six months ended June 30, 2008, Infrastructure gross margin and gross margin percentage increased as we experienced a favorable product mix and derived a larger portion of revenues from richly configured high-end T- and M-series router products as well as high-margin port shipments.

We continued to invest in research and development efforts to continue our innovation of products and expand our Infrastructure product portfolio, but our research and development expense decreased as a percentage of Infrastructure net revenues primarily due to revenue growing faster than expenses. We will continue to make investments to expand our product features and functionality based upon the trends in the market place. Additionally, our sales and marketing expenses decreased slightly as a percentage of Infrastructure revenues, but increased in absolute dollars as we increased our efforts to reach enterprise and service provider customers. We allocate sales and marketing, general and administrative, as well as facility and information technology expenses to the Infrastructure segment generally based upon revenue, usage and headcount.

***SLT Segment***

An analysis of the change in revenue for the SLT segment, and the change in units, can be found above in the section titled *Net Revenues*.



**Table of Contents**

SLT segment operating income increased in the three and six months ended June 30, 2008, compared to the same periods in 2007 primarily due to revenue growth outpacing increases in SLT expenses. SLT product gross margin and gross margin percentage increased in the three and six months ended June 30, 2008, compared to prior year periods, primarily due to product mix, particularly from an increase in the mix of higher margin high-end Firewall and J-series products in 2008. Research and development related costs increased in absolute dollars, but decreased as a percentage of SLT revenues in the three and six months ended June 30, 2008, compared to the same 2007 periods, primarily due to cost control initiatives that resulted in revenue growing faster than research and development expenses.

Additionally, sales and marketing as well as general and administrative expenses as a percentage of SLT net revenues decreased primarily attributable to our focused execution. We allocate sales and marketing, general and administrative, as well as facility and information technology expenses to the SLT segment generally based on revenue, usage and headcount. We generally experienced seasonality and fluctuations in the demand for our SLT products, which may result in greater variations in our quarterly revenue.

**Amortization of Purchased Intangible Assets, Stock-Based Compensation and Related Payroll Tax Expense, Other Charges, Net, and Interest and Other Income, Net.**

See [Nature of Expenses](#) and [Operating Expenses](#) for further discussion.

**Key Performance Measures**

In addition to the financial metrics included in the condensed consolidated financial statements, we use the following key performance measures to assess quarterly operating results:

	<b>Three Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
Days sales outstanding (DSO)(a)	43	35
Book-to-bill ratio(b)	>1	>1

(a) Days sales outstanding, or DSO, is calculated as the ratio of ending accounts receivable, net of allowances, divided by average daily net sales for the preceding 90 days for the three months ended June 30, 2008. DSO increased in the second quarter of 2008 compared to same period of 2007, primarily due to the timing of

receipts from  
our customers.

- (b) Book-to-bill ratio represents the ratio of product bookings divided by product revenues during the period.

### Liquidity and Capital Resources

#### Overview

We have funded our business through our operating activities and by issuing securities. The following table shows our capital resources (in millions, except percentages):

	<b>June 30,</b>	<b>December</b>		
	<b>2008</b>	<b>31,</b>	<b>2007</b>	<b>%</b>
			<b>\$ Change</b>	<b>Change</b>
Working capital	\$1,915.7	\$ 1,175.3	\$ 740.4	63%
Cash and cash equivalents	\$2,040.4	\$ 1,716.1	\$ 324.3	19%
Short-term investments	263.2	240.4	22.8	9%
Long-term investments	45.2	59.3	(14.1)	(24%)
Total cash, cash equivalents and available-for-sale investments	\$2,348.8	\$ 2,015.8	\$ 333.0	17%

The significant components of our working capital are cash and cash equivalents, short-term investments and accounts receivable, reduced by accounts payable, income tax payable, accrued liabilities and short-term deferred revenue. Working capital increased primarily due to an increase in cash and cash equivalents balance due to cash generated from operations and the conversion of our Senior Notes into common stock.

During the six months ended June 30, 2008, we repurchased \$121.3 million or 4.7 million shares of our common stock via open market purchases under two stock repurchase programs that were authorized by our Board of Directors.

**Table of Contents**

Under the \$2.0 billion stock repurchase program approved in 2006 and 2007 (the 2006 Stock Repurchase Program ), we repurchased approximately 2.2 million shares of our common stock at an average price of \$24.61 per share, for a total purchase price of \$53.1 million during the three months ended March 31, 2008. No shares were repurchased under this program during the second quarter of 2008. As of June 30, 2008, we have repurchased and retired approximately 71.6 million shares of our common stock under the 2006 Stock Repurchase Program at an average price of \$23.41 per share, and the program had remaining authorized funds of \$323.8 million.

The Board of Directors approved another \$1.0 billion stock repurchase program in March 2008 (the 2008 Stock Repurchase Program ). Under this program, we repurchased approximately 2.5 million shares of our common stock at an average price of \$26.84 per share, for a total purchase price of \$68.2 million during the three and six months ended June 30, 2008. As of June 30, 2008, the 2008 Stock Repurchase Program had remaining authorized funds of \$931.8 million.

All shares of common stock purchased under the 2006 and 2008 Stock Repurchase Programs have been retired. Share repurchases under the our stock repurchase programs will be subject to a review of the circumstances in place at the time and will be made from time to time in private transactions or open market purchases as permitted by securities laws and other legal requirements. These programs may be discontinued at any time.

Based on past performance and current expectations, we believe that our existing cash and cash equivalents, short-term and long-term investments, together with cash generated from operations as well as cash generated from the exercise of employee stock options and purchase under our employee stock purchase plan will be sufficient to fund our operations, debt, and growth for at least the next 12 months. We believe our working capital is sufficient to meet our liquidity requirements for capital expenditures, commitments and other liquidity requirements associated with our existing operations during the same period.

However, our future capital requirements may vary materially from those now planned depending on many factors, including:

- the overall levels of sales of our products and gross profit margins;
- our business, product, capital expenditures and research and development plans;
- the market acceptance of our products;
- repurchases of our common stock;
- issuance and repayment of debt;
- litigation expenses, settlements and judgments;
- volume price discounts and customer rebates;
- the levels of accounts receivable that we maintain;
- acquisitions of other businesses, assets, products or technologies;
- changes in our compensation policies;
- capital improvements for new and existing facilities;
- technological advances;
- our competitors' responses to our products;

our relationships with suppliers and customers;

45

---

**Table of Contents**

possible future investments in raw material and finished goods inventories;

expenses related to our future restructuring plans, if any;

tax expense associated with stock-based awards;

issuance of stock-based awards and the related payment in cash for withholding taxes in the current year and possibly during future years;

the level of exercises of stock options and stock purchases under our equity incentive plans; and

general economic conditions and specific conditions in our industry and markets, including the effects of international conflicts and related uncertainties.

***Cash Requirements and Contractual Obligations***

Our principal commitments primarily consisted of obligations outstanding under operating leases, purchase commitments, tax liabilities and other contractual obligations.

As of June 16, 2008, holders of approximately \$399.2 million in aggregate principal amount of Senior Notes had converted these notes into approximately 19.8 million shares of our common stock. We settled the remaining Senior Notes with a face value of \$0.3 million principal amount at maturity for cash. As of June 30, 2008, all of our Senior Notes were retired.

