

NETSCOUT SYSTEMS INC

Form 10-K

May 20, 2015

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended March 31, 2015

OR

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

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

Commission file number 0000-26251

NETSCOUT SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware

04-2837575

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

310 Littleton Road, Westford, MA 01886

(978) 614-4000

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

Name of each exchange on which registered: NASDAQ  
Global

Common Stock, \$0.001 Par value

Select Market

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

YES  NO

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

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

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

Indicate by check mark whether the registrant 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

Edgar Filing: NETSCOUT SYSTEMS INC - Form 10-K

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

The aggregate market value of common stock held by non-affiliates of the registrant as of September 30, 2014 (based on the last reported sale price on the Nasdaq Global Select Market as of such date) was approximately \$1,763,327,709. As of May 13, 2015, there were 40,761,729 shares of the registrant’s common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant’s Proxy Statement for the fiscal year 2015 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K. Except as expressly incorporated by reference, the proxy statement is not deemed to be part of this report.

---

Table of Contents

NETSCOUT SYSTEMS, INC.  
 FORM 10-K  
 FOR THE FISCAL YEAR ENDED MARCH 31, 2015  
 TABLE OF CONTENTS

PART I

Item 1.	<u>Business</u>	<u>3</u>
Item 1A.	<u>Risk Factors</u>	<u>12</u>
Item 1B.	<u>Unresolved Staff Comments</u>	<u>25</u>
Item 2.	<u>Properties</u>	<u>25</u>
Item 3.	<u>Legal Proceedings</u>	<u>25</u>
Item 4.	<u>Mine Safety Disclosures</u>	<u>25</u>

PART II

Item 5.	<u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>26</u>
Item 6.	<u>Selected Financial Data</u>	<u>29</u>
Item 7.	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>30</u>
Item 7A.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>49</u>
Item 8.	<u>Financial Statements and Supplementary Data</u>	<u>50</u>
Item 9.	<u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	<u>50</u>
Item 9A.	<u>Controls and Procedures</u>	<u>50</u>
Item 9B.	<u>Other Information</u>	<u>50</u>

PART III

Item 10.	<u>Directors and Executive Officers of the Registrant</u>	<u>51</u>
Item 11.	<u>Executive Compensation</u>	<u>51</u>
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>51</u>
Item 13.	<u>Certain Relationships and Related Transactions</u>	<u>51</u>

Item 14.	<u>Principal Accountant Fees and Services</u>	<u>51</u>
PART IV		
Item 15.	<u>Exhibits and Financial Statement Schedule</u>	<u>52</u>
	<u>Signatures</u>	<u>53</u>

---

Table of Contents

PART I

Item 1. Business

Overview

We are an industry leader for advanced network, application and service assurance solutions, providing high-quality performance analytics that help enterprise, government and service provider customers proactively manage service delivery and identify emerging performance problems. Our offerings help customers around the world quickly resolve technology issues that cause business disruptions or negatively impact the user experience. We design, develop, manufacture, market, license, sell and support these products in integrated hardware and software solutions that are used by commercial enterprises, large governmental agencies and telecommunication service providers in some of the world's largest, most demanding and complex internet protocol (IP) based service delivery environments.

We have been a technology innovator in the three-plus decades since our founding in 1984. Our solutions continue to change how organizations manage and optimize the delivery of business applications and services and assure user experience across global IP networks. We have continually enhanced and expanded our product portfolio to meet the needs of organizations by providing solutions to manage dynamic network and application environments and by improving user experience by providing high-value analytics that help validate and assure service availability, quality and reliability. Our solutions are based on a patented Adaptive Service Intelligence™ (ASI) technology which uses traffic data to provide important service metrics related to network, application, server, database, and user communities performance in real-time.

Our solutions are intended to help users in various roles within enterprises, government agencies and service providers to: quickly analyze data, achieve real-time visibility into and intelligence about their organization's operations, identify service delivery issues early, improve service levels, reduce operational costs, mitigate security risks, and drive better business decisions. By providing a highly scalable and flexible real-time service delivery management platform, our customers are able to optimize the performance of their IP-based networks and the applications and services that run across them, using our analytics to proactively identify and resolve potential issues before users are impacted. As a result, our customers are able to maximize their return on investment and mitigate a myriad of risks associated with unreliable service delivery and poor user experience. Our value proposition to our customers is helping them to manage their complex network and IT infrastructures to achieve their business and financial objectives.

Our mission is to enable IT groups and service providers to realize maximum benefit with minimal risk from technological advances, like IP convergence, network function virtualization (NFV), software defined networking (SDN), virtualization, cloud, mobility, bring your own device (BYOD), web, and the scale of the evolving Internet of Things (IoT) by managing the inherent complexity in a cost-effective manner. Our Adaptive Service Intelligence (ASI) technology has the potential of not only expanding our leadership in the network performance management (NPM) and application performance management (APM) space, but also has potential to extend our reach into new adjacent markets such as cyber security and business intelligence.

Many of the largest service providers, cloud-based businesses and enterprise customers rely on us to assure service delivery and a high-quality experience for their end users. Our customers are in just about every vertical market including financial, health care, utilities, internet, manufacturing, retail, and transportation, as well as service providers and major government agencies. We are a market leader in helping service providers get a return on their 4G/LTE investment by providing them with the intelligence they need about a range of important aspects of service delivery from handset performance on their networks and subscriber preferences to network traffic trends and overall network speed.

We have three primary customer groups; enterprise customers, service provider customers and government customers. Within the enterprise and government segments, our solutions support a wide-range of enterprise IT operations and management organizations including network operations, application managers, network operations centers, network engineering, security operations and service delivery teams. Within the service provider segment, our solutions support a broad range of operational users including network operations, group network engineering, service

operations, application groups, customer care, marketing, chief technology officers and advanced engineering groups. We market and distribute our products globally through our own direct sales force and through strategic channel partners that include distributors, value added resellers and systems integrators. For our enterprise customers, we focus on the Global 5000, which includes diverse industries such as financial, healthcare, manufacturing, retail, technology, utilities, high-tech and education. Our government customers include domestic agencies of federal, state and local governments as well as international government agencies. In the service provider customer group, we sell to mobile operators, wireline operators and cable multi-service operators globally.

## Table of Contents

We have a single operating segment and substantially all of our identifiable assets are located in the United States. Financial information about our operating segment and geographic areas is presented in Item 7, Management Discussion and Analysis and Note 18 of our Notes to Consolidated Financial Statements.

On October 12, 2014, NetScout, Danaher Corporation (Danaher), Potomac Holding LLC, a wholly-owned subsidiary of Danaher (Newco), RS Merger Sub I, Inc., a wholly-owned subsidiary of the NetScout (Merger Sub) and RS Merger Sub II, LLC, a wholly-owned subsidiary of NetScout (Merger Sub II and, together with Merger Sub, the Merger Subs), entered into an Agreement and Plan of Merger and Reorganization (the Merger Agreement) pursuant to which NetScout will acquire the communications group business of Danaher conducted under the brands Tektronix Communications, Fluke Networks and Arbor Networks, but excluding Danaher's data communications cable installation business and its communication service provider business (the Communications Business) in a Reverse Morris Trust transaction (the Transaction). For additional information regarding the proposed acquisition, see Note 20 of our Notes to Consolidated Financial Statements.

### Markets

#### Enterprise Markets

Within the enterprise market, NetScout's nGenius® and Infinistream® technologies enable IT organizations to protect and improve service delivery quality and identify and address business service performance issues before they become serious and affect large numbers of users. Some of the current enterprise IT initiatives our solutions support include:

• **IT Operational Excellence** – We deliver real-time and historical information that provides the necessary insight to restore service, manage capacity, and understand the quality of the users' experience.

• **Data Center Modernization and Cloud Computing** – We enable IT organizations to manage the delivery of services across virtual and physical environments, providing a comprehensive, unified real-time view into network, application, server, and user communities' performance. We proactively detect emerging issues with the ability to help analyze both physical and virtual services delivery environments within the data center enables organizations to optimize datacenter infrastructure investments, protect against service degradations, and simplify the operation of complex, multi-tier application environments in consolidated, state-of-the-art data centers. Our solutions are often used by enterprises to support private cloud computing environments that are aimed at enabling greater, more cost-effective accessibility to applications without compromising the reliability and security of those applications and the network.

• **Unified Communications (UC)** – We deliver deep application-level unified visibility into voice, data and video services side-by-side in order to understand the interrelationships of all UC services that traverse the network infrastructure and assess quality and performance of the delivery of these services. As a result, our real-time, actionable intelligence helps customers to deliver a high-quality UC experience as users make calls, video conference and engage in instant messaging. We also help desktop, network, telecom, and application teams manage UC through a common platform across complex, geographically dispersed, and multi-vendor environments.

• **New Application Service Rollout** - We provide enterprise customers with a holistic view of the new applications and services as they are introduced into their IT environment. This view enables customers to see the relationships and interdependencies across all service delivery components including applications, network, servers, databases, and enabling protocols so they can deliver a superior user experience, achieve outstanding service quality and drive return on their application investments.

