F5 NETWORKS INC
Form 10-Q
August 05, 2011

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended June 30, 2011

OR

o **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 000-26041

F5 NETWORKS, INC.

(Exact name of registrant as specified in its charter)

WASHINGTON	**91-1714307**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

401 Elliott Avenue West
Seattle, Washington 98119
(Address of principal executive offices and zip code)
(206) 272-5555
(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 registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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 þ No o

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 þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares outstanding of the registrant s common stock as of August 2, 2011 was 80,726,859.

F5 NETWORKS, INC.
QUARTERLY REPORT ON FORM 10-Q
For the Quarter Ended June 30, 2011
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

F5 NETWORKS, INC.
CONSOLIDATED BALANCE SHEETS
(unaudited, in thousands)

	June 30, 2011	September 30, 2010
ASSETS		
Current assets		
Cash and cash equivalents	$ 299,804	$ 168,754
Short-term investments	285,530	259,742
Accounts receivable, net of allowances of $2,821 and $4,319	154,741	112,132
Inventories	17,941	18,815
Deferred tax assets	9,197	8,767
Other current assets	30,015	37,745
Total current assets	797,228	605,955
Property and equipment, net	42,323	34,157
Long-term investments	471,567	433,570
Deferred tax assets	38,169	37,864
Goodwill	234,700	234,700
Other assets, net	13,147	15,946
Total assets	$ 1,597,134	$ 1,362,192
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 34,070	$ 21,180
Accrued liabilities	59,721	61,768
Deferred revenue	255,226	204,137
Total current liabilities	349,017	287,085
Other long-term liabilities	16,300	16,153
Deferred revenue, long-term	66,649	55,256
Total long-term liabilities	82,949	71,409
Commitments and contingencies (Note 5)		
Shareholders equity		
Preferred stock, no par value; 10,000 shares authorized, no shares outstanding		
Common stock, no par value; 200,000 shares authorized, 80,727 and 80,355 shares issued and outstanding	505,117	517,215
Accumulated other comprehensive loss	(3,460)	(3,241)
Retained earnings	663,511	489,724

Total shareholders equity	1,165,168	1,003,698
Total liabilities and shareholders equity	$ 1,597,134	$ 1,362,192

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

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F5 NETWORKS, INC.
CONSOLIDATED INCOME STATEMENTS
(unaudited, in thousands, except per share data)

	Three months ended June 30,		Nine months ended June 30,	
	2011	**2010**	**2011**	**2010**
Net revenues				
Products	$ 179,327	$ 147,393	$ 524,529	$ 396,170
Services	111,386	83,081	312,690	231,528
Total	290,713	230,474	837,219	627,698
Cost of net revenues				
Products	31,803	29,328	94,840	82,789
Services	20,645	15,251	57,244	42,335
Total	52,448	44,579	152,084	125,124
Gross profit	238,265	185,895	685,135	502,574
Operating expenses				
Sales and marketing	93,633	77,219	269,790	212,505
Research and development	35,245	30,889	102,358	86,743
General and administrative	21,126	17,658	61,656	49,627
Total	150,004	125,766	433,804	348,875
Income from operations	88,261	60,129	251,331	153,699
Other income, net	1,889	3,561	6,002	7,557
Income before income taxes	90,150	63,690	257,333	161,256
Provision for income taxes	27,601	23,195	83,546	58,338
Net income	$ 62,549	$ 40,495	$ 173,787	$ 102,918
Net income per share basic	$ 0.77	$ 0.51	$ 2.15	$ 1.30
Weighted average shares basic	80,866	79,864	80,773	79,386
Net income per share diluted	$ 0.77	$ 0.50	$ 2.13	$ 1.27
Weighted average shares diluted	81,497	81,031	81,655	80,870

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

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F5 NETWORKS, INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY
(unaudited, in thousands)

	Nine months ended June 30, 2011				
	Common Stock		Accumulated Other Comprehensive	Retained	Total Shareholders
	Shares	Amount	Income/(Loss)	Earnings	Equity
Balance, September 30, 2010	80,355	$ 517,215	$ (3,241)	$ 489,724	$ 1,003,698
Exercise of employee stock options	142	2,197			2,197
Issuance of stock under employee stock purchase plan	256	18,932			18,932
Issuance of restricted stock	1,048				
Repurchase of common stock	(1,074)	(121,526)			(121,526)
Tax benefit from employee stock transactions		20,686			20,686
Stock-based compensation		67,613			67,613
Comprehensive income:					
Net income				173,787	
Foreign currency translation adjustment			(529)		
Unrealized gain on securities, net of tax			310		
Comprehensive income					173,568
Balance, June 30, 2011	80,727	$ 505,117	$ (3,460)	$ 663,511	$ 1,165,168