Our contractual obligations under operating leases primarily relate to our leased facilities under our non-cancelable operating leases. Rent payments are allocated to costs and operating expenses in our condensed consolidated statements of operations. We occupy approximately 1.9 million square feet world wide under operating leases. The majority of our office space is in North America, including our corporate headquarters in Sunnyvale, California. Our longest lease expires in January 2017. As of June 30, 2008, future minimum payments under our non-cancelable operating leases, net of committed sublease income, were \$225.6 million, of which \$28.1 million will be paid over the remaining six months of 2008.

In order to reduce manufacturing lead times and ensure adequate component supply, the contract manufacturers place non-cancelable, non-returnable ( NCNR ) orders for components based on our build forecast. As of June 30, 2008, there were NCNR component orders placed by our contract manufacturers with a value of \$113.0 million. We increased our NCNR component orders by \$10.2 million in the six months ended June 30, 2008, to reduce our production lead time. The contract manufacturers use the components to build products based on our forecasts and on purchase orders we have received from our customers. Generally, we do not take ownership of the components and title to the products transfers from contract manufacturers to us and immediately to our customers upon delivery at a designated shipment location. If the components go unused or the products go unsold for specified periods of time, we may incur carrying charges or obsolete materials charges for components that our contract manufacturers purchased to build products to meet our forecast or customer orders. As of June 30, 2008, we had accrued \$26.2 million based on our estimate of such charges.

As of June 30, 2008, we had \$79.3 million of long-term liabilities in our condensed consolidated balance sheet for unrecognized tax positions. At this time, we are unable to make a reasonably reliable estimate of the timing of payments in individual years beyond the next 12 months due to uncertainties in the timing of tax audit outcomes. As of June 30, 2008, other contractual obligations consisted primarily of an indemnity-related escrow amount of \$2.3 million, a software subscription requiring payment of \$5.0 million in January 2009, and a joint development agreement for \$24.5 million with quarterly payments of \$3.5 million through January 2010. Additionally, in the second quarter of 2008, we entered into a five year, \$34.0 million data center hosting agreement requiring payments of \$8.4 million in the third quarter of 2008. The remaining commitment under this agreement is expected to be paid through the end of April 2013. As of June 30, 2008, \$34.0 million remained unpaid under the data center hosting agreement.



**Table of Contents**

In the six months ended June 30, 2008, cash and cash equivalents increased by \$324.3 million, of which \$455.4 million was generated from our operating activities. This increase was partially offset by cash used in investing activities of \$95.6 million and cash used in financing activities of \$35.5 million.

***Operating Activities***

We generated cash from operating activities of \$455.4 million in the six months ended June 30, 2008, compared to \$350.7 million in the same period of 2007. The increase of \$104.7 million in the 2008 period compared to a year ago was chiefly due to the following activities within the period:

Net income of \$230.8 million in the six months ended June 30, 2008, compared to \$152.8 million in the same 2007 period due to revenue growth and decreases in expenses as a percentage of net revenues.

Cash outflow of \$44.0 million due to an increase in net accounts receivable in the second quarter of 2008, which was primarily due to the timing of product shipments at the end of the quarter.

Cash inflow of \$79.5 million due to an increase in deferred revenue in the six months ended June 30, 2008, as compared to an increase of \$65.1 million for the six months ended June 30, 2007. This increase in cash inflow is due to the impact of the growing installed base on deferred service revenue and the impact on deferred product revenue from customer payments received in advance of product acceptance.

Cash inflow of \$47.7 million primarily due to increases in other payables and liabilities. In particular, our income taxes payable and long-term tax reserve liabilities increased by \$25.9 million in the six months ended June 30, 2008, compared \$4.1 million in the same 2007 period, due to the timing of payments of federal, state and foreign income taxes.

***Investing Activities***

For the six months ended June 30, 2008, net cash used by investing activities was \$95.6 million compared to \$442.8 million of net cash generated by investing activities in the six months ended June 30, 2007. The change compared to the prior year period was primarily due to the movement of cash from short and long-term investments to cash and cash equivalents during the first six months of 2007 in anticipation of stock repurchases under the 2006 Stock Repurchase Program. In the first six months of 2008, we invested a net \$10.2 million in available-for-sale investments based upon our investment strategy.

***Financing Activities***

Net cash used in financing activities was \$35.5 million and \$1,529.8 million for the six months ended June 30, 2008 and 2007, respectively. In the six months ended June 30 2008, we used \$121.3 million to repurchase our common stock, partially offset by cash proceeds of \$77.1 million from common stock issued to employees, compared to the \$1,623.2 million repurchases in the same 2007 period, partially offset by cash proceeds of \$89.6 million from common stock issued to employees.

**Factors That May Affect Future Results**

A description of the risk factors associated with our business is included under **Risk Factors** in Item 1A of Part II of this report.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

**Interest Rate Risk**

We maintain an investment portfolio of various holdings, types and maturities. The values of our investments are subject to market price volatility. In addition, a portion of our cash and marketable securities are held in non-U.S. domiciled countries. These securities are generally classified as available-for-sale and, consequently, are recorded

**Table of Contents**

on our condensed consolidated balance sheet at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income.

At any time, a rise in interest rates could have a material adverse impact on the fair value of our investment portfolio. Conversely, declines in interest rates could have a material impact on interest earnings of our investment portfolio. We do not currently hedge these interest rate exposures. We recognized immaterial net gains or losses during the three and six months ended June 30, 2008 and 2007 related to the sales of our investments.

**Foreign Currency Risk and Foreign Exchange Forward Contracts**

Periodically, we use derivatives to partially offset our market exposure to fluctuations in foreign currencies. We do not enter into derivatives for speculative or trading purposes.

We use foreign currency forward contracts to mitigate transaction gains and losses generated by certain foreign currency denominated monetary assets and liabilities. These derivatives are carried at fair value with changes recorded in other income (expense). Changes in the fair value of these derivatives are largely offset by re-measurement of the underlying assets and liabilities. These foreign exchange contracts have maturities between one and two months.

Our sales are primarily denominated in U.S. dollars. Our costs of revenues and operating expenses are denominated in U.S. dollars as well as other foreign currencies including the British Pound, the Euro, Indian Rupee and Japanese Yen. Periodically, we use foreign currency forward and/or option contracts to hedge certain forecasted foreign currency transactions relating to operating expenses. These derivatives are designated as cash flow hedges and have maturities of less than one year. The effective portion of the derivative's gain or loss is initially reported as a component of accumulated other comprehensive income and, upon occurrence of the forecasted transaction, is subsequently reclassified into the consolidated statements of operations line item to which the hedged transaction relates. We record the ineffectiveness of the hedging instruments, which was immaterial during the three and six months ended June 30, 2008 and 2007, in interest and other income, net on our condensed consolidated statements of operations. Research and development, sales and marketing, as well as general and administrative expenses slightly increased in the three and six months ended June 30, 2008, compared with the same periods in 2007, due to the effect of foreign currency fluctuations.

**Equity Price Risk**

Our portfolio of publicly-traded equity securities is inherently exposed to equity price risk as the stock market fluctuates. We monitor our publicly-traded equity investments for impairment on a periodic basis. In the event that the carrying value of a publicly-traded equity investment exceeds its fair value, and we determine the decline in the value to be other than temporary, we reduce the carrying value to its current fair value. We do not purchase our publicly-traded equity securities with the intent to use them for trading or speculative purposes. They are classified as available-for-sale securities in accordance with Statement of Financial Accounting Standard No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. The aggregate fair value of our marketable equity securities was \$5.0 million and \$8.6 million as of June 30, 2008, and December 31, 2007, respectively. A hypothetical 30% adverse change in the stock prices of our portfolio of publicly-traded equity securities would result in an immaterial loss. In addition to publicly-traded equity securities, we have also invested in privately-held companies. These investments are carried at cost. The aggregate cost of our investments in privately-held companies was \$23.8 million and \$23.3 million as of June 30, 2008, and December 31, 2007, respectively.

