OPNET TECHNOLOGIES INC
Form 10-Q
November 08, 2005
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# 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 September 30, 2005**

**OR**

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

**(Commission file number: 000-30931)**

# OPNET TECHNOLOGIES, INC.

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

| | | |
|---|---|---|
| **Delaware** | **7372** | **52-1483235** |

| | | |
|---|---|---|
| **(State or other jurisdiction of incorporation or organization)** | **(Primary Standard Industrial Classification Code Number)** | **(I.R.S. Employer Identification No.)** |

**7255 Woodmont Avenue**

**Bethesda, MD 20814**

**(Address of principal executive office)**

**(240) 497-3000**

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act.). Yes x No ¨

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

The number of shares of the registrant s Common Stock outstanding on November 2, 2005 was 20,222,698.

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## PART I. FINANCIAL INFORMATION

**ITEM 1.** ***Condensed Consolidated Financial Statements***

## OPNET TECHNOLOGIES, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

**(in thousands, except per share data)**

**(unaudited)**

| | September 30, 2005 | March 31, 2005 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 59,412 | $ 38,171 |
| Marketable securities | 20,373 | 44,014 |
| Accounts receivable, net of $180 in allowance for doubtful accounts at September 30, and March 31, 2005, respectively | 13,377 | 13,480 |
| Unbilled accounts receivable | 3,019 | 2,341 |
| Deferred income taxes, prepaid expenses and other current assets | 3,133 | 3,729 |
| Total current assets | 99,314 | 101,735 |
| Property and equipment, net | 6,060 | 6,227 |
| Intangible assets, net | 896 | 1,279 |
| Goodwill | 14,639 | 14,639 |
| Deferred income taxes and other assets | 1,263 | 1,306 |
| Total assets | $ 122,172 | $ 125,186 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 154 | $ 828 |
| Accrued liabilities | 6,344 | 6,874 |
| Deferred and accrued income taxes | 171 | 380 |
| Deferred revenue | 14,452 | 14,824 |
| Total current liabilities | 21,121 | 22,906 |
| Notes payable | 150 | 150 |
| Deferred rent | 1,129 | 1,107 |
| Deferred revenue | 805 | 1,058 |
| Total liabilities | 23,205 | 25,221 |
| Commitments and contingencies (Note 8) | | |

| | | |
|---|---|---|
| Stockholders equity: | | |
| Common stock-par value $0.001; 100,000 authorized; 26,492 and 26,443 shares issued at September 30 and March 31, 2005, respectively; 20,223 and 20,309 shares outstanding at September 30 and March 31, 2005, respectively | 26 | 26 |
| Additional paid-in capital | 79,715 | 79,421 |
| Deferred compensation | (1) | (15) |
| Retained earnings | 24,699 | 24,713 |
| Accumulated other comprehensive loss | (278) | (80) |
| Treasury stock, at cost 6,269 and 6,134 shares at September 30 and March 31, 2005, Respectively | (5,194) | (4,100) |
| Total stockholders equity | 98,967 | 99,965 |
| Total liabilities and stockholders equity | $ 122,172 | $ 125,186 |

See accompanying notes to condensed consolidated financial statements.

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**OPNET TECHNOLOGIES, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(in thousands, except per share data)**