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

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F5 NETWORKS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

	Nine months ended June 30, 2011	Nine months ended June 30, 2010
Operating activities		
Net income	$ 173,787	$ 102,918
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized gain on disposition of assets and investments	(203)	(117)
Stock-based compensation	67,613	50,991
Provisions for doubtful accounts and sales returns	453	794
Depreciation and amortization	15,715	17,923
Deferred income taxes	(387)	10,659
Gain on auction rate securities put option		(1,491)
Loss on trading auction rate securities		1,491
Changes in operating assets and liabilities, net of amounts acquired:		
Accounts receivable	(43,062)	3,350
Inventories	874	(3,927)
Other current assets	8,452	(10,380)
Other assets	(365)	(1,651)
Accounts payable and accrued liabilities	10,086	154
Deferred revenue	62,481	56,507
Net cash provided by operating activities	295,444	227,221
Investing activities		
Purchases of investments	(692,812)	(571,072)
Sales and maturities of investments	629,766	397,702
Investment of restricted cash	(406)	(26)
Acquisition of intangible assets	(80)	
Purchases of property and equipment	(20,544)	(10,119)
Net cash used in investing activities	(84,076)	(183,515)
Financing activities		
Excess tax benefits from stock-based compensation	20,221	16,419
Proceeds from the exercise of stock options and purchases of stock under employee stock purchase plan	21,131	29,338
Repurchase of common stock	(121,526)	(55,000)
Net cash used in financing activities	(80,174)	(9,243)
Net increase in cash and cash equivalents	131,194	34,463
Effect of exchange rate changes on cash and cash equivalents	(144)	(1,487)
Cash and cash equivalents, beginning of period	168,754	110,837
Cash and cash equivalents, end of period	$ 299,804	$ 143,813

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

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F5 NETWORKS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1. Summary of Significant Accounting Policies

Description of Business

F5 Networks, Inc. (the Company) provides products and services to help companies manage their Internet Protocol (IP) traffic and file storage infrastructure efficiently and securely. The Company s application delivery networking products improve the performance, availability and security of applications on Internet-based networks. Internet traffic between network-based applications and clients passes through these devices where the content is inspected to ensure that it is safe and modified as necessary to ensure that it is delivered securely and in a way that optimizes the performance of both the network and the applications. The Company s storage virtualization products simplify and reduce the cost of managing files and file storage devices, and ensure fast, secure, easy access to files for users and applications. The Company also offers a broad range of services that include consulting, training, maintenance and other technical support services.

Basis of Presentation

The year end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. In the opinion of management, the unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for their fair statement in conformity with accounting principles generally accepted in the United States of America. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted in accordance with the rules and regulations of the Securities and Exchange Commission. The information included in this Form 10-Q should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2010.

Certain reclassifications have been made to the prior year s financial statements to conform to the fiscal year 2011 presentation. Such reclassifications did not affect total revenues, operating income or net income.

Revenue Recognition

The Company sells products through distributors, resellers, and directly to end users. Revenue is recognized provided that all of the following criteria have been met:

Persuasive evidence of an arrangement exists. Evidence of an arrangement generally consists of a purchase order issued pursuant to the terms and conditions of a distributor, reseller or end user agreement.

Delivery has occurred. The Company uses shipping or related documents, or written evidence of customer acceptance, when applicable, to verify delivery or completion of any performance terms.

The sales price is fixed or determinable. The Company assesses whether the sales price is fixed or determinable based on payment terms associated with the transaction and whether the sales price is subject to refund or adjustment.

Collectability is reasonable assured. The Company assesses collectability primarily based on the creditworthiness of the customer as determined by credit checks and related analysis, as well as the Customer s payment history.

In certain regions where the Company does not have the ability to reasonably estimate returns, the Company defers revenue on sales to its distributors until they have received information from the channel partner indicating that the product has been sold to the end-user customer. Payment terms to domestic customers are generally net 30 days to net 45 days. Payment terms to international customers range from net 30 days to net 120 days based on normal and customary trade practices in the individual markets. The Company offers extended payment terms to certain customers, in which case, revenue is recognized when payments are due.