**Item 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

Attached as exhibits to this report are certifications of our principal executive officer and principal financial officer, which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended (the Exchange Act). This Controls and Procedures section includes information concerning the controls and related



**Table of Contents**

evaluations referred to in the certifications and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

We carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Based upon that evaluation, our principal executive officer and principal financial officer concluded that, as of the end of the period covered in this report, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Controls**

In 2007, we initiated a multi-year implementation to upgrade certain key internal systems and processes, including our company-wide human resources management system, CRM system and our ERP system. This project is the result of our normal business process to evaluate and upgrade or replace our systems software and related business processes to support our evolving operational needs. There were no changes in our internal control over financial reporting that occurred during the second quarter of 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Inherent Limitations on Effectiveness of Controls**

Our management, including the CEO and CFO, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Our controls and procedures are designed to provide reasonable assurance that our control system's objective will be met and our CEO and CFO have concluded that our disclosure controls and procedures are effective at the reasonable assurance level. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

The information set forth under "Legal Proceedings" section in Note 9 "Commitments and Contingencies in the Notes to Condensed Consolidated Financial Statements in Item 1 Part I of this Quarterly Report on Form 10-Q, is incorporated herein by reference.

**Item 1A. Risk Factors****Factors That May Affect Future Results**

Investments in equity securities of publicly traded companies involve significant risks. The market price of our stock reflects a higher multiple of expected future earnings than many other companies. Accordingly, even small changes in investor expectations for our future growth and earnings, whether as a result of actual or rumored financial or operating results, changes in the mix of the products and services sold, acquisitions, industry changes or other

**Table of Contents**

factors, could trigger, and have triggered significant fluctuations in the market price of our common stock. Investors in our securities should carefully consider all of the relevant factors, including, but not limited to, the following factors, that could affect our stock price.

***Our quarterly results are inherently unpredictable and subject to substantial fluctuations and, as a result, we may fail to meet the expectations of securities analysts and investors, which could adversely affect the trading price of our common stock.***

Our revenues and operating results may vary significantly from quarter to quarter due to a number of factors, many of which are outside of our control and any of which may cause our stock price to fluctuate.

The factors that may affect the unpredictability of our quarterly results include, but are not limited to; limited visibility into customer spending plans, changes in the mix of products sold, changing market conditions, including current and potential customer consolidation, competition, customer concentration, long sales and implementation cycles, regional economic and political conditions and seasonality. For example, many companies in our industry experience adverse seasonal fluctuations in customer spending patterns, particularly in the first and third quarters.

As a result, we believe that quarter-to-quarter comparisons of operating results are not necessarily a good indication of what our future performance will be. It is likely that in some future quarters, our operating results may be below the expectations of securities analysts or investors, in which case the price of our common stock may decline. Such a decline could occur, and has occurred in the past, even when we have met our publicly stated revenue and/or earnings guidance.

***Fluctuating economic conditions make it difficult to predict revenues for a particular period and a shortfall in revenues or increase in costs of production may harm our operating results.***

Our revenues depend significantly on general economic conditions and the demand for products in the markets in which we compete. Economic weakness, customer financial difficulties and constrained spending on network expansion have previously resulted (for example, in 2001 and 2002), and may in the future result, in decreased revenues and earnings and could negatively impact our ability to forecast and manage our contract manufacturer relationships. In addition, recent turmoil in the geopolitical environment in many parts of the world and sustained increases in energy costs may continue to put pressure on global economic conditions, which could lead to higher costs of production and/or reduced demand for our products. Economic downturns may also lead to restructuring initiatives and associated expenses and impairment of investments. In addition, our operating expenses are largely based on anticipated revenue trends and a high percentage of our expenses are, and will continue to be, fixed in the short-term. Uncertainty about future economic conditions makes it difficult to forecast operating results and to make decisions about future investments. Future economic weakness, customer financial difficulties, increases in costs of production, and reductions in spending on network expansion could have a material adverse effect on demand for our products and consequently on our results of operations and stock price.

***Telecommunications companies and other large companies generally require more onerous terms and conditions of their vendors. As we seek to sell more products to such customers, we may be required to agree to terms and conditions that may have an adverse effect on our business or ability to recognize revenues.***

Telecommunications service provider companies and other large companies, because of their size, generally have had greater purchasing power and, accordingly, have requested and received more favorable terms, which often translate into more onerous terms and conditions for their vendors. As we seek to sell more products to this class of customer, we may be required to agree to such terms and conditions, which may include terms that affect the timing of our ability to recognize revenue and have an adverse effect on our business and financial condition. Consolidation among such large customers can further increase their buying power and ability to require onerous terms.

For example, many customers in this class have purchased products from other vendors who promised certain functionality and failed to deliver such functionality and/or had products that caused problems and outages in the networks of these customers. As a result, this class of customers may request additional features from us and require substantial penalties for failure to deliver such features or may require substantial penalties for any network outages that may be caused by our products. These additional requests and penalties, if we are required to agree to them,

**Table of Contents**

may affect our ability to recognize the revenues from such sales, which may negatively affect our business and our financial condition. For example, in April 2006, we announced that we would be required to defer a large amount of revenue from a customer due to the contractual obligations required by that customer.

For arrangements with multiple elements, vendor specific objective evidence of fair value of the undelivered element is required in order to separate the components and to account for elements of the arrangement separately. Vendor specific objective evidence of fair value is based on the price charged when the element is sold separately. However, customers may require terms and conditions that make it more difficult or impossible for us to maintain vendor specific objective evidence of fair value for the undelivered elements to a similar group of customers, the result of which could cause us to defer the entire arrangement fees for a similar group of customers (product, maintenance, professional services, etc.) and recognize revenue only when the last element is delivered or if the only undelivered element is maintenance revenue would be recognized ratably over the contractual maintenance period, which is generally one year but could be substantially longer.

***If we fail to accurately predict our manufacturing requirements, we could incur additional costs or experience manufacturing delays which would harm our business.***

We provide demand forecasts to our contract manufacturers. If we overestimate our requirements, the contract manufacturers may assess charges or we may have liabilities for excess inventory, each of which could negatively affect our gross margins. Conversely, because lead times for required materials and components vary significantly and depend on factors such as the specific supplier, contract terms and the demand for each component at a given time, if we underestimate our requirements, the contract manufacturers may have inadequate time or materials and components required to produce our products, which could increase costs or could delay or interrupt manufacturing of our products and result in delays in shipments and deferral or loss of revenues.

***We are dependent on sole source and limited source suppliers for several key components, which makes us susceptible to shortages or price fluctuations in our supply chain and we may face increased challenges in supply chain management in the future.***

With the current demand for electronic products, component shortages are possible and the predictability of the availability of such components may be limited. Growth in our business and the economy is likely to create greater pressures on us and our suppliers to accurately project overall component demand and to establish optimal component levels. If shortages or delays persist, the price of these components may increase, or the components may not be available at all. We may not be able to secure enough components at reasonable prices or of acceptable quality to build new products in a timely manner and our revenues and gross margins could suffer until other sources can be developed. For example, from time to time, including the first quarter of 2008, we have experienced component shortages that resulted in delays of product shipments. We currently purchase numerous key components, including ASICs, from single or limited sources. The development of alternate sources for those components is time consuming, difficult and costly. In addition, the lead times associated with certain components are lengthy and preclude rapid changes in quantities and delivery schedules. In the event of a component shortage or supply interruption from these suppliers, we may not be able to develop alternate or second sources in a timely manner. If, as a result, we are unable to buy these components in quantities sufficient to meet our requirements on a timely basis, we will not be able to deliver product to our customers, which would seriously impact present and future sales, which would, in turn, adversely affect our business.