**(unaudited)**

| | Three Months Ended September 30, | | Six Months Ended September 30, | |
|---|---|---|---|---|
| | **2005** | **2004** | **2005** | **2004** |
| **Revenue:** | | | | |
| New software licenses | $ 7,584 | $ 5,739 | $ 14,210 | $ 13,785 |
| Software license updates and technical support | 5,951 | 4,963 | 11,724 | 9,619 |
| Professional services | 4,729 | 3,512 | 8,807 | 7,597 |
| Total revenue | 18,264 | 14,214 | 34,741 | 31,001 |
| **Cost of revenue:** | | | | |
| New software licenses | 182 | 182 | 362 | 376 |
| Software license updates and technical support | 673 | 586 | 1,293 | 1,137 |
| Professional services | 3,170 | 2,255 | 6,444 | 4,761 |
| Amortization of acquired technology | 192 | 134 | 383 | 268 |
| Total cost of revenue | 4,217 | 3,157 | 8,482 | 6,542 |
| **Gross profit** | 14,047 | 11,057 | 26,259 | 24,459 |
| **Operating expenses:** | | | | |
| Research and development | 4,677 | 3,661 | 9,188 | 7,056 |
| Sales and marketing | 6,258 | 5,251 | 12,176 | 10,701 |
| General and administrative | 3,091 | 1,687 | 6,041 | 3,390 |
| Total operating expenses | 14,026 | 10,599 | 27,405 | 21,147 |
| **Income (loss) from operations** | 21 | 458 | (1,146) | 3,312 |
| Interest and other income, net | 614 | 265 | 1,127 | 461 |
| Income (loss) before provision for income taxes | 635 | 723 | (19) | 3,773 |
| Provision (benefit) for income taxes | 195 | 229 | (5) | 1,239 |
| **Net income (loss)** | $ 440 | $ 494 | $ (14) | $ 2,534 |
| Basic net income per common share | $ 0.02 | $ 0.02 | $ 0.00 | $ 0.13 |
| Diluted net income per common share | $ 0.02 | $ 0.02 | $ 0.00 | $ 0.12 |

| | | | | |
|---|---|---|---|---|
| Basic weighted average common shares outstanding | 20,311 | 20,135 | 20,336 | 20,019 |
| Diluted weighted average common shares outstanding | 20,552 | 20,639 | 20,336 | 20,745 |

See accompanying notes to condensed consolidated financial statements.

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**OPNET TECHNOLOGIES, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(in thousands)**

**(unaudited)**

| | Six Months Ended September 30, 2005 | Six Months Ended September 30, 2004 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net (loss) income | $ (14) | $ 2,534 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,164 | 1,113 |
| Provision for losses on accounts receivable | (7) | |
| Deferred income taxes | 815 | (163) |
| Non-cash stock option compensation expense | 12 | 3 |
| Loss on disposition of fixed assets | 2 | |
| Changes in assets and liabilities: | | |
| Accounts receivable | (568) | 717 |
| Prepaid expenses and other current assets | (205) | (1,183) |
| Other assets | 29 | (233) |
| Accounts payable | (674) | 69 |
| Accrued liabilities | (530) | 51 |
| Accrued income taxes | (209) | 59 |
| Tax benefit from exercise of stock options | 7 | |
| Deferred revenue | (625) | 388 |
| Deferred rent | 22 | 76 |
| Net cash (used in) provided by operating activities | (781) | 3,431 |
| Cash flows from investing activities: | | |
| Acquisition of Altaworks | | (453) |
| Purchase of property and equipment | (616) | (569) |
| Purchase of investments | (12,727) | (29,684) |
| Proceeds from sale/maturity of investments | 36,368 | 26,797 |
| Net cash provided by (used in) investing activities | 23,025 | (3,909) |
| Cash flows from financing activities: | | |
| Acquisition of treasury stock | (1,094) | |
| Proceeds from exercise of common stock options | 50 | 393 |
| Proceeds from issuance of common stock under employee stock purchase plan | 239 | 181 |
| Net cash (used in) provided by financing activities | (805) | 574 |
| Effect of exchange rate changes on cash and cash equivalents | (198) | (63) |
| Net increase in cash and cash equivalents | 21,241 | 33 |

| | | |
|---|---|---|
| Cash and cash equivalents, beginning of period | 38,171 | 41,492 |
| Cash and cash equivalents, end of period | $ 59,412 | $ 41,525 |

See accompanying notes to condensed consolidated financial statements.