• **Application and Desktop Virtualization** - We provide clear and actionable insights that help customers fully realize the operational benefits associated with Application and Desktop Virtualization, and reduce the time it takes to identify and resolve service problems. We offer visibility across all virtual desktop infrastructure (VDI) tiers including remote access, client, virtualization, web, front-end application, and related database systems, and help customers gain actionable metrics from monitoring and analyzing the consumption and performance of VDI services.

• **CyberSecurity** – Cyberattacks are becoming more sophisticated and target users, applications, infrastructure, and mobile devices. We provide an additional layer of visibility that provides insight into potential emerging security issues missed by traditional security tools. We also provide incident response activities with deep-dive network forensics and offer contextual information surrounding a specific alert or incident to enhance investigative capabilities

and avoid false positives.

4

---



## Table of Contents

### Government Markets

Similar to our enterprise markets, government agencies are focused on streamlining and transforming IT into more efficient and more easily managed environments. To accomplish this, agencies are turning to IT solutions that will help simplify managing and assuring their IT environments as well as reduce costs. However, governmental markets differ from enterprise markets in that their purchasing cycles are driven by a political process and allocated funding.

### Telecommunication Service Provider Markets

Today's service providers are focused on creating a compelling set of services, with a high quality user experience, while also keeping an eye on reducing operational complexity and costs. This, coupled with the challenge of Internet Protocol (IP) transformation activities and emerging new technologies such as LTE, virtualization, Internet Protocol Television (IP-TV), wireless network (WiFi) and cloud services drives the need for a more automated and unified approach to managing service delivery and the subscriber experience. Service providers must reduce the cost of service delivery, address increasing complexity, scale globally and adapt to emerging technologies such as cloud services, virtualization and unified communication services while assuring high quality user experiences to retain their revenue base.

For Mobile Operators – The fundamental transformation of the mobile network to all-IP enables mobile operators to build highly-scalable service delivery environments to offer new services to meet the growing subscriber demand for data, voice and video-centric services and to consolidate and simplify network operations. However, to capitalize fully on the value of IP and the significant market opportunities, mobile operators need detailed IP packet-level insight and core-to-access visibility.

For Fixed-line and Cable Operators – The growing demand for high-bandwidth triple-play services, broadband connectivity, content anywhere, IP-TV, on-demand video traffic, new extended WiFi initiatives and carrier Ethernet services presents service providers with significant revenue opportunities. IP has become the de facto convergence mechanism for access, distribution and core networks, enabling new service offerings, simplifying network operations while reducing total cost of operations. For example, we also are starting to see cable operators use our solutions to monitor and manage their local area WiFi connectivity services. To realize these benefits, operators need comprehensive insight into IP services, service usage, service availability, application awareness, traffic load, network availability and network performance.

### Products & Technology Overview

NetScout continuously develops its solutions to meet the increasing demands and ever changing technology landscape of IP networks, service and applications. In recent years, we have delivered major product upgrades across our product lines, more tightly integrating deep packet analysis and forensics into our top-down performance management workflows, improving the flexibility of our industry-leading intelligent early warning capabilities, and adding support for new sources of user experience and performance related metrics.

During Fiscal Year 2015, we continued to invest in development programs aimed at enhancing our range of offerings, including delivering new features and functionality for our nGeniusONE™ Service Assurance platform that addresses the evolving requirements of our enterprise, service provider and government customers. The nGeniusONE platform is powered by Adaptive Service Intelligence™ (ASI) 2.0, NetScout's next generation Deep Packet Inspection (DPI) technology that exploits the inherent richness of packet-flow data to provide real-time, contextual analysis of service, network, and application performance. The patented ASI technology is a critical differentiating technology that enables the creation of statistical metadata, session transaction records and adaptive session traces enabling real-time, scalable monitoring of all users, all applications and all services consistently across the network. NetScout's solutions are used by customers to better understand and manage network and application performance, alert themselves to problems that impacting end users, validate services and network policy, plan and optimize network capacity, generate timely reports and conduct deep forensic and historical analysis. Key products include:

nGeniusONE™ Service Assurance Solution – Used to support NetScout's enterprise, service provider and government customers, the nGeniusONE Service Assurance Solution platform enables customers to predict, preempt, and resolve network and service delivery problems while facilitating the optimization and capacity planning of their network

infrastructures. Key features within the nGeniusONE™ platform include:

- Service Dashboard - Providing at-a-glance metrics, holistic status visibility of business services, network and application components, enabling network and IT professionals to focus their triage efforts where needed most.

5

---

Table of Contents

Performance Analysis: Offering comprehensive analysis of specific application transactions, such as email, databases, enabling services, and unified communications, as well as traffic analysis to identify the root cause of performance issues. The specialized service monitors provide holistic visibility into application sessions, their query/response volume, their latencies, and any errors associated with the specific servers, including affected user communities.

Session Analysis: Enabling drilldowns, with context, from service monitors to specific session-level analysis related to the issue being investigated.

Packet Analysis: Facilitating detailed analysis of network traffic at a granular, packet level, along with forensic evidence collection that is relevant to the issue at hand based on the context of the workflows already performed.

NetScout's nGeniusONE Service Assurance Solution also provides other high-value complementary capabilities including:

nGenius UC Server for monitoring and managing advanced unified communications (UC) across a range of collaboration tools including IP-based telephony, video and instant messaging;

nGenius Subscriber Intelligence for visibility into mobile data sessions across a range of mobile network architectures;

NetScout's product family also includes:

nGenius Intelligent Data Sources for data collection - NetScout's Intelligent Data Sources provide the capabilities of gathering and analyzing information rich packet-flow data from across the network to enable the granular analysis and reporting capabilities of the nGenius Service Assurance Solution. The nGenius Intelligent Data Sources consist of:

(1) the InfiniStream appliances, which provide hardware-based data capture and metadata creation for the nGenius Service Assurance Solution; (2) the nGenius VI2000, which extends NetScout's visibility into virtualized and cloud environments by embedding the ASI technology into virtual machines (VMs); and (3) nGenius Collectors, which support collection of network-based statistics from network equipment supporting standards-based data such as Cisco NetFlow, jFlow and sFlow.

nGenius Packet Flow Switches and Taps for data aggregation and distribution - NetScout's comprehensive network monitoring fabric switching solution provides targeted network traffic access to an increasing number of monitoring systems, including the nGeniusONE Performance Management platform, as well as other monitoring and security systems. It enables flexible access to packet-flow traffic to support diverse network traffic monitoring operations including performance management, service delivery management, and security monitoring. NetScout's Test Access Point (TAP) family provides the nGenius InfiniStream appliances and nGenius packet flow switches with full, non-disruptive access to network traffic while remaining transparent to the networking infrastructure with multiple link type and speed options.

NetScout Test Optimization Products - NetScout's packet flow switches and management software support test laboratories in their efforts to optimize the performance and speeds of network equipment within simulated network infrastructures.

nGenius NetFlow Solutions for analyzing and managing enterprise networks by leveraging specific flow-based data such as Cisco NetFlow, Juniper J-Flow, sFlow, Huawei NetStream, and Cisco IP SLA test results collected from flow-capable network devices such as routers or switches.

## Table of Contents

### Integration with Third-party Solutions

To have greater operational impact on assuring performance of applications and service delivery, NetScout has integrated its technology with third-party management consoles and business service management systems. This integration allows organizations to receive alarms on impending performance problems and to link into the nGenius Service Assurance solution in order to perform detailed problem analysis and troubleshooting. By providing seamless integration into management platforms, NetScout fills a significant gap in the third party product functionality and visibility into the interaction of applications, services and infrastructure resources from a packet-based network vantage point. NetScout collaborates with technology partners to provide integrated solutions and extend the value of the nGenius Service Assurance Solution for application and network performance management across the organization. Using packet-flow data, key performance indicators and other sources of performance information derived from the nGenius Service Assurance Solution, an organization's ability to optimize, simplify and protect the service delivery environment are enhanced. Among the third-party solutions providers that NetScout has integrated its solutions with are Cisco Systems, Cisco Sourcefire, Citrix Systems, EMC Corporation, Hewlett-Packard Company, IBM Tivoli and VMWare.

### Growth Strategy

Our key objectives have been to continue to gain market share in the wireless service provider market and to accelerate our enterprise growth by extending into the application performance management segment. In addition, given the nature of the customers in our government segment, we believe future cybersecurity products would be effective in this market. We believe that the acquisition of Danaher's Communications Business (see Note 20 of our Consolidated Financial Statements) will further accelerate key elements of our strategy, which include:

**Drive technology innovation** – NetScout will continue to invest in research and development, and leverage the strong technical and domain expertise across its organization. As a result of the planned acquisition of the Communications Business, NetScout's base of research and development professionals is expected to grow by more than 400% from its current level of over 350 people. The combined company's engineering teams will be focused on advancing technical innovation across its broad product portfolio. By capitalizing on NetScout's extensive experience with global enterprise, service provider and government organizations with IP-based networks, NetScout will be well positioned to cross-leverage its technology development across all major platforms and relevant technologies to address the evolving demands of current and prospective customers. NetScout works closely with its largest enterprise and service provider customers to better understand and address their near-term and longer-term requirements. By better understanding the key, time-sensitive needs of NetScout's global customer base, NetScout will continue to enhance and extend its product line to meet the increasing challenges of managing a diverse range of services over an increasingly global network environment.