In addition, the development, licensing or acquisition of new products in the future may increase the complexity of supply chain management. Failure to effectively manage the supply of key components and products would adversely affect our business.

***We are dependent on contract manufacturers with whom we do not have long-term supply contracts, and changes to those relationships, expected or unexpected, may result in delays or disruptions that could cause us to lose revenue and damage our customer relationships.***

We depend on independent contract manufacturers (each of which is a third party manufacturer for numerous companies) to manufacture our products. Although we have contracts with our contract manufacturers, those contracts do not require them to manufacture our products on a long-term basis in any specific quantity or at any



**Table of Contents**

specific price. In addition, it is time consuming and costly to qualify and implement additional contract manufacturer relationships. Therefore, if we should fail to effectively manage our contract manufacturer relationships or if one or more of them should experience delays, disruptions or quality control problems in our manufacturing operations, or if we had to change or add additional contract manufacturers or contract manufacturing sites, our ability to ship products to our customers could be delayed. Also, the addition of manufacturing locations or contract manufacturers would increase the complexity of our supply chain management. Moreover, an increasing portion of our manufacturing is performed in China and other countries and is therefore subject to risks associated with doing business in other countries. For example, in connection with the 2008 Olympic Games the government of China has indicated that it may impose temporary limits on certain activities, including business operations and personal travel. While we do not expect to be impacted by any such limitations, there can be no assurance that any such limits will not adversely affect our contract manufacturers or suppliers activities in China. Each of these factors could adversely affect our business and financial results.

***Our ability to process orders and ship products in a timely manner is dependent in part on our business systems and performance of the systems and processes of third parties such as our contract manufacturers, suppliers or other partners, as well as interfaces with the systems of such third parties. If our systems, the systems and processes of those third parties or the interfaces between them experience delays or fail, our business processes and our ability to build and ship products could be impacted, and our financial results could be harmed.***

Some of our business processes depend upon our information technology systems, the systems and processes of third parties and on interfaces with the systems of third parties. For example, our order entry system feeds information into the systems of our contract manufacturers, which enables them to build and ship our products. If those systems fail or are interrupted, our processes may function at a diminished level or not at all. This could negatively impact our ability to ship products or otherwise operate our business, and our financial results could be harmed. For example, although it did not adversely affect our shipments, an earthquake in late December of 2006 disrupted communications with China, where a significant part of our manufacturing occurs.

We also rely upon the performance of the systems and processes of our contract manufacturers to build and ship our products. If those systems and processes experience interruption or delay, our ability to build and ship our products in a timely manner may be harmed. For example, as we have expanded our contract manufacturing base to China, we have experienced instances where our contract manufacturer was not able to ship products in the time periods expected by us. If we are not able to ship our products or if product shipments are delayed, our ability to recognize revenue in a timely manner for those products would be affected and our financial results could be harmed.

***We expect gross margin to vary over time and our recent level of product gross margin may not be sustainable.***

Our product gross margins will vary from quarter to quarter and the recent level of gross margins may not be sustainable and may be adversely affected in the future by numerous factors, including product mix shifts, increased price competition in one or more of the markets in which we compete, increases in material or labor costs, excess product component or obsolescence charges from our contract manufacturers, increased costs due to changes in component pricing or charges incurred due to component holding periods if our forecasts do not accurately anticipate product demand, warranty related issues, or our introduction of new products or entry into new markets with different pricing and cost structures.

***A limited number of our customers comprise a significant portion of our revenues and any decrease in revenue from these customers could have an adverse effect on our net revenues and operating results.***

A substantial majority of our net revenues depend on sales to a limited number of customers and distribution partners. NSN accounted for greater than 10% of our net revenues during the three months ended June 30, 2008, and no single customer accounted for greater than 10% of our net revenues during the six months ended June 30, 2008. NSN and Verizon each accounted for greater than 10% of our net revenues during the three and six months ended June 30, 2007. This customer concentration increases the risk of quarterly fluctuations in our revenues and operating results. Any downturn in the business of our key customers or potential new customers could significantly decrease sales to such customers, which could adversely affect our net revenues and results of operations. In addition, in recent years there has been consolidation in the telecommunications industry (for example, the acquisitions of AT&T Inc., MCI, Inc. and BellSouth Corporation) and consolidation among the large vendors of



**Table of Contents**

telecommunications equipment and services (for example, the combination of Alcatel and Lucent, the joint venture of NSN and the acquisition of Redback by Ericsson). Such consolidation may cause our customers who are involved in these acquisitions to suspend or indefinitely reduce their purchases of our products or have other unforeseen consequences that could harm our business and operating results.

***The long sales and implementation cycles for our products, as well as our expectation that some customers will sporadically place large orders with short lead times, may cause our revenues and operating results to vary significantly from quarter to quarter.***

A customer's decision to purchase certain of our products involves a significant commitment of its resources and a lengthy evaluation and product qualification process. As a result, the sales cycle may be lengthy. In particular, customers making critical decisions regarding the design and implementation of large or next-generation networks may engage in very lengthy procurement processes that may delay or impact expected future orders. Throughout the sales cycle, we may spend considerable time educating and providing information to prospective customers regarding the use and benefits of our products. Even after making the decision to purchase, customers may deploy our products slowly and deliberately. Timing of deployment can vary widely and depends on the skill set of the customer, the size of the network deployment, the complexity of the customer's network environment and the degree of hardware and operating system configuration necessary to deploy the products. Customers with large networks usually expand their networks in large increments on a periodic basis. Accordingly, we may receive purchase orders for significant dollar amounts on an irregular basis. These long cycles, as well as our expectation that customers will tend to sporadically place large orders with short lead times, may cause revenues and operating results to vary significantly and unexpectedly from quarter to quarter.

***If we do not successfully anticipate market needs and develop products and product enhancements that meet those needs, or if those products do not gain market acceptance, we may not be able to compete effectively and our ability to generate revenues will suffer.***

We cannot guarantee that we will be able to anticipate future market needs or be able to develop new products or product enhancements to meet such needs or to meet them in a timely manner. If we fail to anticipate market requirements or to develop new products or product enhancements to meet those needs, such failure could substantially decrease market acceptance and sales of our present and future products, which would significantly harm our business and financial results. Even if we are able to anticipate, develop and commercially introduce new products and enhancements, there can be no assurance that new products or enhancements will achieve widespread market acceptance. For example, in the first quarter of 2008, we announced new products designed to address the Ethernet switching market, a market in which we have not had a historical presence. If these new products do not gain market acceptance at a sufficient rate of growth, or at all, our ability to meet future financial targets may be adversely affected. Any failure of our products to achieve market acceptance could adversely affect our business and financial results.