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**OPNET TECHNOLOGIES, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(in thousands, except per share data)**

**(unaudited)**

**1. Organization and Significant Accounting Policies**

***Organization.*** OPNET Technologies, Inc., or OPNET is a provider of management software for networks and applications. Our solutions address: application performance management, network configuration management, capacity planning, and network research and development. OPNET differentiates itself from traditional management providers by focusing on analytics. Traditional management tools emphasize monitoring and reporting, which are inherently reactive processes. In contrast, OPNET focuses on algorithms and modeling to rapidly troubleshoot and resolve performance problems; and, even more importantly, to proactively prevent problems from occurring. We sell our products to corporate enterprises, government and defense agencies, network service providers, and network equipment manufacturers. We market our product suite in North America primarily through a direct sales force and, to a lesser extent, several resellers and original equipment manufacturers. Internationally, we conduct research and development through our wholly-controlled subsidiary in Ghent, Belgium and market our products through our wholly-owned subsidiaries in Paris, France; Frankfurt, Germany; Slough, United Kingdom; and Sydney, Australia; third-party distributors; and value-added resellers. OPNET is headquartered in Bethesda, Maryland and has offices in Cary, North Carolina; Dallas, Texas; Santa Clara, California and Nashua, New Hampshire.

The accompanying condensed consolidated financial statements include our results and the results of our wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The interim condensed consolidated financial statements included herein are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP, and applicable rules and regulations of the Securities and Exchange Commission, or SEC regarding interim financial reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Accordingly, these interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes thereto contained in the Company s Annual Report on Form 10-K, for the year ended March 31, 2005, filed with the SEC. The March 31, 2005 condensed consolidated balance sheet included herein was derived from the audited financial statements as of that date, but does not include all disclosures including notes required by GAAP. In the opinion of management, these interim condensed consolidated financial statements reflect all adjustments of a normal and recurring nature necessary to present fairly our results for the interim periods. The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amount of revenue and expenses during the reporting periods. Actual results could differ from those estimates. In addition, our operating results for the three and six months ended September 30, 2005 may not be indicative of the operating results for the full fiscal year or any other future period.

***Stock-Based Compensation.*** The Company accounts for stock-based compensation given to employees using the intrinsic value method in accordance with Accounting Principles Board, or APB Opinion No. 25, Accounting for Stock Issued to Employees , and accordingly, recognizes compensation expense for fixed stock option grants when the exercise price is less than the quoted market price of the shares on the date of the grant. SFAS No. 123, Accounting for Stock-Based Compensation , as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, permits the use of either a fair-value based method or the intrinsic value method provided in APB No. 25 to account for employee stock-based compensation arrangements. Companies that elect to use the intrinsic value method provided in APB No. 25 are required to disclose the pro forma net income (loss) and earnings (loss) per share that would have resulted from the use of the fair value method. We have provided below the pro forma disclosures of the effect on net income and earnings per share as if SFAS No. 123, as amended, had been applied in measuring compensation expense for all periods.

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| | Three Months Ended September 30, | | Six Months Ended September 30, | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| | (In thousands, except per share data) | | | |
| Net income (loss) | $ 440 | $ 494 | $ (14) | $ 2,534 |
| Add: Stock-based employee compensation expense included in reported net income, net of related tax effects | 3 | (13) | 12 | 3 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (444) | (913) | (885) | (1,751) |
| Pro forma net (loss) income | $ (1) | $ (432) | $ (887) | $ 786 |
| Basic net income (loss) per common share: | | | | |
| As reported | $ 0.02 | $ 0.02 | $ 0.00 | $ 0.13 |
| Pro forma | $ 0.00 | $ (0.02) | (0.04) | $ 0.04 |
| Diluted net income (loss) per common share: | | | | |
| As reported | $ 0.02 | $ 0.02 | $ 0.00 | $ 0.12 |
| Pro forma | $ 0.00 | $ (0.02) | (0.04) | $ 0.04 |

**2. Acquisition of Altaworks**

On October 6, 2004, OPNET completed the acquisition of Altaworks Corporation. As a result of the merger, we acquired two commercially available software products that provide advanced correlation and analysis technologies to our product portfolio for end-to-end application performance analysis and, with the addition of Altaworks employees, have greater engineering depth and technical expertise. Pursuant to the merger agreement, the purchase price, including assumed liabilities, totaled approximately $3,431; the purchase price was paid in cash from the Company s working capital. The total purchase price of approximately $3,431 consisted of the following:

| | (in thousands) |
|---|---|
| Cash consideration | $ 2,940 |
| Acquisition costs | 491 |
| Total consideration and acquisition costs | $ 3,431 |