**Continued portfolio enhancements** – We plan to continue to enhance our products and solutions to address the management challenges associated with virtualization, cloud computing, service-oriented architectures, VoIP, video, and telepresence technologies. In addition, we will continue to drive our solutions to help IT organizations address the challenges of complex service delivery, datacenter consolidation, branch office consolidation and optimization, increasing mobility and the move to a more process-oriented operating environment. The acquisition will add Tektronix Communications' high-value troubleshooting capabilities, which targets service providers, with Fluke Networks' troubleshooting capabilities, which targets small to mid-sized enterprises. These capabilities are expected to complement NetScout's traditional strengths in monitoring large, complex IP-based networks and the mission-critical services that run across them. Over the longer term, NetScout anticipates that the post-acquisition product roadmap integration would support migrating key features and functionalities from various product platforms into new, higher value solutions at more attractive price points that will appeal to a broader range of customers globally.

**Extension into adjacent markets** – By enhancing and expanding NetScout's product portfolio, NetScout can also enter complementary adjacent markets that will help it further expand its customer relationships and increase its total addressable market. For example, the acquisition of the Arbor Networks business will bring new security offerings that complement NetScout's core range of solutions by helping customers identify, mitigate and remediate complex technical threats and unauthorized intrusions into their network and IT infrastructures. The Arbor Networks business

will accelerate NetScout's entry into cyber security with market-leading solutions used by leading service providers and enterprises to prevent and mitigate distributed denial of service (DDoS) attacks. In addition, the acquisition will bring new solutions for optimizing the radio access networks (RANs) of service providers and sophisticated business intelligence analytics that are used by service providers to increase customer satisfaction, reduce churn, and increase profits.

• Enable pervasive visibility – We intend to continue to expand our intelligent data source family to enable our customers to achieve greater visibility into more places across their end-to-end network environment. We plan to

7

---

## Table of Contents

integrate various capabilities, including our Adaptive Service Intelligence software, across the combined company's product portfolio to enable wider deployment of our technology within virtual computing environments, network devices and computing platforms and to support a broader range of network and application performance management, security and business intelligence requirements. This includes fortifying and enhancing our capabilities and technology by supporting new and innovative ways to address the ongoing challenges associated with the increasing volume of data traffic and enable scalable support for 40 Gigabit, 100 Gigabit topologies and increasing global deployments of IPv6. Advancing these capabilities will enable NetScout to cross-sell a wider range of solutions into NetScout's existing base of customers using solutions from the Communications Business, as well as increase business with the current base of Communications Business customers by cross-selling NetScout solutions.

Expand our customer base in both enterprise and service provider markets – It is our intention to substantially grow our presence in both the enterprise and service provider markets. In the enterprise market, we are growing our installed base to include a broader number of top-tier enterprise customers as well as extending to reach mid-market enterprise customers. We intend to increase the use of our products across the IT organization to include new operational groups by expanding their capabilities and value. In the service provider market, we are expanding our presence by winning new service provider customers. We are also expanding our service provider footprint further out into the radio access network and deeper into the core. As a result of the acquisition, NetScout will have a larger direct sales force with specialized expertise in targeting the enterprise, service provider and government markets, along with a more extensive global network of value-added resellers and systems integrators.

Increase market relevance and awareness – The acquisition will substantially expand our customer base around the world. To generate increased demand for NetScout's products, NetScout will implement marketing campaigns aimed at promoting its thought leadership and driving lead generation for its technology, products and solutions among both enterprise and service provider customers. In addition, we will continue to drive industry initiatives around managing service delivery.

Extend our technology partner alliance ecosystem – Supporting a larger, more global customer base as a result of the acquisition will require alliances with complementary solutions providers. We plan to continue to enhance our technology value, product capabilities and customer relevance through the continued integration of our products into technology partner products. This includes both interoperability integration efforts, as well as embedding our technology into alliance partner products to gain a more pervasive footprint across both enterprise and service provider networks.

Pursue strategic acquisitions – We completed five acquisitions in recent years that helped broaden our capabilities, products and technologies, and better position the Company to meet the needs of its customers and prospects. After the acquisition of the Communications Business, we plan to be opportunistic in pursuing strategic acquisitions in order to achieve key business and technology objectives.

Improve cost structure and drive efficiencies – We have continued to improve our profitability as we have expanded our business. We will continue to focus on directing prudent investment into the key technology, product development, sales and marketing, and other initiatives that will enable us to drive long-term profitable growth. We believe that the Danaher Communications Business acquisition will create a range of opportunities to further improve the Company's operating profitability by pursuing cost synergies. NetScout will seek to leverage its purchasing power and extend its proven manufacturing techniques in ways that can improve product gross margin. In addition, NetScout plans to integrate certain operations that have previously been managed separately across various business and product lines. NetScout also expects to achieve synergies by using common infrastructure platforms, and by eliminating or reducing redundancies associated with pre-existing resources, programs and capabilities.

### Support Services

Customer satisfaction is a key driver of NetScout's success. NetScout's MasterCare™ support programs offer customers various levels of high quality support services to assist in the deployment and use of our solutions. We have support personnel strategically deployed across the globe to deliver 24/7 telephone support to our premium MasterCare customers. Certain support services, such as on-site support activities, are provided by qualified third party support partners. In addition many of our certified resellers provide Partner Enabled Support to NetScout end-users. This is

especially prevalent in international locations where time zones and language, among other factors, make it more efficient for end-users to have the reseller provide initial support functions. MasterCare support also includes updates to our software and firmware at no additional charge, if and when such updates are developed and made generally available to our commercial customer base. If ordered, MasterCare support commences upon expiration of the standard warranty for software. For software, which also includes firmware, the standard warranty commences upon shipment and expires 90 days thereafter. With regard to hardware, the standard warranty

## Table of Contents

commences upon shipment and expires 12 months thereafter. We believe our warranties are consistent with commonly accepted industry standards.

### Manufacturing

Our manufacturing operations consist primarily of final product assembly, configuration and testing. We purchase components and subassemblies from suppliers and construct our hardware products in accordance with NetScout standard specifications. We inspect, test and use process control to ensure the quality and reliability of our products. We maintain an ISO 9001 quality systems registration, a certification showing that our corporate procedures and manufacturing facilities comply with standards for quality assurance and process control. We also maintain an ISO 9001:2000 quality systems registration, a certification showing that our corporate procedures comply with standards for continuous improvement and customer satisfaction.

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

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

### Sales and Marketing

#### Sales

We sell our products, support and services through a direct sales force and an indirect reseller and distribution channel.

Our direct sales force uses a “high-touch” sales model that consists of face-to-face meetings with customers to understand and identify their unique business challenges and requirements. Our sales teams then translate those requirements into tailored business solutions that allow the customer to maximize the performance of its infrastructure and service delivery environment. Due to the complexity of the systems and the capital expenditure involved, our sales cycle typically takes three to twelve months. We build strategic relationships with our customers by continually enhancing our solution to help them address their evolving service delivery management challenges. In addition to providing a comprehensive solution to meet these needs, we continually provide software enhancements to our customers as part of their maintenance contracts with us. These enhancements are designed to provide additional and ongoing value to our existing customers to promote loyalty and the expansion of their deployment of our products. Existing customer growth is also driven by the expansion and changes in their networks as they add new infrastructure elements, new users, new locations, new applications and experience increasing service traffic volumes.

We also maintain an indirect reseller and distribution channel. Sales to customers outside the United States are primarily export sales through channel partners. Our channel partners assist us by improving our reach to customers, extending our presence in new markets, and marketing and selling our products to a broad array of organizations globally. We sell through a range of channel partners including value added resellers, value added distributors, resellers, and system integrators, to our enterprise, service provider and government customers. Historically and currently, we have used indirect distribution channels principally as intermediaries on contractual terms for customers with whom we have no contract. Our sales force meets with end user customers to present NetScout products and solutions, conduct demonstrations, provide evaluation equipment, recommend detailed product solutions, develop product deployment designs and timelines, and assist in establishing financial and other justification for the proposed solution. During this selling process, a channel partner, who has contracts with both the end customer and NetScout, may be brought in to facilitate the transaction and to provide fulfillment services. In the case of international channel partners, those services usually also include currency translation and support. In the U.S., fulfillment services are usually limited to invoicing and cash collection. Under this approach, we have limited dependence upon channel



partners for the major elements of the selling process. In many cases, there are multiple channel partners with the required contractual relationships, so dependence on any single channel partner is not significant. Total revenue from indirect channels represented 49% of our total revenue for the fiscal years ended March 31, 2015, 2014 and 2013. During the fiscal year ended March 31, 2015, two direct customers accounted for more than 10% of total revenue, while no indirect channel partner accounted for more than 10% of total revenue. During the fiscal year ended March

## Table of Contents

31, 2014, one direct customer accounted for more than 10% of total revenue, while no indirect channel partner accounted for more than 10% of total revenue. During the fiscal year ended March 31, 2013, no direct customer or indirect channel partner accounted for more than 10% of total revenue.

Our sales force is organized into four main geographic teams covering sales around the globe: United States, Europe, Asia and the rest of the world. Revenue from sales outside the United States represented 23%, 24% and 25% of our total revenue in the fiscal years ended March 31, 2015, 2014 and 2013, respectively. For additional information regarding our sales by geographic location, see Note 18 of our Notes to Consolidated Financial Statements.