***We rely on value-added resellers and distribution partners to sell our products, and disruptions to, or our failure to effectively develop and manage our distribution channel and the processes and procedures that support it could adversely affect our ability to generate revenues from the sale of our products.***

Our future success is highly dependent upon establishing and maintaining successful relationships with a variety of value-added reseller and distribution partners. The majority of our revenues are derived through value-added resellers and distributors, most of which also sell competitors' products. Our revenues depend in part on the performance of these partners. The loss of or reduction in sales to our value-added resellers or distributors could materially reduce our revenues. During 2006, Alcatel, another value-added reseller and a competitor of ours, acquired Lucent, one of our largest value-added resellers. In addition, in April 2007 our largest customer, Siemens, transferred its telecommunications business to a joint venture between Siemens and Nokia. Our competitors may in some cases be effective in providing incentives to current or potential resellers and distributors to favor their products or to prevent or reduce sales of our products. If we fail to maintain relationships with our partners, fail to develop new relationships with value-added resellers and distributors in new markets or expand the number of distributors and resellers in existing markets, fail to manage, train or motivate existing value-added resellers and distributors effectively or if these partners are not successful in their sales efforts, sales of our products may decrease and our operating results would

suffer.



**Table of Contents**

In addition, we recognize a portion of our revenue based on a sell-through model using information provided by our distributors. If those distributors provide us with inaccurate or untimely information, the amount or timing of our revenues could be adversely impacted.

Further, in order to develop and expand our distribution channel, we must continue to scale and improve our processes and procedures that support it, and those processes and procedures may become increasingly complex and inherently difficult to manage. Our failure to successfully manage and develop our distribution channel and the processes and procedures that support it could adversely affect our ability to generate revenues from the sale of our products.

***We face intense competition that could reduce our revenues and adversely affect our financial results.***

Competition is intense in the markets that we address. The IP infrastructure market has historically been dominated by Cisco with other companies such as Alcatel-Lucent, Ericsson, Extreme Networks, Foundry Networks, Huawei, and Nortel providing products to a smaller segment of the market. In addition, a number of other small public and private companies have products or have announced plans for new products to address the same challenges and markets that our products address.

In the service layer technologies market, we face intense competition from a broader group of companies including appliance vendors such as Cisco, Fortinet, F5 Networks, Nortel and Riverbed, and software vendors such as CheckPoint. In addition, a number of other small public and private companies have products or have announced plans for new products to address the same challenges and markets that our products address.

In addition, actual or speculated consolidation among competitors, or the acquisition of our partners and resellers by competitors, can increase the competitive pressures faced by us. In this regard, Alcatel combined with Lucent in 2006 and Ericsson acquired Redback in 2007. A number of our competitors have substantially greater resources and can offer a wider range of products and services for the overall network equipment market than we do. If we are unable to compete successfully against existing and future competitors on the basis of product offerings or price, we could experience a loss in market share and revenues and/or be required to reduce prices, which could reduce our gross margins, and which could materially and adversely affect our business, operating results and financial condition.

***We are a party to lawsuits, which are costly to investigate and defend and, if determined adversely to us, could require us to pay damages or prevent us from taking certain actions, any or all of which could harm our business and financial condition.***

We and certain of our current and former officers and current and former members of our board of directors are subject to various lawsuits. For example, we have been served with lawsuits related to the alleged backdating of stock options and other related matters, a description of which can be found above in Note 9 Commitments and Contingencies in Notes to Condensed Consolidated Financial Statements under the heading Legal Proceedings. There can be no assurance that these or any actions that have been or may be brought against us will be resolved in our favor. Regardless of whether they are resolved in our favor, these lawsuits are, and any future lawsuits to which we may become a party will likely be, expensive and time consuming to investigate, defend, settle and/or resolve. Such costs of investigation and defense, as well as any losses resulting from these claims or settlement of these claims, could significantly increase our expenses and adversely affect our profitability and cash flow.

In addition, we are party to a lawsuit which seeks to enjoin us from granting equity awards under our 2006 Equity Incentive Plan (the 2006 Plan ), as well as to invalidate all awards granted under such plan to date. The 2006 Plan is the only active plan under which we currently grant stock options and restricted stock units to our employees. If this lawsuit is not resolved in our favor, we may be prevented from using the 2006 Plan to provide these equity awards to recruit new employees or to compensate existing employees, which would put us at a significant disadvantage to other companies that compete for workers in high technology industries such as ours. Accordingly, our ability to hire, retain and motivate current and prospective employees would be harmed, the result of which could negatively impact our business operations.

**Table of Contents*****We are currently implementing upgrades to key internal systems and processes, and problems with the design or implementation of these systems and processes could interfere with our business and operations.***

We have initiated a project to upgrade certain key internal systems and processes, including our company-wide human resources management system, our CRM system and our ERP system. We have invested, and will continue to invest, significant capital and human resources in the design and implementation of these systems and processes, which may be disruptive to our underlying business. Any disruptions or delays in the design and implementation of the new systems or processes, particularly any disruptions or delays that impact our operations, could adversely affect our ability to process customer orders, ship products, provide service and support to our customers, bill and track our customers, fulfill contractual obligations, record and transfer information in a timely and accurate manner, file SEC reports in a timely manner or otherwise run our business. Even if we do not encounter these adverse effects, the design and implementation of these new systems and processes may be much more costly than we anticipated. If we are unable to successfully design and implement these new systems and processes as planned, or if the implementation of these systems and processes is more costly than anticipated, our financial position, results of operations and cash flows could be negatively impacted.

***Litigation or claims regarding intellectual property rights may be time consuming, expensive and require a significant amount of resources to prosecute, defend or make our products non-infringing.***

Third parties have asserted and may in the future assert claims or initiate litigation related to patent, copyright, trademark and other intellectual property rights to technologies and related standards that are relevant to our products. The asserted claims and/or initiated litigation may include claims against us or our manufacturers, suppliers or customers, alleging infringement of their proprietary rights with respect to our products. Regardless of the merit of these claims, they have been and can be time consuming, result in costly litigation and may require us to develop non-infringing technologies or enter into license agreements. Furthermore, because of the potential for high awards of damages or injunctive relief that are not necessarily predictable, even arguably unmeritorious claims may be settled for significant amounts of money. If any infringement or other intellectual property claim made against us by any third party is successful, if we are required to settle litigation for significant amounts of money, or if we fail to develop non-infringing technology or license required proprietary rights on commercially reasonable terms and conditions, our business, operating results and financial condition could be materially and adversely affected.

***Changes in effective tax rates or adverse outcomes resulting from examination of our income or other tax returns could adversely affect our results.***

Our future effective tax rates could be subject to volatility or adversely affected by: earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated earnings in countries where we have higher statutory rates; by changes in the valuation of our deferred tax assets and liabilities; by expiration of or lapses in the R&D tax credit laws; by transfer pricing adjustments related to certain acquisitions including the license of acquired intangibles under our intercompany R&D cost sharing arrangement; by tax effects of stock-based compensation; by costs related to intercompany restructurings; or by changes in tax laws, regulations, accounting principles, or interpretations thereof. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse effect on our operating results and financial condition.

***We are exposed to fluctuations in currency exchange rates which could negatively affect our financial results and cash flows.***

Because a majority of our business is conducted outside the United States, we face exposure to adverse movements in non-US currency exchange rates. These exposures may change over time as business practices evolve and could have a material adverse impact on our financial results and cash flows.