The Company accounted for the acquisition using the purchase method of accounting. The summary of the purchase price allocation related to the assets acquired and liabilities assumed in the acquisition is as follows:

| | (in thousands) |
|---|---|
| Current assets | $ 74 |
| Property, plant and equipment | 11 |
| Other assets | 18 |
| Acquired intangible assets (3-year, straight-line amortization) | 690 |

| | | |
|---|---|---|
| Goodwill | | 2,427 |
| Deferred tax asset | | 1,179 |
| Current liabilities assumed | | (968) |
| Total consideration and acquisition costs | $ | 3,431 |

The assets acquired and liabilities assumed were recorded at estimated fair values as determined by the Company s management based on information currently available and on current assumptions as to future operations. We completed our

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analysis of the purchase price allocation in the fourth quarter of fiscal 2005 and adjusted goodwill to reflect a deferred tax asset of $1,179. The Company obtained valuation services from an independent company and assessed the reasonableness of the valuation to determine the fair value of acquired intangibles and their remaining useful lives.

The following pro forma quarterly financial information presents the combined results of operations of the Company and Altaworks, and gives effect to the acquisition of Altaworks as if it occurred on April 1, 2003. We began presenting the combined results of operations of the Company and Altaworks in our consolidated financial statements in the third quarter of fiscal year 2005. The pro forma condensed combined financial information for the six months ended September 30, 2004 set forth below reflects certain adjustments, including adjustments to reflect amortization of acquired intangibles and adjustments to the tax provision to reflect the tax benefit the combined group would have received from Altaworks losses. However, pro forma results do not include any anticipated operating expense cost savings. The pro forma condensed combined financial information set forth below neither purports to represent what the consolidated results of operations or financial condition of the Company would actually have been if the Altaworks acquisition had in fact occurred on such date nor projects the future consolidated results of operations or financial condition of the Company.

Pro forma financial information:

| | Six Months Ended September 30, 2004 |
|---|---|
| | (in thousands) |
| Revenue | $ 31,166 |
| Net income | 1,021 |
| Basic net income per share | $ 0.05 |
| Diluted net income per share | $ 0.05 |

Pro forma basic net income per share is computed using the weighted-average number of common shares outstanding as of the dates presented.

**3. Intangible Assets**

Intangible assets consisted of the following:

| | At September 30, 2005 | At March 31, 2005 |
|---|---|---|
| | (in thousands) | |
| Acquired technology | $ 3,372 | $ 3,372 |
| Accumulated amortization | (2,476) | (2,093) |
| Intangible assets, net | $ 896 | $ 1,279 |

Acquired technology relating to the NetMaker, WDM NetDesign, Anite and Altaworks acquisitions resulted in amortization expense for the three months ended September 30, 2005 and 2004 of $192 and $134, respectively. Acquired technology relating to the NetMaker, WDM NetDesign, Anite and Altaworks acquisitions resulted in amortization expense for the six months ended September 30, 2005 and 2004 of $383 and $268, respectively. Amortization expense associated with Anite commenced in Q4 of fiscal 2004 and amortization associated with Altaworks commenced in Q3 of fiscal 2005. Amortization expense from acquired technology is included in cost of revenue in the condensed consolidated statements of operations. We currently expect amortization expense attributable to these acquisitions of $766 in the fiscal year ending March 31, 2006, $333 in fiscal year ending March 31, 2007, $151 in the fiscal year ending March 31, 2008, and $29 in the fiscal year ending March 31, 2009.