### Marketing

Our marketing organization drives our market research, strategy, product positioning and messaging and produces and manages a variety of programs such as advertising, trade shows, industry events, public and analyst relations, social media, direct mail, seminars, sales promotions, and web marketing to promote the sale and acceptance of our solutions and to build the NetScout, ASI®, nGenius® and Infinistream® brand names in the marketplace. We also host an annual worldwide user conference as a way to engage with existing customers, to provide education and awareness, and to promote expanded use of our software with these customers.

Key elements of our marketing strategy focus on thought leadership, market positioning, market education, go to market strategies, reputation management, demand generation, and the acceleration of our strategic selling relationships with local and global resellers, systems integrators, and our technology alliance partners. During fiscal year 2015, NetScout began investment to redesign the NetScout logo and further fortify and amplify the NetScout brand. These activities are expected to continue into fiscal year 2016.

### Research and Development

Our continued success depends significantly on our ability to anticipate and create solutions that will meet emerging customer requirements. We have invested significant financial resources and personnel into the development of our products and technology. Our continued investment in research and development is crucial to our business and our continued success in the market. We have assembled a team of highly skilled engineers with expertise in various technologies associated with our business and the technologies being deployed by our customers. We plan to continue to expand our product offerings and capabilities in the near future, and, therefore, plan to continue to invest and dedicate significant resources to our research and development activities. In addition, as we continue to expand our position in the service provider market, we will need to continue to expand our offerings and focused capabilities for these customers. We will continue to make substantial investments in growing our service provider technology expertise to maintain and grow our market and technology lead for this rapidly growing market opportunity.

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

### Seasonality

We have experienced, and expect to continue to experience, quarterly variations in our order bookings as a result of a number of factors, including the length of the sales cycle, complexity of customer environments, new product introductions and their market acceptance and seasonal factors affected by customer projects and typical IT buying cycles. Due to these factors, we historically have experienced stronger bookings during our fiscal third and fourth quarters than in the first and second quarters.

### Customers

We sell our products to enterprises, service providers and governmental agencies with large- and medium-sized high-speed IP computer networks. Our enterprise customers cover a wide variety of industries, such as financial services, technology, manufacturing, healthcare, utilities, education, transportation and retail. In the telecommunications service provider customer group we address mobile operators, wireline operators and cable operators. A significant number of our service provider customers are mobile operators.



## Table of Contents

NetScout solutions are deployed at more than 20,000 of the world's largest enterprises, government agencies, and more than 165 service providers, on over one million physical and 2,000 virtual network segments.

### Backlog

We produce our products on the basis of our forecast of near-term demand and maintain inventory in advance of receipt of firm orders from customers. We configure our products to customer specifications and generally deliver products shortly after receipt of the purchase order. Service engagements are also included in certain orders. Customers generally may reschedule or cancel orders with little or no penalty. We believe that our backlog at any particular time is not meaningful because it is not necessarily indicative of future sales levels. Our combined product backlog at March 31, 2015, consisting of orders booked or received prior to our year end, was an immaterial amount compared to \$37.4 million at March 31, 2014.

### Competition

We compete with many companies in the markets we serve. The service assurance and performance management market is highly competitive, rapidly evolving, and fragmented with overlapping technologies and a wide range of competitors. Consequently, there are a number of companies that deliver some elements of our solutions.

Principal competitive factors in our market include scalability; ability to address a large number of applications, locations and users; product performance; the ability to easily deploy into existing network environments; the ability to offer virtualized solutions; and the ability to administer and manage the solution.

While NetScout faces multiple competitors within the service assurance industry, we believe that we compete favorably on the basis of these factors. We provide a comprehensive service delivery management solution that is capable of addressing the needs of both enterprise and service provider customers and can be scaled to meet the challenges of today's dynamic service delivery environments. We believe that our solutions provide superior data and compete favorably on a broad range of metrics including the ability to recognize and track a large number of applications, scalability to support high and increasing levels of data and network traffic, the ability to look at both data and control plane traffic across an entire network, and the ability to provide real-time information about service performance and real-time alerts to emerging service problems.

In the enterprise market, our competitors include companies such as Avaya, AppDynamics, CA Technologies, Compuware, ExtraHop, Fluke Networks, InfoVista, Ixia, JDSU (through its Network Instruments business that was acquired in 2014), Gigamon, Lancope, New Relic, Riverbed Technology and SolarWinds. In addition, we both compete with and partner with large enterprise management vendors, such as HP and IBM, who offer performance management solutions.

In the service provider market, we compete with probe vendors, network equipment manufacturers, big data and analytics vendors, and virtualization vendors. These vendors include Alcatel-Lucent, Astellia, Anritsu, Cisco, Empirix, Ericsson, EMC, EXFO, Guavas, Huawei, IBM, JDSU, Niksun, Polystar, Radcom, SevOne, Splunk, Tektronix and Zettics. We face additional competitive threats from startups and new entrants that seek to offer innovative solutions in an industry characterized by rapid technological change.

Our ability to sustain a competitive advantage depends on our ability to deliver continued technology innovation and adapt to meet the evolving needs of our customers. Competitive factors in our industry are further described in Item 1A "Risk Factors."

### Intellectual Property Rights

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

NetScout uses contracts, statutory laws, domestic and foreign intellectual property registration processes, and international intellectual property treaties to police and protect its intellectual property portfolio and rights from infringement. From a contractual perspective, NetScout uses license agreements and non-disclosure agreements to control the use of our intellectual property and protect NetScout trade secrets from unauthorized use and disclosure. In addition to license agreements, NetScout relies on U.S. and international copyright law to protect against unauthorized

copying of software programs, in the U.S. and abroad. NetScout has obtained U.S. and foreign trademark registrations to preserve and protect certain trademarks and trade names. NetScout has also filed and obtained U.S. patents and international counterparts to protect certain unique NetScout inventions from being unlawfully exploited by other parties. However, there is no assurance that pending or future patent

Table of Contents

applications will be granted, that we will be able to obtain patents covering all of our products, or that we will be able to license, if needed, patents from other companies on favorable terms or at all. Our proprietary rights are subject to other risks and uncertainties described under Item 1A “Risk Factors.”

**Employees**

At March 31, 2015, we had a total of 1,069 employees, 697 of whom were employed in the United States. The majority of our employees are not subject to a collective bargaining agreement. In accordance with applicable law, employees in certain international jurisdictions are subject to collective bargaining agreements. Employees by department at March 31, 2015 were as follows:

Function	Number of Employees
Sales and marketing	373
Research and development	357
Support services	178
General and administrative	128
Manufacturing	33
	1,069

**Corporate information**

Our corporate headquarters are located at 310 Littleton Road, Westford, Massachusetts, and our telephone number is (978) 614-4000. NetScout was incorporated in Delaware in 1984.

NetScout’s internet address is <http://www.netscout.com>. Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended (Exchange Act), are made available free of charge on or through our website at <http://ir.netscout.com/phoenix.zhtml?c=92658&p=iro1-sec> as soon as reasonably practicable after such reports are filed with, or furnished to, the Securities and Exchange Commission (the SEC). None of the information posted on our website is incorporated by reference into this Annual Report.

We webcast our earnings calls and certain events we participate in or host with members of the investment community are made available on our investor relations web-site at

<http://ir.netscout.com/phoenix.zhtml?c=92658&p=iro1-calendar>. Additionally, we provide notifications of news or announcements regarding our financial performance, including SEC filings, investor events, press and earnings releases, as part of our investor relations web-site. The contents of these sections of our investor relations website are not intended to be incorporated by reference into this report or in any other report or document we file.

**Item 1A. Risk Factors.**

In addition to the other information in this report, the following discussion should be considered carefully in evaluating NetScout and our business. This Annual Report on Form 10-K contains forward-looking statements under Section 21E of the Exchange Act and other federal securities laws. These statements relate to future events or our future financial performance and are identified by terminology such as “may,” “will,” “could,” “should,” “expects,” “plans,” “intends,” “seeks,” “anticipates,” “believes,” “estimates,” “potential” or “continue,” or the negative of such terms or other common terminology. These statements are only predictions. You should not place undue reliance on these forward-looking statements. Actual events or results may differ materially. Factors that may cause such differences include, but are not limited to, the factors discussed below and in our other filings with the SEC. These factors may cause our actual results to differ materially from any forward-looking statement.

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

operations. Such factors are among many that may have a material adverse impact upon our business, results of operations and financial condition.

Table of Contents

Risks related to the proposed acquisition of Danaher's Communications Business

The announcement and pendency of the proposed acquisition of the Communications Business could have an adverse effect on our stock price, business, financial condition, results of operations or business prospects.

The announcement and pendency of the transaction could disrupt our business in the following ways, among others: Our customers, channel partners and other third-party business partners may delay or defer purchase decisions with regard to our products and services or may seek to terminate and/or renegotiate their relationships with us as a result of the transaction, whether pursuant to the terms of their existing agreements with us or otherwise; and Current and prospective employees may experience uncertainty regarding their future roles with the combined company, which might adversely affect our ability to retain, recruit and motivate key personnel and may adversely affect the focus of our employees on our sales efforts.

Should they occur, any of these matters could adversely affect our stock price or harm our financial condition, results of operations or business prospects.