The majority of our revenues and expenses are transacted in U.S. Dollars. We also have some transactions that are denominated in foreign currencies, primarily the British Pound, the Euro, Indian Rupee and Japanese Yen related to our sales and service operations outside of the United States. An increase in the value of the U.S. Dollar could increase the real cost to our customers of our products in those markets outside the United States where we sell in



**Table of Contents**

U.S. Dollars, and a weakened dollar could increase the cost of local operating expenses and procurement of raw materials to the extent we must purchase components in foreign currencies.

Currently, we hedge only those currency exposures associated with certain assets and liabilities denominated in nonfunctional currencies and periodically will hedge anticipated foreign currency cash flows. The hedging activities undertaken by us are intended to offset the impact of currency fluctuations on certain nonfunctional currency assets and liabilities. However, no amount of hedging can be effective against all circumstances, including long-term declines in the value of the U.S. Dollar. If our attempts to hedge against these risks are not successful or if long-term declines in the value of the U.S. Dollar persist, our net income could be adversely impacted.

***We are required to expense equity compensation given to our employees, which has reduced our reported earnings, will significantly harm our operating results in future periods and may reduce our stock price and our ability to effectively utilize equity compensation to attract and retain employees.***

We historically have used stock options and other equity awards as a significant component of our employee compensation program in order to align employees' interests with the interests of our stockholders, encourage employee retention, and provide competitive compensation packages. The Financial Accounting Standards Board has adopted changes that require companies to record a charge to earnings for employee stock option grants and other equity incentives. We adopted this standard effective January 1, 2006. By causing us to record significantly increased compensation costs, such accounting changes have reduced, and will continue to reduce, our reported earnings, and will significantly harm our operating results in future periods. This may require us to reduce the availability and amount of equity incentives provided to employees, which may make it more difficult for us to attract, retain and motivate key personnel. Moreover, if securities analysts, institutional investors and other investors adopt financial models that include stock option expense in their primary analysis of our financial results, our stock price could decline as a result of reliance on these models with higher expense calculations. Each of these results could materially and adversely affect our business.

***Matters related to the investigation into our historical stock option granting practices and the restatement of our financial statements has resulted in litigation and regulatory proceedings, and may result in additional litigation or other possible government actions.***

Our historical stock option granting practices and the restatement of our financial statements have exposed us to greater risks associated with litigation, regulatory proceedings and government enforcement actions. For more information regarding our current litigation and related inquiries, please see Note 9 – Commitments and Contingencies in Notes to Condensed Consolidated Financial Statements under the heading Legal Proceedings as well as the other risk factors related to litigation set forth in this section. We have provided the results of our internal review and independent investigation to the SEC and the United States Attorney's Office for the Northern District of California, and in that regard we have responded to formal and informal requests for documents and additional information. In August 2007, we announced that we entered into a settlement agreement with the SEC in connection with our historical stock option granting practices in which we consented to a permanent injunction against any future violations of the antifraud, reporting, books-and-records and internal control provisions of the federal securities laws. This settlement concluded the SEC's formal investigation of the Company with respect to this matter. In addition, while we believe that we have made appropriate judgments in determining the correct measurement dates for our stock option grants, the SEC may disagree with the manner in which we accounted for and reported, or did not report, the corresponding financial impact. We are also subject to civil litigation related to the stock option matters. No assurance can be given regarding the outcomes from litigation or other possible government actions. The resolution of these matters will be time consuming, expensive, and may distract management from the conduct of our business. Furthermore, if we are subject to adverse findings in litigation or if we enter into any settlements related thereto, we could be required to pay damages or penalties or have other remedies imposed, which could harm our business, financial condition, results of operations and cash flows.

**Table of Contents**

***If we fail to adequately evolve our financial and managerial control and reporting systems and processes, our ability to manage and grow our business will be negatively affected.***

Our ability to successfully offer our products and implement our business plan in a rapidly evolving market depends upon an effective planning and management process. We will need to continue to improve our financial and managerial control and our reporting systems and procedures in order to manage our business effectively in the future. If we fail to continue to implement improved systems and processes, our ability to manage our business and results of operations may be negatively affected.

***Our success depends upon our ability to effectively plan and manage our resources and restructure our business through rapidly fluctuating economic and market conditions.***

Our ability to successfully offer our products and services in a rapidly evolving market requires an effective planning, forecasting, and management process to enable us to effectively scale our business and adjust our business in response to fluctuating market opportunities and conditions. In periods of market expansion, we have increased investment in our business by, for example, increasing headcount and increasing our investment in research and development and other parts of our business. Conversely, during 2001 and 2002, in response to downward trending industry and market conditions, we restructured our business and reduced our workforce. Many of our expenses, such as real estate expenses, cannot be rapidly or easily adjusted as a result of fluctuations in our business or numbers of employees. Moreover, rapid changes in the size of our workforce could adversely affect the ability to develop and deliver products and services as planned or impair our ability to realize our current or future business objectives.

***Our ability to develop, market and sell products could be harmed if we are unable to retain or hire key personnel.***

Our future success depends upon our ability to recruit and retain the services of executive, engineering, sales, marketing and support personnel. The supply of highly qualified individuals, in particular engineers in very specialized technical areas, or sales people specializing in the service provider and enterprise markets, is limited and competition for such individuals is intense. None of our officers or key employees is bound by an employment agreement for any specific term. The loss of the services of any of our key employees, the inability to attract or retain personnel in the future or delays in hiring required personnel, particularly engineers and sales people, and the complexity and time involved in replacing or training new employees, could delay the development and introduction of new products, and negatively impact our ability to market, sell or support our products.

***We sell our products to customers that use those products to build networks and IP infrastructure and, if the demand for network and IP systems does not continue to grow, then our business, operating results and financial condition could be adversely affected.***

A substantial portion of our business and revenue depends on the growth of secure IP infrastructure and on the deployment of our products by customers that depend on the continued growth of IP services. As a result of changes in the economy and capital spending or the building of network capacity in excess of demand, all of which have in the past particularly affected telecommunications service providers, spending on IP infrastructure can vary, which could have a material adverse effect on our business and financial results. In addition, a number of our existing customers are evaluating the build out of their next generation network, or NGN. During the decision making period when the customers are determining the design of those networks and the selection of the equipment they will use in those networks, such customers may greatly reduce or suspend their spending on secure IP infrastructure. Such pauses in purchases can make it more difficult to predict revenues from such customers, can cause fluctuations in the level of spending by these customers and, even where our products are ultimately selected, can have a material adverse effect on our business and financial results.

***Integration of past acquisitions and future acquisitions could disrupt our business and harm our financial condition and stock price and may dilute the ownership of our stockholders.***

We have made, and may continue to make, acquisitions in order to enhance our business. In 2005 we completed the acquisitions of five private companies. Acquisitions involve numerous risks, including problems combining the purchased operations, technologies or products, unanticipated costs, diversion of management's attention from our core businesses, adverse effects on existing business relationships with suppliers and customers, risks associated

**Table of Contents**

with entering markets in which we have no or limited prior experience and potential loss of key employees. There can be no assurance that we will be able to successfully integrate any businesses, products, technologies or personnel that we might acquire. The integration of businesses that we have acquired has been, and will continue to be, a complex, time consuming and expensive process. Acquisitions may also require us to issue common stock that dilutes the ownership of our current stockholders, assume liabilities, record goodwill and non-amortizable intangible assets that will be subject to impairment testing on a regular basis and potential periodic impairment charges, incur amortization expenses related to certain intangible assets, and incur large and immediate write-offs and restructuring and other related expenses, all of which could harm our operating results and financial condition.