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**4. Earnings Per Share**

The following is a reconciliation of the amounts used in calculating basic and diluted net income per common share for the three and six months ended September 30, 2005 and 2004:

| | Three Months Ended September 30, | | Six Months Ended September 30, | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| | (in thousands, except per share data) | | | |
| Net income (loss) (numerator): | | | | |
| Basic and diluted net income | $ 440 | $ 494 | $ (14) | $ 2,534 |
| Shares (denominator): | | | | |
| Weighted average shares outstanding (basic) | 20,311 | 20,135 | 20,336 | 20,109 |
| Plus: | | | | |
| Effect of other dilutive securities options | 241 | 504 | | 636 |
| Weighted average shares outstanding (diluted) | 20,552 | 20,639 | 20,336 | 20,745 |
| Net income per common share: | | | | |
| Basic | $ 0.02 | $ 0.02 | $ 0.00 | $ 0.13 |
| Diluted | $ 0.02 | $ 0.02 | $ 0.00 | $ 0.12 |

**5. Stockholders Equity**

During the three months ended September 30, 2005 and 2004, respectively, we received proceeds of approximately $15 and $136 and issued 2,646 and 37,469 shares of common stock, pursuant to employee exercises of stock options. During the three months ended September 30, 2005 and 2004, respectively, employees did not purchase any shares of common stock under the OPNET 2000 Employee Stock Purchase Plan.

During the six months ended September 30, 2005 and 2004, respectively, we received proceeds of approximately $50 and $393 and issued 13,958 and 86,643 shares of common stock, pursuant to employee exercises of stock options. During the six months ended September 30, 2005 and 2004, respectively, employees purchased 34,692 and 16,284 shares of common stock under the OPNET 2000 Employee Stock Purchase Plan, resulting in proceeds to us of approximately $239 and $181.

**6. Business Segment and Geographic Information**

We operate in one industry segment, the development and sale of computer software programs and related services. Revenue from transactions with United States government agencies was approximately 47% and 50% of total revenue for the three months ended September 30, 2005 and 2004, respectively. Revenue from transactions with United States government agencies was approximately 46% and 49% of total revenue for the six months ended September 30, 2005 and 2004, respectively. Substantially all assets were held in the United States at September 30 and March 31, 2005. Revenue by geographic area and as a percentage of total revenue is as follows:

| | Three Months Ended September 30, | | Six Months Ended September 30, | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| | (dollars in thousands) | | | |
| Geographic Area: | | | | |
| United States | $ 14,407 | $ 11,647 | $ 27,414 | $ 25,690 |
| International | 3,857 | 2,567 | 7,327 | 5,311 |
| Total revenue | $ 18,264 | $ 14,214 | $ 34,741 | $ 31,001 |
| Geographic Area: | | | | |
| United States | 78.9% | 81.9% | 78.9% | 82.9% |
| International | 21.1 | 18.1 | 21.1 | 17.1 |
| Total revenue | 100.0% | 100.0% | 100.0% | 100.0% |

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**7. Comprehensive Income**

Comprehensive income includes net income, foreign currency translation adjustments, and unrealized gain or loss on marketable securities. The components of comprehensive income, net of tax, are as follows:

| | Three Months Ended September 30, | | Six Months Ended September 30, | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| | (in thousands) | | | |
| Net income (loss) | $ 440 | $ 494 | $ (14) | $ 2,534 |
| Foreign currency translation adjustments | | 10 | (242) | 2 |
| Unrealized gain (loss) on marketable securities | 14 | 17 | 44 | (65) |
| Total comprehensive income (loss) | $ 454 | $ 521 | $ (212) | $ 2,471 |

**8. Commitments and Contingencies**

On September 27, 2004, OPNET received notice of a lawsuit filed by Compuware Corporation in the United States District Court for the Eastern District of Michigan alleging patent infringement. Compuware Corporation is seeking injunctive relief and unspecified monetary damages. To date, no injunctive relief has been granted and the court has scheduled the matter for a jury trial beginning on April 11, 2006. At this stage, we cannot predict the outcome of the claims, nor can we reasonably estimate a range of possible loss, if any, that may arise. OPNET believes that it has substantial defenses to the allegations, and OPNET intends to vigorously defend against the litigation.