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Whenever product, training services and post-contract customer support (PCS) elements are sold together, a portion of the sales price is allocated to each element based on their respective fair values as determined when the individual elements are sold separately. Revenue from the sale of products is recognized when the product has been shipped and the customer is obligated to pay for the product. When rights of return are present and the Company cannot estimate returns, it recognizes revenue when such rights of return lapse. Revenues for PCS are recognized on a straight-line basis over the service contract term. PCS includes a limited period of telephone support updates, repair or replacement of any failed product or component that fails during the term of the agreement, bug fixes and rights to upgrades, when and if available. Consulting services are customarily billed at fixed hourly rates, plus out-of-pocket expenses, and revenues are recognized when the consulting has been completed. Training revenue is recognized when the training has been completed.

In October 2009, the Financial Accounting Standards Board (FASB) amended the accounting standards for revenue recognition to remove from the scope of industry-specific software revenue recognition guidance any tangible products containing software components and non-software components that operate together to deliver the products essential functionality. In addition, the FASB amended the accounting standards for certain multiple element revenue arrangements to:

Provide updated guidance on whether multiple elements exist, how the elements in an arrangement should be separated, and how the arrangement consideration should be allocated to the separate elements;

Require an entity to allocate arrangement consideration to each element based on a selling price hierarchy, where the selling price for an element is based on vendor-specific objective evidence (VSOE), if available, third-party evidence (TPE), if available and VSOE is not available; or the best estimate of selling price (BESP), if neither VSOE or TPE is available; and

Eliminate the use of the residual method and require an entity to allocate arrangement consideration using the selling price hierarchy.

The Company adopted this guidance in the first quarter of fiscal year 2011 on a prospective basis for applicable arrangements originating or materially modified after October 1, 2010. The impact of this adoption was not material to the Company s financial position and results of operations for the three and nine months ended June 30, 2011.

The majority of the Company s products are hardware appliances which contain software essential to the overall functionality of the products. Accordingly, the Company no longer recognizes revenue on sales of these products in accordance with the industry-specific software revenue recognition guidance.

For all transactions entered into prior to the first quarter of fiscal year 2011 and for sales of nonessential and stand-alone software after October 1, 2010, the Company allocates revenue for arrangements with multiple elements based on the software revenue recognition guidance. Software revenue recognition guidance requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair values of those elements. The fair value of an element must be based on VSOE. Where fair value of certain elements is not available, revenue is recognized on the residual method based on the fair value of undelivered elements. If evidence of the fair value of one or more undelivered elements does not exist, all revenue is deferred and recognized at the earlier of the delivery of those elements or the establishment of fair value of the remaining undelivered elements.

For transactions entered into subsequent to the adoption of the amended revenue recognition standards that are multiple-element arrangements, the arrangement consideration is allocated to each element based on the relative selling prices of all of the elements in the arrangement using the fair value hierarchy in the amended revenue recognition guidance.

Consistent with the methodology used under the previous accounting guidance, the Company establishes VSOE for its products, training services, PCS and consulting services based on the sales price charged for each element when sold separately. The sales price is discounted from the applicable list price based on various factors including the type of customer, volume of sales, geographic region and program level. The Company s list prices are generally not fair value as discounts may be given based on the factors enumerated above. The Company believes that the fair value of its consulting services is represented by the billable consulting rate per hour, based on the rates they charge customers when they purchase standalone consulting services. The price of consulting services is not based on the type of customer, volume of sales, geographic region or program level.

The Company uses historical sales transactions to determine whether VSOE can be established for each of the elements. In most instances, VSOE of fair value is the sales price of actual standalone (unbundled) transactions within the past 12 month period that are priced within a reasonable range, which the Company has determined to be plus or minus 15% of the median sales price of each respective price list.

VSOE of PCS is based on standalone sales since the Company does not provide stated renewal rates to its customers. In accordance with the Company s PCS pricing practice (supported by standalone renewal sales), renewal contracts are priced as a percentage of the undiscounted product list price. The PCS renewal percentages may vary, depending on the type and length of PCS purchased. The Company offers standard and premium PCS, and the term generally ranges from one to three years. The Company employs a bell-shaped-curve approach in evaluating VSOE of fair value of PCS. Under this approach, the Company considers VSOE of the fair value of PCS to exist when a substantial majority of its standalone PCS sales fall within a narrow range of pricing.

The Company is typically not able to determine TPE for its products or services. TPE is determined based on competitor prices for similar elements when sold separately. Generally, the Company s go-to-market strategy differs from that of other competitive products or services in its markets and the Company s offerings contain a significant level of differentiation such that the comparable pricing of products with similar functionality cannot be obtained. Furthermore, the Company is unable to reliably determine the selling prices on a stand-alone basis of similar products offered by its competitors.