In addition, if we fail in our integration efforts with respect to our acquisitions and are unable to efficiently operate as a combined organization utilizing common information and communication systems, operating procedures, financial controls and human resources practices, our business and financial condition may be adversely affected.

***Our products are highly technical and if they contain undetected errors, our business could be adversely affected and we might have to defend lawsuits or pay damages in connection with any alleged or actual failure of our products and services.***

Our products are highly technical and complex, are critical to the operation of many networks and, in the case of our security products, provide and monitor network security and may protect valuable information. Our products have contained and may contain one or more undetected errors, defects or security vulnerabilities. Some errors in our products may only be discovered after a product has been installed and used by end customers. Any errors, defects or security vulnerabilities discovered in our products after commercial release could result in loss of revenues or delay in revenue recognition, loss of customers, loss of future business, and increased service and warranty cost, any of which could adversely affect our business and results of operations. Also, in the event an error, defect or vulnerability is attributable to a component supplied by a third-party vendor, we may not be able to recover from the vendor all of the costs of remediation that we may incur. In addition, we could face claims for product liability, tort or breach of warranty. Defending a lawsuit, regardless of its merit, is costly and may divert management's attention. In addition, if our business liability insurance coverage is inadequate or future coverage is unavailable on acceptable terms or at all, our financial condition could be harmed.

***A breach of network security could harm public perception of our security products, which could cause us to lose revenues.***

If an actual or perceived breach of network security occurs in the network of a customer of our security products, regardless of whether the breach is attributable to our products, the market perception of the effectiveness of our products could be harmed. This could cause us to lose current and potential end customers or cause us to lose current and potential value-added resellers and distributors. Because the techniques used by computer hackers to access or sabotage networks change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques.

***If our products do not interoperate with our customers' networks, installations will be delayed or cancelled and could harm our business.***

Our products are designed to interface with our customers' existing networks, each of which have different specifications and utilize multiple protocol standards and products from other vendors. Many of our customers' networks contain multiple generations of products that have been added over time as these networks have grown and evolved. Our products will be required to interoperate with many or all of the products within these networks as well as future products in order to meet our customers' requirements. If we find errors in the existing software or defects in the hardware used in our customers' networks, we may have to modify our software or hardware to fix or overcome these errors so that our products will interoperate and scale with the existing software and hardware, which could be costly and negatively impact our operating results. In addition, if our products do not interoperate with those of our customers' networks, demand for our products could be adversely affected or orders for our products could be cancelled. This could hurt our operating results, damage our reputation and seriously harm our business and prospects.

**Table of Contents*****Governmental regulations affecting the import or export of products could negatively affect our revenues.***

The United States and various foreign governments have imposed controls, export license requirements and restrictions on the import or export of some technologies, especially encryption technology. In addition, from time to time, governmental agencies have proposed additional regulation of encryption technology, such as requiring the escrow and governmental recovery of private encryption keys. Governmental regulation of encryption technology and regulation of imports or exports, or our failure to obtain required import or export approval for our products, could harm our international and domestic sales and adversely affect our revenues.

***Due to the global nature of our operations, economic or social conditions or changes in a particular country or region could adversely affect our sales or increase our costs and expenses, which could have a material adverse impact on our financial condition.***

We conduct significant sales and customer support operations directly and indirectly through our distributors and value-added resellers in countries throughout the world and also depend on the operations of our contract manufacturers and suppliers that are located inside and outside of the United States. In addition, our research and development and our general and administrative operations are conducted in the United States as well as other countries. Accordingly, our future results could be materially adversely affected by a variety of uncontrollable and changing factors including, among others, political or social unrest, natural disasters, epidemic disease, war, or economic instability in a specific country or region, trade protection measures and other regulatory requirements which may affect our ability to import or export our products from various countries, service provider and government spending patterns affected by political considerations and difficulties in staffing and managing international operations. Any or all of these factors could have a material adverse impact on our revenue, costs, expenses, results of operations and financial condition.

***Our products incorporate and rely upon licensed third-party technology and if licenses of third-party technology do not continue to be available to us or become very expensive, our revenues and ability to develop and introduce new products could be adversely affected.***

We integrate licensed third-party technology into certain of our products. From time to time, we may be required to license additional technology from third parties to develop new products or product enhancements. Third-party licenses may not be available or continue to be available to us on commercially reasonable terms. Our inability to maintain or re-license any third-party licenses required in our products or our inability to obtain third-party licenses necessary to develop new products and product enhancements, could require us to obtain substitute technology of lower quality or performance standards or at a greater cost, any of which could harm our business, financial condition and results of operations.

***We are subject to risks arising from our international operations.***

We derive a majority of our revenues from our international operations, and we plan to continue expanding our business in international markets in the future. As a result of our international operations, we are affected by economic, regulatory and political conditions in foreign countries, including changes in IT spending generally, the imposition of government controls, changes or limitations in trade protection laws, unfavorable changes in tax treaties or laws, natural disasters, labor unrest, earnings expatriation restrictions, misappropriation of intellectual property, acts of terrorism and continued unrest in many regions and other factors, which could have a material impact on our international revenues and operations. In particular, in some countries we may experience reduced intellectual property protection. Moreover, local laws and customs in many countries differ significantly from those in the United States. In many foreign countries, particularly in those with developing economies, it is common for others to engage in business practices that are prohibited by our internal policies and procedures or United States regulations applicable to us. Although we implement policies and procedures designed to ensure compliance with these laws and policies, there can be no assurance that all of our employees, contractors and agents will not take actions in violation of them. Violations of laws or key control policies by our employees, contractors or agents could result in financial reporting problems, fines, penalties, or prohibition on the importation or exportation of our products and could have a material adverse effect on our business.

**Table of Contents**

***While we believe that we currently have adequate internal control over financial reporting, we are exposed to risks from legislation requiring companies to evaluate those internal controls.***

Section 404 of the Sarbanes-Oxley Act of 2002 requires our management to report on, and our independent auditors to attest to, the effectiveness of our internal control over financial reporting. We have an ongoing program to perform the system and process evaluation and testing necessary to comply with these requirements. We have and will continue to incur significant expenses and devote management resources to Section 404 compliance on an ongoing basis. In the event that our chief executive officer, chief financial officer or independent registered public accounting firm determine in the future that our internal controls over financial reporting are not effective as defined under Section 404, investor perceptions may be adversely affected and could cause a decline in the market price of our stock.

***Regulation of the telecommunications industry could harm our operating results and future prospects.***

The telecommunications industry is highly regulated and our business and financial condition could be adversely affected by changes in the regulations relating to the telecommunications industry. Currently, there are few laws or regulations that apply directly to access to or commerce on IP networks. We could be adversely affected by regulation of IP networks and commerce in any country where we operate. Such regulations could address matters such as voice over the Internet or using Internet Protocol, encryption technology, and access charges for service providers. In addition, regulations have been adopted with respect to environmental matters, such as the Waste Electrical and Electronic Equipment ( WEEE ) and Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment ( RoHS ) regulations adopted by the European Union, as well as regulations prohibiting government entities from purchasing security products that do not meet specified local certification criteria. Compliance with such regulations may be costly and time-consuming for us and our suppliers and partners. The adoption and implementation of such regulations could decrease demand for our products, and at the same time could increase the cost of building and selling our products as well as impact our ability to ship products into affected areas and recognize revenue in a timely manner, which could have a material adverse effect on our business, operating results and financial condition.