The Internal Revenue Service, or IRS is examining our federal corporate income tax returns for fiscal years ended March 31, 2002 and 2003. While the outcome of the IRS examination is not final at this time, we have reached a preliminary agreement with respect to the amount of tax deficiencies asserted that relate to research and development tax credits that we claimed on our tax returns for fiscal years ended March 31, 2002 and 2003. Based on the preliminary agreement we have reached with the IRS regarding the amount of tax deficiencies asserted that relate to research and development tax credits, we estimate that the aggregate amount of the research and development tax credits that will be disallowed on our tax returns for fiscal years ended March 31, 2002 and 2003 will be approximately $350. As a result, our Q3 fiscal 2005 tax provision reflected the reversal of approximately $350 of previously claimed research and development tax credits. The IRS also asserted that there are tax deficiencies related to the timing of revenue reported on our tax returns for fiscal years ended March 31, 2002 and 2003. The tax deficiencies asserted by the IRS related to timing of revenue are associated with contract milestone billings that the IRS asserts should have been included in taxable income on our tax returns for the fiscal year ended March 31, 2002, but were instead included in taxable income on our tax returns for the fiscal year ended March 31, 2003. We do not believe any tax deficiencies related to the timing of revenue will be material to the financial statements.

We are involved in other claims and legal proceedings arising from our normal operations. We do not expect these matters, individually or in the aggregate, to have a material effect on our financial condition, results of operations, or cash flows.

**9. Treasury Stock**

On January 31 2005, we announced that our Board of Directors had authorized the repurchase of up to 1,000,000 shares of our common stock from time to time on the open market or in privately negotiated transactions. This stock repurchase program does not have a specified termination date. Any repurchased shares will be available for use in connection with our stock plans or other corporate purposes. We expended $733 to purchase 90,000 shares during the three months ended September 30, 2005, at an average price of $8.14. We expended $1,094 to purchase 135,400 shares during the six months ended September 30, 2005, at an average price of $8.08. As of September 30, 2005, we have repurchased 135,400 shares of common stock under this program.

**10. Subsequent Event**

On October 26, 2005, our Board of Directors or, the Board, approved the accelerated vesting of all unvested options that had an exercise price of $11.75 or greater and are held by current employees, including executive officers. This accelerated vesting affected options with respect to 254,400 shares of our common stock that are not currently vested under such options, and was effective for stock options outstanding as of the close of business on October 26, 2005.

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The Board s primary purpose in accelerating vesting was to eliminate future stock-based employee compensation expense that we would otherwise recognize in our consolidated statement of operations with respect to these accelerated options once Financial Accounting Standards Board Statement No. 123R, Share Based Payment, becomes effective. Furthermore, the Board concluded that the retention value of the unvested portion of these options was minimal given the current market price for the Company s common stock. Because these options have exercise prices well in excess of the Company s current stock price which was $8.13 at the close of business on October 26, 2005, as reported by the NASDAQ National Market, the Board concluded that these options likely would not offer sufficient incentive to the employees to remain with the Company when compared to the future compensation expense that would have been attributable to the options. The estimated maximum future expense that will be eliminated is approximately $922.

All of these options had an exercise price of $11.75, a grant date of October 23, 2003, and a vesting schedule that provided for pro rata annual vesting for 99.8% of the grants over five years from the date of the grant and for cliff vesting for 0.2% of the grants in three years from the date of the grant. In the case of options held by executive officers of the Company, vesting was accelerated with respect to the following number of shares: Marc Cohen 48,000 shares.

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**ITEM 2.** ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion and analysis relate to our financial condition and results of operations for the three and six months ended September 30, 2005 and 2004, and should be read in conjunction with our condensed consolidated financial statements and the related notes included elsewhere in this report. You should also read the following discussion and analysis in conjunction with our consolidated financial statements and the related notes and Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended March 31, 2005, filed with the SEC. This discussion and analysis contains forward-looking statements that involve risks, uncertainties, and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth under Certain Factors That May Affect Future Results and elsewhere in this Quarterly Report on Form 10-Q.

**Overview**

OPNET Technologies, Inc. is a provider of management software for networks and applications. Our solutions address: application performance management, network configuration management, capacity planning, and network research and development. Our customers include corporate enterprises, government and defense agencies, network service providers, and network equipment manufacturers. Our solutions are designed to help our customers make better use of resources, reduce operational problems and improve competitiveness.