Failure to complete the proposed acquisition of the Communications Business could negatively impact our business, financial condition, results of operations or stock price.

Completion of the transactions is conditioned upon NetScout and Danaher satisfying certain closing conditions, including the approval of the shares to be issued in connection with the transaction by our stockholders, as set forth in the merger agreement. The required conditions to closing may not be satisfied in a timely manner, if at all, or, if permissible, waived. If the transaction is not consummated for these or any other reasons, our ongoing business may be adversely affected and will be subject to a number of risks including:

• The market price of our common stock may decline to the extent that the current market price reflects a market assumption that the transaction will be completed;

• We may experience negative reactions to the termination of the transaction from customers, channel partners, suppliers, strategic partners, investors or analysts;

• We would not realize any of the anticipated benefits of having completed the transaction;

• We may be required to pay a termination fee of \$55.0 million to Danaher if the Merger Agreement is terminated under certain circumstances; and

• Our expenses incurred related to the transaction, such as legal and accounting fees, must be paid even if the transaction is not completed and may not, except in certain circumstances, be recovered from Danaher.

In addition, any delay in the consummation of the transaction or, any uncertainty about the consummation of the transaction, may adversely affect our future business, growth, revenue and results of operations.

The market price of our common stock may decline as a result of the acquisition of the Communications Business.

The market price of our common stock may decline as a result of the transaction for a number of reasons including if:

• We do not achieve the perceived benefits of the transaction as rapidly or to the extent anticipated;

• The effect of the transaction on our business and prospects is not consistent with the expectations of financial or industry analysts; or

• Investors react negatively to the effect of the transaction on our business and prospects.

NetScout and Danaher may be unable to satisfy the conditions or obtain the approvals required to complete the proposed transactions.

The consummation of the proposed transactions is subject to numerous conditions including (i) consummation of certain transactions contemplated by the Merger Agreement and the Separation and Distribution Agreement, dated as of October 12, 2014, by and among Danaher, NetScout and Newco (as the same may be amended from time to time) (the Distribution Agreement) (such as the separation of the Communications Business from Danaher's other business) and (ii) the receipt of NetScout stockholder approval for the issuance of NetScout common stock in the First Merger (as defined in Note 20 of our Notes to Consolidated Financial Statements included in this Annual Report on Form 10-K). We cannot make any assurances that the acquisition of the Communications Business and related transactions will be consummated on the terms or timeline





Table of Contents

currently contemplated, or at all. Each of Danaher and NetScout has and will continue to expend time and resources and incur expenses related to the proposed transactions.

The risk to our stockholders that the calculation of the merger consideration will not be adjusted if the value of the business or assets of the Communications Business declines or if the value of NetScout increases before the transactions are completed.

The calculation of the number of shares of NetScout common stock to be distributed in the Transaction will not be adjusted if the value of the business or assets of the Communications Business declines prior to the consummation of the Transaction or the value of NetScout increases prior to the Transaction. We will not be required to consummate the Transaction if there has been any material adverse effect on the Communications Business. However, we will not be permitted to terminate the Merger Agreement or resolicit the vote of our stockholders because of any changes in the market price of our common stock or any changes in the value of the Communications Business that do not constitute a material adverse effect with respect to the Communications Business.

Our estimates and judgments related to the acquisition accounting models used to record the purchase price allocation may be inaccurate.

Our management will make significant accounting judgments and estimates for the application of acquisition accounting under GAAP and the underlying valuation models. Our business, operating results and financial condition could be materially and adversely impacted in future periods if our accounting judgments and estimates related to these models prove to be inaccurate.

We may be required to recognize impairment charges for goodwill and other intangible assets.

Based on the closing price of our common stock on May 1, 2015, the proposed transaction will add approximately \$3.0 billion of goodwill and other intangible assets to our consolidated balance sheet. In accordance with GAAP, our management periodically assesses these assets to determine if they are impaired. Significant negative industry or economic trends, disruptions to our business, inability to effectively integrate acquired businesses, unexpected significant changes or planned changes in use of the assets, divestitures and market capitalization declines may impair goodwill and other intangible assets. Any charges relating to such impairments would adversely affect results of operations in the periods recognized.

If completed, the proposed transactions may not be successful or achieve their anticipated benefits.

If the proposed transactions are completed we may not be able to successfully realize anticipated growth opportunities or integrate our business and operations with the Communications Business' business and operations. After the transactions, we will have significantly more revenue, expenses, assets and employees than we did prior to the transactions. In the internal restructuring and reorganization of the Communications Business and related assets and liabilities, we will also be assuming certain liabilities of the Communications Business and taking on other obligations (including collective bargaining agreements and certain non-U.S. pension obligations with respect to transferred employees). We may not successfully or cost-effectively integrate the Communications Business' business and operations into our existing business and operations. Even if the combined company is able to integrate the combined businesses and operations successfully, this integration may not result in the realization of the full benefits of the growth and other opportunities that we currently expect from the transactions within the anticipated time frame, or at all.

We are required to abide by potentially significant restrictions, which could limit our ability to undertake certain corporate actions (such as the issuance of our common stock or the undertaking of a merger or consolidation) that otherwise could be advantageous.

To preserve the tax-free treatment to Danaher and/or its stockholders of the proposed transactions, under the Tax Matters Agreement in substantially the form attached as Exhibit A to the Distribution Agreement (the Tax Matters Agreement), we are restricted from taking any action that prevents such transactions from being tax-free for U.S. federal income tax purposes. These restrictions may limit our ability to pursue certain strategic transactions or engage in other transactions, including using our common stock to make acquisitions and in connection with equity capital market transactions that might increase the value of our business.

The Distribution could result in significant tax liability, and NetScout may be obligated to indemnify Danaher for any such tax liability imposed on Danaher.

The Distribution (as defined in Note 20 of our Notes to Consolidated Financial Statements included in this Annual Report on Form 10-K) and certain aspects of the internal restructuring to separate and consolidate certain assets and liabilities used in

Table of Contents

the Communications Business under Newco, could be taxable to Danaher if Newco, its unit holders, NetScout or NetScout's stockholders were to engage in certain actions specified under the Tax Matters Agreement. In such cases, under the Tax Matters Agreement, Newco and NetScout will be required to indemnify Danaher against any taxes that arise as a result of such specified actions. If Danaher were to recognize gain on the Distribution or certain aspects of the internal restructuring of the Communications Business for reasons not related to a specified action under the Tax Matters Agreement by Newco or NetScout, Danaher would not be entitled to be indemnified under the Tax Matters Agreement and the resulting tax to Danaher could have a material adverse effect on Danaher. If Newco or NetScout were required to indemnify Danaher as a result of the Distribution or certain aspects of the internal restructuring of the Communications Business being taxable, this indemnification obligation would likely be substantial and could have a material adverse effect on us, including with respect to our financial condition and results of operations.

Upon completion of the proposed transactions, we will incur significant expenses in connection with the integration of the Communications Business.

Upon completion of the proposed transactions, we expect to incur significant expenses in connection with the integration of the Communications Business, including integrating products and technology, personnel, information technology systems, accounting systems, suppliers, and channel partners of each business and implementing consistent standards, policies, and procedures, and may possibly be subject to material write downs in assets and charges to earnings, which may include severance pay and other costs.

The Merger Agreement contains provisions that may discourage other companies from trying to acquire NetScout. In addition, we will have more shares of our common stock outstanding after the transactions, which may discourage other companies from trying to acquire NetScout.

The Merger Agreement contains provisions that may discourage a third-party from submitting a business combination proposal to NetScout prior to the closing of the proposed transactions that might result in greater value to our stockholders than the proposed transactions. For example, the Merger Agreement generally prohibits us from soliciting any takeover proposal. In addition, if the Merger Agreement is terminated by NetScout or Danaher in circumstances that obligate us to pay a termination fee or to reimburse transaction expenses to Danaher, our liquidity or financial condition may be materially adversely affected as a result of such payment, and the requirement to make such a payment might deter third parties from proposing alternative business combination proposals. In addition, the Merger Agreement requires that we seek stockholder approval for the issuance of shares of our common stock in the First Merger, even if our board of directors changes its recommendation regarding the issuance of shares of our common stock in the First Merger.

We expect to issue 62.5 million shares of our common stock as part of the proposed transactions, assuming no adjustments pursuant to the Merger Agreement. Because we will be a significantly larger company and have significantly more shares of our common stock outstanding after the proposed transactions, an acquisition of NetScout may become more expensive. As a result, some companies may not seek to acquire NetScout, and the reduction in potential parties that may seek to acquire NetScout could negatively impact the prices at which our common stock trades.

**Risks Related to the Combined Company's Business Following the Proposed Transactions**

We will assume certain non-U.S. pension benefit obligations associated with the Communications Business. Future funding obligations related to these liabilities could restrict cash available for our operations, capital expenditures or other requirements, or require us to borrow additional funds.