***Our reported financial results could suffer if there is an additional impairment of goodwill or other intangible assets with indefinite lives.***

We are required to test annually, and review on an interim basis, our goodwill and intangible assets with indefinite lives, including the goodwill associated with past acquisitions and any future acquisitions, to determine if impairment has occurred. If such assets are deemed impaired, an impairment loss equal to the amount by which the carrying amount exceeds the fair value of the assets would be recognized. This would result in incremental expenses for that quarter which would reduce any earnings or increase any loss for the period in which the impairment was determined to have occurred. For example, such impairment could occur if the market value of our common stock falls below certain levels for a sustained period or if the portions of our business related to companies we have acquired fail to grow at expected rates or decline. In the second quarter of 2006, this impairment evaluation resulted in a reduction of \$1,280.0 million to the carrying value of goodwill on our balance sheet for the SLT operating segment, primarily due to the decline in our market capitalization that occurred over a period of approximately nine months prior to the impairment review and, to a lesser extent, a decrease in the forecasted future cash flows used in the income approach. Declines in our stock prices in the future as well as any marked decline in our level of revenues or gross margins increase the risk that goodwill and intangible assets may become impaired in future periods. We cannot accurately predict the amount and timing of any impairment of assets.

***The investment of our cash balance and our investments in government and corporate debt securities are subject to risks which may cause losses and affect the liquidity of these investments.***

At June 30, 2008, we had \$2,040.4 million in cash and cash equivalents and \$308.4 million in short- and long-term investments. We have invested these amounts primarily in U.S. government securities, corporate notes and bonds, commercial paper, and money market funds meeting certain criteria. Certain of these investments are subject to general credit, liquidity, market and interest rate risks, which may be exacerbated by U.S. sub-prime mortgage defaults that have affected various sectors of the financial markets and caused credit and liquidity issues. These market risks associated with our investment portfolio may have a negative adverse effect on our results of operations,



liquidity and financial condition.

**Table of Contents*****Uninsured losses could harm our operating results.***

We self-insure against many business risks and expenses, such as intellectual property litigation and our medical benefit programs, where we believe we can adequately self-insure against the anticipated exposure and risk or where insurance is either not deemed cost-effective or is not available. We also maintain a program of insurance coverage for various types of property, casualty, and other risks. We place our insurance coverage with various carriers in numerous jurisdictions. The types and amounts of insurance that we obtain vary from time to time and from location to location, depending on availability, cost, and our decisions with respect to risk retention. The policies are subject to deductibles, policy limits and exclusions that result in our retention of a level of risk on a self-insurance basis. Losses not covered by insurance could be substantial and unpredictable and could adversely affect our results of operations.

**Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds.***

There were no unregistered sales of equity securities during the period covered by this report.

**(c) Issuer Purchases of Equity Securities**

Period	Total Number of Shares Purchased(1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(1)
April 1 April 30, 2008	282,404	\$ 27.32	282,404	\$ 1,316,032,950
May 1 May 31, 2008	1,129,616	28.28	1,129,616	1,284,061,654
June 1 June 30, 2008	1,129,616	25.23	1,129,616	1,255,536,054
Total	2,541,636	\$ 26.84	2,541,636	

(1) In July 2006 and February 2007, the Company's Board of Directors (the Board) approved a stock repurchase program (the 2006 Stock Repurchase Program). This program authorizes the Company to purchase up to a total of

\$2.0 billion of the Company's common stock. In addition, during March 2008, the Board approved a new stock repurchase program (the 2008 Stock Repurchase Program) which enables the Company to purchase up to \$1.0 billion of the Company's common stock. This new program is in addition to the 2006 Stock Repurchase Program. During the three and six months ended June 30, 2008, the Company repurchased and retired 2,541,636 shares and 4,697,794 shares of common stock at an average price of \$26.84 per share and \$25.82 per share, respectively, under the 2006 Stock Repurchase Program and the 2008 Stock Repurchase Program. Purchases under

these programs will be subject to a review of the circumstances in place at the time.

Acquisitions under this stock repurchase program will be made from time to time as permitted by securities laws and other legal requirements.

These programs may be discontinued at any time.

**Item 4. Submission of Matters to a Vote of Security Holders**

The annual meeting of stockholders of Juniper Networks, Inc. was held on May 21, 2008, at 1220 N. Mathilda Ave., Sunnyvale, California. The results of the voting on the matters submitted to the stockholders are as follows:

Proposal 1: To elect two members of the Company's Board of Directors.

	<b>Votes For</b>	<b>Withheld</b>
Mary B. Cranston	453,837,706	11,261,829
J. Michael Lawrie	456,349,256	8,750,279

**Table of Contents**

Proposal 2: To approve the Juniper Networks, Inc. 2008 Employee Stock Purchase Plan.

Votes for:	410,178,332
Votes against:	3,885,111
Abstain:	4,297,495

Proposal 3: To ratify the appointment of Ernst & Young LLP as our independent auditors for the fiscal year ending December 31, 2008.

Votes for:	451,993,615
Votes against:	8,717,697
Abstain:	4,388,222

In addition to Ms. Cranston and Mr. Lawrie, the terms of following members of the Company's Board of Directors continued following the annual meeting of stockholders: Scott Kriens, Robert Calderoni, Michael Rose, Stratton Sclavos, Pradeep Sindhu and William Stensrud.

**Table of Contents**

**Item 6. Exhibits**

**Exhibit**

**Number**

**Description of Document**

- |      |   |
|------|---|
| 3.1  | Juniper Networks, Inc. Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 27, 2001)         |
| 3.2  | Amended and Restated Bylaws of Juniper Networks, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 12, 2008)                              |
| 10.1 | Description of Compensatory Arrangements for Edward Minshull adopted on May 13, 2008 (incorporated by reference to Item 5.02 of the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 13, 2008) |
| 10.2 | Juniper Networks, Inc. 2008 Employee Stock Purchase Plan (incorporated by reference to Exhibit 4.3 of the Company's Registration Statement on Form S-8 filed with the Securities and Exchange Commission on June 16, 2008)                  |
| 10.3 | Juniper Networks, Inc. Deferred Compensation Plan (incorporated by reference to Exhibit 4.4 of the Company's Registration Statement on Form S-8 filed with the Securities and Exchange Commission on June 16, 2008)                         |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934  |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934  |
| 32.1 | Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 32.2 | Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Juniper Networks, Inc.

August 8, 2008

By: /s/ Robyn M. Denholm  
Robyn M. Denholm  
Executive Vice President and Chief Financial Officer  
(Duly Authorized Officer and Principal Financial and  
Accounting Officer)

64

---

**Table of Contents**

**Exhibit Index**

<b>Exhibit Number</b>	<b>Description of Document</b>
3.1	Juniper Networks, Inc. Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 27, 2001)
3.2	Amended and Restated Bylaws of Juniper Networks, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 12, 2008)
10.1	Description of Compensatory Arrangements for Edward Minshull adopted on May 13, 2008 (incorporated by reference to Item 5.02 of the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 13, 2008)
10.2	Juniper Networks, Inc. 2008 Employee Stock Purchase Plan (incorporated by reference to Exhibit 4.3 of the Company's Registration Statement on Form S-8 filed with the Securities and Exchange Commission on June 16, 2008)
10.3	Juniper Networks, Inc. Deferred Compensation Plan (incorporated by reference to Exhibit 4.4 of the Company's Registration Statement on Form S-8 filed with the Securities and Exchange Commission on June 16, 2008)
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934
32.1	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002