We operate in one reportable industry segment, the development and sale of computer software programs and related services. Our operations are principally in the United States, and we have subsidiaries in Australia, Belgium, France, Germany and the United Kingdom. We primarily depend upon our direct sales force to generate revenue in the United States. Sales outside the United States are made through our international sales team as well as third-party distributors and value-added resellers, who generally are responsible for providing technical support and service to customers within their territory.

Our revenue is derived from three primary sources: (1) new software licenses, (2) software license updates and technical support, and (3) professional services, which include consulting and training services. New software license revenue represents all fees earned from granting customers licenses to use our software, and exclude revenue derived from software license updates, which are included in software license updates and technical support revenue. Our software master license agreement provides our customers with the right to use our software either perpetually ( perpetual licenses ) or during a defined term, generally for 2 to 4 years ( term licenses ). For the six months ended September 30, 2005, perpetual licenses represented approximately 97% of software license transactions. Substantially all of our software license arrangements include both perpetual licenses and software license updates and technical support. Software license updates and technical support revenue represents fees associated with the sale of unspecified license updates and technical support under our maintenance agreements. We offer professional services, under both time and material and fixed-price agreements, primarily to facilitate the adoption of our technology.

We consider our consulting services to be an integral part of our business model as they are centered on our software product offerings. Because our consulting services facilitate the adoption of our solutions, we believe that they ultimately generate additional sales of software licenses.

The key strategies of our business plan include increasing sales to existing customers, increasing deal size by selling modules and introducing new products, improving our sales and marketing execution, establishing alliances to extend our market reach and increasing our international presence. We have focused our sales, marketing, and other efforts on corporate enterprise and United States Government opportunities, and to a much lesser extent, service provider and network equipment manufacturer opportunities. Our focus and strategies are designed to increase revenue and profitability. Because of the uncertainty surrounding the amount and timing of revenue growth, we expect to closely manage the increases in our total expenses as we implement these strategies.

In March 2005, we entered into a multi-year worldwide distribution agreement with Cisco Systems. Under the terms of the agreement, Cisco will distribute a broad range of our software products. We will also collaborate with Cisco s Network Management Technology Group to develop new network management solutions. Cisco began sales of our products in the second half of calendar 2005, although we do not expect to see revenue from the Cisco Systems agreement until the fourth quarter of fiscal year 2006.

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**Acquisition**

On October 6, 2004, we completed the acquisition of Altaworks for a total purchase price of approximately $3,431. As a result of the merger, we acquired all the assets and liabilities of Altaworks. We paid the purchase price in cash from working capital. As a result of the acquisition, we acquired two commercially available software products that provide advanced correlation and analysis technologies to our product portfolio for end-to-end application performance analysis and, with the addition of Altaworks employees, have greater engineering depth and technical expertise.

This acquisition was accounted for as a purchase; consequently, operations of the acquired business will be included in our financial statements prospectively from the date of acquisition. See Note 2 to our condensed consolidated financial statements for additional information related to our acquisition of Altaworks.

**Summary of Our Financial Performance and Trends That May Affect Our Business and Future Results**

During the three months ended September 30, 2005, or Q2 2006, as compared to the three months ended June 30, 2005, or Q1 2006, we generated growth in revenue, gross profit and operating margin.

The following table summarizes information on certain key metrics:

| | Three Months Ended | | | |
|---|---|---|---|---|
| | September 30, 2005 | June 30, 2005 | Amount Change | Percentage Change |
| | (dollars in thousands, except per share data) | | | |
| **Operations Data:** | | | | |
| Total revenue | $ 18,264 | $ 16,477 | $ 1,787 | 10.8% |
| Total cost of sales | $ 4,217 | $ 4,265 | $ (48) | (1.1)% |
| Gross profit | $ 14,047 | $ 12,212 | $ 1,835 | 15.0% |
| Gross profit as a percentage of total revenue (gross margin) | | | | |