In the proposed transactions, we will assume certain funded and unfunded non-U.S. pension obligations related to non-U.S. employees of the Communications Business who become employees of Newco to the extent the assumption is required by applicable law. In connection therewith, Danaher will transfer to us all assets set aside by Danaher to fund such non-U.S. pension obligations related to the Communications Business. If the non-U.S. pension liabilities transferred by Danaher exceed the assets transferred by Danaher, Danaher is obligated to transfer an amount of cash to us equal to the difference between the non-U.S. pension liabilities transferred and the assets transferred. The transfers of assets and non-U.S. pension liabilities will be governed by applicable law, provided that if the mechanism for the transfers is not mandated by applicable law, the assets and liabilities will be transferred on a projected benefit

obligation basis in accordance with GAAP.

Funding obligations with respect to non-U.S. pension plans change due to, among other things, the actual investment return on plan assets. Continued volatility in the capital markets may have a further negative impact on the funded status of the non-U.S. pension plans, which may in turn increase attendant funding obligations. Changing economic conditions, poor pension

15

---

Table of Contents

investment returns or other factors may require us to make substantial cash contributions to the pension plans in the future, preventing the use of increased cash contributions for other purposes and adversely affecting our liquidity. While we intend to comply with any future funding obligations for its non-U.S. pension benefit plans through the use of cash from operations, there can be no assurance that we will generate enough cash to do so and also meet its other required or intended cash uses. Our inability to fund these obligations through cash from operations could require it to seek funding from other sources, including through additional borrowings, which could materially increase our outstanding debt or debt service requirements.

Current NetScout stockholders' ownership interest in NetScout will be substantially diluted in the proposed transactions.

Following the consummation of the proposed transactions, our stockholders will, in the aggregate, own a significantly smaller percentage of NetScout than they will own of NetScout immediately prior to the consummation of the transactions. It is expected that immediately after consummation of the First Merger, pre-First Merger holders of Newco common units and Newco employees will hold approximately 59.5% of NetScout's common stock on a fully-diluted basis and NetScout's existing equityholders will hold approximately 40.5% of NetScout's common stock on a fully-diluted basis. Our current stockholders, as a group, will be able to exercise less influence over the management and policies of NetScout following the proposed transactions than they will exercise over the management and policies of NetScout immediately prior to the transactions.

Sales of our common stock after the proposed transactions may negatively affect the market price of our common stock.

The shares of our common stock to be issued in the proposed transactions to holders of Newco common units will generally be eligible for immediate resale. The market price of our common stock could decline as a result of sales of a large number of shares of our common stock in the market after the consummation of the proposed transactions or even the perception that these sales could occur.

It is expected that immediately after consummation of the First Merger, pre-First Merger holders of Newco common units and Newco employees will hold approximately 59.5% of NetScout's common stock on a fully-diluted basis and our existing equityholders will hold approximately 40.5% of our common stock on a fully-diluted basis, subject to potential adjustment under certain limited circumstances. Currently, Danaher stockholders may include index funds that have performance tied to certain stock indices and institutional investors subject to various investing guidelines. Because we may not be included in these indices following the consummation of the proposed transactions or may not meet the investing guidelines of some of these institutional investors, these index funds and institutional investors may decide to or may be required to sell the NetScout common stock that they receive in the proposed transactions. In addition, the investment fiduciaries of Danaher's defined contribution and defined benefit plans may decide to sell any NetScout common stock that the trusts for these plans receive in the proposed transactions, or may decide not to participate in the exchange offer, if applicable, in response to their fiduciary obligations under applicable law. These sales, or the possibility that these sales may occur, may also make it more difficult for us to obtain additional capital by selling equity securities in the future at a time and at a price that we deem appropriate.

The historical financial information of the Communications Business may not be representative of its results or financial condition if it had been operated independently of Danaher and, as a result, may not be a reliable indicator of its future results.

The Communications Business is currently operated by Danaher. Consequently, the financial information of the Communications Business included in this document has been derived from the consolidated financial statements and accounting records of the Communications Business and reflects all direct costs as well as assumptions and allocations made by management of Danaher. The financial position, results of operations and cash flows of the Communications Business presented may be different from those that would have resulted had the Communications Business been operated independently of Danaher during the applicable periods or at the applicable dates. For example, in preparing the financial statements of the Communications Business, Danaher made allocations of costs and Danaher corporate expenses deemed to be attributable to the Communications Business. However, these costs and expenses reflect the costs and expenses attributable to the Communications Business operated as part of a larger

organization and do not necessarily reflect costs and expenses that would be incurred by the Communications Business had it been operated independently. As a result, the historical financial information of the Communications Business may not be a reliable indicator of future results.

Table of Contents

Our business, financial condition and results of operations may be adversely affected following the proposed transactions if we cannot negotiate terms that are as favorable as those Danaher has received when we replaces contracts after the closing of the proposed transactions.

Prior to consummation of the proposed transactions, certain functions (such as purchasing, information systems, sales, logistics and distribution) for the Communications Business are generally being performed under centralized systems that will not be transferred to us and, in some cases, under contracts that are also used for Danaher's other businesses and which are not intended to be assigned to us with the Communications Business. In addition, some other contracts that Danaher or its subsidiaries are a party to on behalf of the Communications Business require consents of third parties to assign them to Newco. While Danaher, under the Transition Services Agreement (in substantially the form attached as Exhibit B to the Distribution Agreement), will agree to provide us with certain services, there can be no assurance that we will be able to obtain those consents or negotiate terms that are as favorable as those Danaher received when and if we replace these services with its own agreements for similar services. Although we believe that we will be able to obtain any such consents or enter into new agreements for similar services, it is possible that the failure to obtain consents for or replace a significant number of these agreements for any of these services or to replace them on terms that as are as favorable as those Danaher has received could have a material adverse impact on our business, financial condition and results of operations following the proposed transactions.

Our failure to successfully integrate the Communications Business into our business within our expected timetable could adversely affect the combined company's future results and the market price of our common stock following the completion of the proposed transactions.

The success of the proposed transactions will depend, in large part, on our ability, as a combined company following the completion of the proposed transactions, to realize the anticipated benefits and on the sales and profitability of the combined company. To realize these anticipated benefits, the combined company must successfully integrate its respective businesses. This integration will be complex and time-consuming. The failure to successfully integrate and manage the challenges presented by the integration process may result in our failure to achieve some or all of the anticipated benefits of the proposed transactions.

Potential difficulties that may be encountered in the integration process include the following:

- lost sales and customers as a result of customers of NetScout or the Communications Business deciding not to do business with the combined company;
- complexities associated with managing the larger, more complex, combined business;
- integrating personnel of NetScout and the Communications Business while maintaining focus on providing consistent, high-quality products and service to customers;
- the loss of key employees; and
- potential unknown liabilities and unforeseen expenses, delays or regulatory conditions associated with the proposed transactions

If any of these events were to occur, our ability to maintain relationships with customers, channel partners, suppliers and employees or our ability to achieve the anticipated benefits of the proposed transactions could be adversely affected, or could reduce our sales or earnings or otherwise adversely affect our business and financial results after the proposed transactions and, as a result, adversely affect the market price of our common stock.

The success of the combined company will also depend on relationships with third parties and pre-existing customers and channel partners of NetScout and the Communications Business, which relationships may be affected by customer, channel partner or third-party preferences or public attitudes about the proposed transactions. Any adverse changes in these relationships could adversely affect the combined company's business, financial condition or results of operations.

The combined company's success will depend on our ability to maintain and renew relationships with pre-existing customers, channel partners, suppliers, and other third parties of both NetScout and the Communications Business and our ability to establish new relationships. There can be no assurance that the business of the combined company will be able to maintain and renew pre-existing contracts and other business relationships, or enter into or maintain new contracts and other business relationships, on acceptable terms, if at all. The failure to maintain important business



relationships could have a material adverse effect on our business, financial condition or results of operations as a combined company.

17

---

Table of Contents

The growth of the combined company could suffer if the markets into which the combined company sells its products and services experience cyclical.

The growth of the combined company will depend in part on the growth of the markets which the Communications Business serves. The Communications Business serves certain industries that have historically been cyclical and have experienced periodic downturns that have had a material adverse impact on demand for the products, software and services that the Communications Business offers. Any of these factors could adversely affect the business, financial condition and results of operations of the combined company in any given period.

Defects, quality issues, inadequate disclosure or misuse with respect to the products, software or services of the combined company could adversely affect the business, reputation and financial statements of the combined company. Defects in, quality issues with respect to or inadequate disclosure of risks relating to the use of the combined company's products, software and services, or the misuse of the combined company's products, software and services, could lead to lost profits and other economic damage, property damage, violation of privacy rights, personal injury or other liability resulting in third party claims, criminal liability, significant costs, damage to its reputation and loss of business. Any of these factors could adversely affect the business, financial condition and results of operations of the combined company.

International economic, political, legal, compliance and business factors could negatively affect the financial statements and growth of the combined company.

The Communications Business derives significant sales from customers outside the U.S. and certain manufacturing operations, suppliers and employees of the Communications Business are located outside the U.S. The Communications Business expects to continue to increase its sales and presence outside the U.S., particularly in the high-growth markets. The Communications Business' international business (and particularly its business in high-growth markets) is subject to risks that are customarily encountered in non-U.S. operations, any of which could negatively affect the business, financial condition and results of operations of the combined company.

**Risks Related to the Company and its Operations**

Our quarterly revenue and operating results may fluctuate.