When the Company is unable to establish selling price of its non-software elements using VSOE or TPE, the Company uses BESP in its allocation of arrangement consideration. The objective of BESP is to determine the price at which the Company would transact a sale if the product or service were sold on a stand-alone basis. The Company determines BESP for a product or service by considering multiple factors including, but not limited to, cost of products, gross margin objectives, pricing practices, geographies, customer classes and distribution channels.

The Company has established and regularly validates the VSOE of fair value and BESP for elements in its multiple element arrangements. The Company accounts for taxes collected from customers and remitted to governmental authorities on a net basis and excluded from revenues.

Goodwill

Goodwill represents the excess purchase price over the estimated fair value of net assets acquired as of the acquisition date. The Company tests goodwill for impairment on an annual basis and between annual tests when impairment indicators are identified, and goodwill is written down when impaired. Goodwill was recorded in connection with the acquisition of Acopia Networks, Inc. in fiscal year 2007, Swan Labs, Inc. in fiscal year 2006, MagniFire Websystems, Inc. in fiscal year 2004 and uRoam, Inc. in fiscal year 2003.

The Company performs its annual goodwill impairment test during the second fiscal quarter, or whenever events or changes in circumstances indicate that the carrying amount of goodwill may not be recoverable. The first step of the test identifies whether potential impairment may have occurred, while the second step of the test measures the amount of the impairment, if any. Impairment is recognized when the carrying amount of goodwill exceeds its fair value. For its annual goodwill impairment analysis, the Company operates under one reporting unit. The Company determined the fair value of its reporting unit based on the Company s enterprise value. In March 2011, the Company completed its annual impairment test and concluded there was no impairment of goodwill. The Company also considered potential impairment indicators at June 30, 2011 and noted no indicators of impairment.

Stock-Based Compensation

The Company accounts for stock-based compensation using the straight-line attribution method for recognizing compensation expense. The Company recognized $22.9 million and $17.4 million of stock-based compensation expense for the three months ended June 30, 2011 and 2010, respectively, and $67.6 million and $51.0 million for the nine months ended June 30, 2011 and 2010, respectively. As of June 30, 2011, there was $55.7 million of total unrecognized stock-based compensation cost, the majority of which will be recognized over the next two years. Going forward, stock-based compensation expenses may increase as the Company issues additional equity-based awards to continue to attract and retain key employees.

The Company issues incentive awards to its employees through stock-based compensation consisting of restricted stock units (RSUs). On July 29, 2011, the Company s Compensation Committee approved 833,739 RSUs to employees and executive officers pursuant to the Company s annual equity awards program. The value of RSUs is determined using the fair value method, which in this case, is based on the number of shares granted and the quoted price of the Company s common stock on the date of grant.

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The Company recognizes compensation expense for only the portion of restricted stock units that are expected to vest. Therefore, the Company applies estimated forfeiture rates that are derived from historical employee termination behavior. Based on historical differences with forfeitures of stock-based awards granted to the Company s executive officers and Board of Directors versus grants awarded to all other employees, the Company has developed separate forfeiture expectations for these two groups. The Company s estimated forfeiture rate in the third quarter of fiscal year 2011 is 2.7% for grants awarded to the Company s executive officers and Board of Directors, and 9.7% for grants awarded to all other employees. If the actual number of forfeitures differs from those estimated by management, additional adjustments to compensation expense may be required in future periods.

In August 2010, the Company granted 181,334 and 83,000 RSUs to certain current executive officers as part of the annual equity and retention awards programs, respectively. Fifty percent of the aggregate number of RSUs granted as part of the annual equity awards program vest in equal quarterly increments over three years, until such portion of the grant is fully vested on August 1, 2013. One-sixth of the annual equity awards RSU grant, or a portion thereof, was subject to the Company achieving specified quarterly revenue and EBITDA goals during the period beginning in the fourth quarter of fiscal year 2010 through the third quarter of fiscal year 2011. In each case, 50% of the quarterly performance stock grant is based on achieving at least 80% of the quarterly revenue goal and the other 50% is based on achieving at least 80% of the quarterly EBITDA goal. The quarterly performance stock grant is paid linearly above 80% of the targeted goals. At least 100% of both goals must be attained in order for the quarterly performance stock grant to be awarded over 100%. Each goal is evaluated individually and subject to the 80% achievement threshold and 100% over-achievement threshold. The remaining 33.33% of this annual equity awards RSU grant shall be subject to performance based vesting for each of the four quarter periods beginning with the fourth quarters of fiscal years 2011 and 2012 (16.66% in each period). The Compensation Committee of the Board of Directors will set applicable performance targets and vesting formulas for each of these periods. All RSUs granted as part of the retention awards program fully vest on August 1, 2013.