Our quarterly revenue and operating results are difficult to predict and may fluctuate significantly from quarter to quarter. Our quarterly revenue may fluctuate as a result of a variety of factors, many of which may be outside of our control, including the following:

- technology spending by current and potential customers;
- uneven demand for service delivery and application performance management solutions;
- the timing and size of orders from customers, especially in light of our lengthy sales cycle;
- the timing and market acceptance of new products or product enhancements by us or our competitors;
- the timing of hiring sales personnel and the speed at which such personnel become productive;
- our ability to anticipate or adapt effectively to developing markets and rapidly changing technologies and technology requirements;
- changes in the number and size of our competitors and changes in the prices and capabilities of competitors' products;
- customer ability to implement our products;
- changes in foreign currency exchange rates;
- attrition of key employees; and
- economic slowdowns and the occurrence of unforeseeable global events, which contribute to such slowdowns.

Most of our expenses, such as employee compensation, benefits and rent, are relatively fixed in the short term.

Moreover, our expense levels are based, in part, on our expectations regarding future revenue levels. As a result, if revenue for a particular quarter is below our expectations, we may not be able to reduce operating expenses proportionately for that quarter, and, therefore, this revenue shortfall would have a disproportionately negative impact on our operating results for that quarter.

Table of Contents

If we fail to introduce new products or enhance our existing products to keep up with rapid technological change, demand for our products may decline.

The market for application and network performance management and service assurance solutions is characterized by rapid changes in technology, evolving industry standards, changes in customer requirements and frequent product introductions and enhancements. Our success is dependent upon our ability to meet our customers' needs, which are driven by changes in computer networking technologies, new application technologies and the emergence of new industry standards. In addition, new technologies may shorten the life cycle for our products or could render our existing or planned products obsolete. If we are unable to develop and introduce new network and application performance management and service assurance products or enhancements to existing products in a timely and successful manner, this inability could have a material and adverse impact on our business, operating results and financial condition.

We have introduced and intend to continue to introduce new products. If the introduction of these products is significantly delayed or if we are unsuccessful in bringing these products to market, our business, operating results and financial condition could be materially and adversely impacted.

We face significant competition from other technology companies.

The service assurance and performance management market is a highly competitive, rapidly evolving, and fragmented market that has overlapping technologies and competitors, both large and small. We believe customers make service management system purchasing decisions based primarily upon the following factors:

- product performance, functionality and price;
- timeliness of new product introductions;
- ease of installation, integration, and use;
- customer service and technical support;
- name and reputation of vendor; and
- alliances with industry partners.

We compete with a growing number of providers of application performance management solutions and providers of portable network traffic analyzers and probes. In addition, leading network equipment and application technology vendors offer their own management solutions, including products which they license from other competitors. Some of our current and potential competitors have greater name recognition and substantially greater financial, management, marketing, service, support, technical, distribution and other resources than we do. Further, in recent years some of our competitors have been acquired by larger companies that are seeking to enter or expand in the markets in which we operate. We expect this trend to continue as companies attempt to strengthen or maintain their market positions in an evolving industry. Therefore, given their larger size and greater resources our competitors may be able to respond more effectively than we can to new or changing opportunities, technologies, standards and customer requirements.

As a result of these and other factors, we may not be able to compete effectively with our current or future competitors. This competition could result in increased pricing pressure, reduced profit margins, increased sales and marketing expenses, and failure to increase, or the loss of, market share, any of which would likely have a material and adverse impact on our business, operating results and financial condition.

Our success depends, in part, on our ability to manage and leverage our distribution channels.

Sales to our distribution channels, which include resellers, original equipment manufacturers, distributors, systems integrators and service providers, accounted for 49%, 49%, and 49% of our total revenue for the fiscal years ended March 31, 2015, 2014 and 2013, respectively. To increase our sales we need to continue to enhance our indirect sales efforts, to continue to manage and expand these existing distribution channels and to develop new indirect distribution channels. Our channel partners have no obligation to purchase any products from us. In addition, they could internally develop products that compete with our solutions or partner with our competitors or bundle or resell competitors' solutions, possibly at lower prices. The potential inability to develop new relationships or to expand and manage our existing relationships with partners, the potential inability or unwillingness of our partners to market and sell our products effectively or the loss of existing partnerships could have a material and adverse impact on our business,

operating results and financial condition. Our international operations, including our operations in the United Kingdom, mainland Europe, India, Asia-Pacific and other regions, are generally also subject to the risk of longer sales cycles through our international distribution channels. Sales to customers outside the United States accounted for 23%, 24%, and 25% of our total revenue for the fiscal years ended March 31, 2015, 2014 and 2013, respectively.

Table of Contents

If our products contain errors, they may be costly to correct, revenue may be delayed, we could be sued and our reputation could be harmed.

Despite testing by our customers and us, errors may be found in our products after commencement of commercial shipments. If errors are discovered, we may not be able to correct them in a timely manner or at all. In addition, we may need to make significant expenditures to eliminate errors and failures. Errors and failures in our products could result in loss of or delay in market acceptance of our products and could damage our reputation. If one or more of our products fail, a customer may assert warranty and other claims for substantial damages against us. The occurrence or discovery of these types of errors or failures could have a material and adverse impact on our business, operating results and financial condition.

Increased customer demands on our technical support services may adversely affect our relationships with our customers and our financial results.

We offer technical support services with many of our products. We may be unable to respond quickly enough to accommodate short-term increases in customer demand for support services. We also may be unable to modify the format of our support services to compete with changes in support services provided by competitors. Further customer demand for these services, without corresponding revenues, could have a material and adverse impact on our financial condition and results of operations.

We must hire and retain skilled personnel, and plan for and manage the succession of key executives.

Our future success depends in large part upon our ability to attract, train, motivate and retain highly skilled employees, particularly executives, sales and marketing personnel, software engineers, and technical support personnel. If we are unable to attract and retain the highly skilled technical personnel that are integral to our sales, marketing, product development and technical support teams, the rate at which we can generate sales and develop new products or product enhancements may be limited. This inability could have a material and adverse impact on our business, operating results and financial condition. In addition, we must maintain and periodically increase the size of our sales force in order to increase our direct sales and support our indirect sales channels. Because our products are very technical, sales people require a comparatively long period of time to become productive, typically three to twelve months. This lag in productivity, as well as the challenge of attracting qualified candidates, may make it difficult to meet our sales force growth targets. Further, we may not generate sufficient sales to offset the increased expense resulting from growing our sales force. If we are unable to maintain and periodically expand our sales capability, our business, operating results and financial condition could be materially and adversely impacted.

Loss of key personnel could adversely impact our business. Our future success depends to a significant degree on the skills, experience and efforts of Anil Singhal, our President, Chief Executive Officer, and co-founder, and our other key executive officers and senior managers to work effectively as a team. The loss of one or more of our key personnel could have a material and adverse impact on our business, operating results and financial condition. We must, therefore, plan for and manage the succession of key executives due to retirement, illness or competitive offers elsewhere.

The success of our business depends, in part, on the continued growth in the market for and the continued commercial demand for service delivery service assurance solutions focused on the performance monitoring and management of applications and networks.

We derive nearly all of our revenue from the sale of products and services that are designed to allow our customers to assure the delivery of services through the management of the performance of applications across IP networks. Therefore, we must be able to predict the appropriate features and prices for future products to address the market, the optimal distribution strategy and the future changes to the competitive environment. In order for us to be successful, our potential customers must recognize the value of more sophisticated application management solutions, decide to invest in the management of their networked applications and, in particular, adopt our management solutions. Any failure of this market to continue to be viable would materially and adversely impact our business, operating results and financial condition. Additionally, businesses may choose to outsource the operations and management of their networks to managed service providers. Our business may depend on our ability to continue to develop relationships with these service providers and successfully market our products to them.

We may not successfully complete acquisitions or integrate acquisitions we do make, which could impair our ability to compete and could harm our operating results.

We may need to acquire complementary businesses, products or technologies to remain competitive or expand our business. We actively investigate and evaluate potential acquisitions of complementary businesses, products and technologies in the ordinary course of business. We may compete for acquisition opportunities with entities having significantly greater resources than us. As a result, we may not succeed in acquiring some or all businesses, products or technologies that we seek to

Table of Contents

acquire. Our inability to effectively consummate acquisitions on favorable terms could significantly impact our ability to compete effectively in our targeted markets and could negatively affect our results of operations.

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

- the potentially dilutive issuance of common stock or other equity instruments;
- the incurrence of debt and amortization expenses related to goodwill and acquired intangible assets;
- the potentially costly and disruptive impact of assuming unfavorable pre-existing contractual relationships of acquired companies that we would not have otherwise entered into and potentially exiting or modifying such relationships;
- the potential litigation or other claims in connection with, or inheritance of claims or litigation risk as a result of, an acquisition including claims from terminated employees, customers, third parties or enforcement actions by various regulators;
- the incurrence of significant costs and expenses; and
- the potentially negative impact of poor performance of an acquisition on our earnings per share.