In August 2009, the Company granted 420,000 RSUs to certain current executive officers. Fifty percent of the aggregate number of RSUs granted at such time vest in equal quarterly increments over two years, until such portion of the grant is fully vested on August 1, 2011. Twenty-five percent of the RSU grant, or a portion thereof, was subject to the Company achieving specified quarterly revenue and EBITDA goals during the period beginning in the fourth quarter of fiscal year 2009 through the third quarter of fiscal year 2010 and the remaining twenty-five percent was subject to the Company achieving specified quarterly revenue and EBITDA goals during the period beginning in the fourth quarter of fiscal year 2010 through the third quarter of fiscal year 2011. In each case, 50% of the quarterly performance stock grant is based on achieving at least 80% of the quarterly revenue goal and the other 50% is based on achieving at least 80% of the quarterly EBITDA goal. The quarterly performance stock grant is paid linearly above 80% of the targeted goals. At least 100% of both goals must be attained in order for the quarterly performance stock grant to be awarded over 100%. Each goal is evaluated individually and subject to the 80% achievement threshold and 100% over-achievement threshold.

The Company recognizes compensation costs for awards with performance conditions when it concludes it is probable that the performance condition will be achieved. The Company reassesses the probability of vesting at each balance sheet date and adjusts compensation costs based on the probability assessment.

Common Stock Repurchase

On October 22, 2008, the Company announced that its Board of Directors approved a program to repurchase up to an additional $200 million of the Company s outstanding common stock. As of September 30, 2010, the Company had $37.6 million remaining to purchase shares as part of this repurchase program. On October 26, 2010, the Company announced that its Board of Directors approved a new program to repurchase up to an additional $200 million of the Company s outstanding common stock. Acquisitions for the share repurchase programs will be made from time to time in private transactions or open market purchases as permitted by securities laws and other legal requirements. The programs can be terminated at any time. As of August 2, 2011, the Company had repurchased and retired 5,666,566 shares at an average price of $51.09 per share and the Company had $110.2 million remaining to purchase shares as part of its repurchase programs.

Earnings Per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income by the weighted average number of common and dilutive common stock equivalent shares outstanding during the period. The Company s nonvested restricted stock awards and restricted stock units do not have nonforfeitable rights to dividends or dividend equivalents.

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

	Three months ended June 30,		Nine months ended June 30,	
	2011	2010	2011	2010
Numerator				
Net income	$ 62,549	$ 40,495	$ 173,787	$ 102,918
Denominator				
Weighted average shares outstanding basic	80,866	79,864	80,773	79,386
Dilutive effect of common shares from stock options and restricted stock units	631	1,167	882	1,484
Weighted average shares outstanding diluted	81,497	81,031	81,655	80,870
Basic net income per share	$ 0.77	$ 0.51	$ 2.15	$ 1.30
Diluted net income per share	$ 0.77	$ 0.50	$ 2.13	$ 1.27

An immaterial amount of common shares potentially issuable from stock options for the three and nine months ended June 30, 2011 and 2010, are excluded from the calculation of diluted earnings per share because the exercise price was greater than the average market price of common stock for the respective periods.

Comprehensive Income

Comprehensive income includes certain changes in equity that are excluded from net income. Specifically, unrealized gains (losses) on securities and foreign currency translation adjustments are included in accumulated other comprehensive loss. Comprehensive income and its components were as follows (in thousands):

	Three months ended June 30,		Nine months ended June 30,	
	2011	2010	2011	2010
Net Income	$ 62,549	$ 40,495	$ 173,787	$ 102,918
Unrealized gain (loss) on securities, net of tax	1,273	(277)	310	(1,088)
Foreign currency translation adjustment	(101)	(724)	(529)	(1,170)
Total comprehensive income	$ 63,721	$ 39,494	$ 173,568	$ 100,660

Recent Accounting Pronouncements

Management believes there have been no significant changes during the nine months ended June 30, 2011, to the items disclosed as recently adopted accounting pronouncements in Management s Discussion and Analysis of Financial Condition and Results of Operations in the Company s Annual Report on Form 10-K for the year ended September 30, 2010. For a further discussion, refer to the Recent Accounting Pronouncements discussion contained therein.

2. Fair Value Measurements

In accordance with the authoritative guidance on fair value measurements and disclosure under GAAP, the Company determines fair value using a fair value hierarchy that distinguishes between market participant assumptions developed based on market data obtained from sources independent of the reporting entity, and the reporting entity s own assumptions about market participant assumptions developed based on the best information available in the circumstances and expands disclosure about fair value measurements.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the