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

- difficulties in assimilating the acquired operations, technologies, personnel and products;
- difficulties in managing geographically dispersed operations;
- difficulties in assimilating diverse financial reporting and management information systems;
- difficulties in maintaining uniform standards, controls, procedures and policies;
- the diversion of management's attention from other business concerns;
- use of cash to pay for acquisitions that may limit other potential uses of our cash, including stock repurchases and retirement of outstanding indebtedness;
- substantial accounting charges for restructuring and related expenses, write-off of in-process research and development, impairment of goodwill, amortization or impairment of intangible assets and share-based compensation expense;
- the potential disruption of our business;
- the potential loss of key employees, customers, distributors or suppliers;
- the inability to generate sufficient revenue to offset acquisition or investment costs; and
- the potential for delays in customer purchases due to uncertainty and the inability to maintain relationships with customers of the acquired businesses.

Failure to manage growth properly and to implement enhanced automated systems could adversely impact our business.

The growth in size and complexity of our business and our customer base has been and will continue to be a challenge to our management and operations. To manage further growth effectively, we must integrate new personnel and manage expanded operations. If we are unable to manage our growth effectively, our costs, the quality of our products, the effectiveness of our sales organization, attraction and retention of key personnel, our business, our operating results and financial condition could be materially and adversely impacted. Any disruptions or ineffectiveness relating to our systems implementations and enhancements could adversely affect our ability to process customer orders, ship products, provide services and support to our customers, bill and track our customers, fulfill contractual obligations, and otherwise run our business.

Our success depends, in part, on our ability to manage our international research and development operations.

We must continue to enhance our existing products and introduce new products in order to keep up with rapid technological change. Our international research and development teams play a critical role in these efforts. We must attract, train, motivate and retain our international research and development team members. To maintain this stable international employee research and development talent, we believe we must provide our international engineers with compelling and strategically significant work, coupled with technical and architectural ownership of their respective development projects. We





Table of Contents

must develop the leaders of these international teams, while ensuring their frequent inclusion and participation in corporate strategic and operational planning.

If we violate the U.S. Foreign Corrupt Practices Act or applicable anti-bribery laws in other countries, or if we fail to comply with U.S. export controls and government contracting laws, our business could be harmed.

We earn a significant portion of our total revenues from international sales. As a result, we are subject to the U.S. Foreign Corrupt Practices Act (FCPA), which generally prohibits U.S. companies and their intermediaries from making corrupt payments to foreign officials for the purpose of obtaining or keeping business or otherwise obtaining favorable treatment and requires companies to maintain appropriate record-keeping and internal accounting practices to accurately reflect the transactions of the company. Under the FCPA, U.S. companies may be held liable for actions taken by agents or local partners or representatives. In addition, regulators may seek to hold us liable for successor liability FCPA violations committed by companies which we acquire. We are also subject to the U.K. Bribery Act and may be subject to certain anti-corruption laws of other countries in which we do business. We are also subject to the export and re-export control laws of the U.S., including the U.S. Export Administration Regulations (EAR). We are also subject to U.S. government contracting laws, rules and regulations, and may be subject to government contracting laws of other countries in which we do business. If we or our distributors, resellers, agents, or other intermediaries fail to comply with the FCPA, the EAR or U.S. government contracting laws, or the anti-corruption, export or governmental contracting laws of other countries, governmental authorities in the U.S. or other countries could seek to impose civil and/or criminal penalties, which could have a material adverse effect on our business, results of operations, financial conditions and cash flows.

The current economic and geopolitical environment may impact some specific industries into which we sell.

Many of our customers are concentrated in certain industries, including financial services, public sector, healthcare, and the service provider market segment. Certain industries may be more acutely affected by economic, geopolitical and other factors than other sectors. Our public sector customers are affected by federal, state and local budget decisions. To the extent that one or more of the sectors in which our customer base operates is adversely impacted, whether as a result of general conditions affecting all sectors or as a result of conditions affecting only those particular sectors, our business, financial condition and results of operations could be materially and adversely impacted.

Uncertain conditions in the global economy and constraints in the global credit market may adversely affect our revenue and results of operations.

Disruptions in the global economy and constraints in the global credit market may cause some of our customers to reduce, delay, or cancel spending on capital and technology projects, resulting in reduced spending with us. While some industry sectors such as government and telecommunications may be less susceptible to the effects of an economic slowdown, our enterprise customers may be adversely affected, especially in financial services and consumer industries. Continued volatility in, or disruption of financial markets could limit customers' ability to obtain adequate financing to maintain operations and result in a decrease in sales volume that could have a negative impact on our results of operations. Further, competitors may respond to economic conditions by lowering their prices, which could put pressure on our pricing. We could also experience lower than anticipated order levels, cancellations of orders in backlog, defaults on outstanding accounts receivable and extended payment or delivery terms.

The price of our common stock may fluctuate with market volatility.

The market price of our common stock has been volatile and may continue to fluctuate in response to a number of factors, some of which are beyond our control. Trading activity of our stock has historically been relatively thin, in part as a result of officers and directors and institutional stockholders holding a significant percentage of our stock. Broad market fluctuations could adversely affect the market price of our common stock, which in turn could cause impairment of goodwill that could materially and adversely impact our financial condition and results of operations. It is not uncommon when the market price of a stock has been volatile for holders of that stock to institute securities class action litigation against the company that issues that stock. If any of our stockholders brought such a lawsuit against us, even if the lawsuit is without merit, we could incur substantial costs defending the lawsuit beyond any insurance coverage which we may have for such risks. Such a lawsuit could also divert the time and attention of our management.



Table of Contents

We may fail to secure necessary additional financing.

Our future success may depend in part on our ability to obtain additional financing to support our continued growth and operations. If our existing sources of liquidity are insufficient to satisfy our operating requirements, we may need to seek to raise capital by:

- issuing additional common stock or other equity instruments;
- acquiring additional bank debt;
- issuing debt securities; or
- obtaining lease financings.

However, we may not be able to obtain additional capital when we want or need it, or capital may not be available on satisfactory terms. Furthermore, any additional capital may have terms and conditions that adversely affect our business, such as new financial or operating covenants, or that may result in additional dilution to our stockholders. Our effective tax rate may increase or fluctuate, which could increase our income tax expense and reduce our net income.

Our effective tax rate could be adversely affected by several factors, many of which are outside of our control, including:

- Changes in the relative proportions of revenues and income before taxes in the various jurisdictions in which we operate that have differing statutory tax rates;
- Changing tax laws, regulations, and interpretations in multiple jurisdictions in which we operate as well as the requirements of certain tax rulings;
- Changes in accounting and tax treatment of share-based compensation;
- The valuation of generated and acquired deferred tax assets and the related valuation allowance on these assets;
- The tax effects of purchase accounting for acquisitions and restructuring charges that may cause fluctuations between reporting periods; and
- Tax assessments or any related tax interest or penalties that could significantly affect our income tax expense for the period in which the settlements take place.

An adverse change in our effective tax rate could have a material and adverse effect on our financial condition and results of operations.

Our estimates and judgments related to critical accounting policies could be inaccurate.

We consider accounting policies related to marketable securities, revenue recognition, valuation of goodwill and acquired intangible assets and share-based compensation to be critical in fully understanding and evaluating our financial results. Management makes accounting judgments and estimates related to these policies. Our business, operating results and financial condition could be materially and adversely impacted in future periods if our accounting judgments and estimates related to these critical accounting policies prove to be inaccurate.

Our reliance on sole source suppliers could adversely impact our business.

Specific components that are necessary for the hardware assembly of our instruments are obtained from separate sole source suppliers or a limited group of suppliers. These components include our network interface cards and proprietary NetScout hardware. Our reliance on sole or limited suppliers involves several risks, including a potential inability to obtain an adequate supply of required components and the inability to exercise control over pricing, quality and timely delivery of components. It is our practice to mitigate these risks by partnering with key suppliers, including distributors, to establish a variety of supply continuity practices. These practices may include, among other approaches, establishing buffer supply requiring suppliers to maintain adequate stocks of materials, bonding agreements with distributors, and use-based and kanban programs to set supply thresholds. We also enter into escrow arrangements for certain technologies. Where possible, we use widely-available off the shelf hardware and work with large suppliers with multiple factories and other risk management practices. However, failure of supply or failure to execute effectively on any of these programs could result in our inability to obtain adequate deliveries or the occurrence of any other circumstance that would require us to seek alternative sources of these



Table of Contents

components would impact our ability to ship our products on a timely basis. This could damage relationships with our current and prospective customers, cause shortfalls in expected revenue, and could materially and adversely impact our business, operating results and financial condition.

Necessary licenses for third-party technology may not be available to us or may be very expensive.

We currently and will in the future license technology from third parties that we use to produce or embed in our products. While we have generally been able to license required third-party technology to date, future required third-party licenses may not be available to us on commercially reasonable terms or at all. Third parties who hold exclusive rights to technology that we seek to license may include our competitors. If we are unable to obtain any necessary third-party licenses, we would be required to redesign our product or obtain substitute technology, which may not perform as well, be of lower quality or be more costly.

Our success depends on our ability to protect our intellectual property rights.

Our business is heavily dependent on our intellectual property. We rely upon a combination of patent, copyright, trademark and trade secret laws and registrations and non-disclosure and other contractual and license arrangements to protect our intellectual property rights. The reverse engineering, unauthorized copying, or other misappropriation of our intellectual property could enable third parties to benefit from our technology without compensating us. Legal proceedings to enforce our intellectual property rights could be burdensome and expensive and could involve a high degree of uncertainty. In addition, legal proceedings may divert management's attention from growing our business. There can be no assurance that the steps we have taken to protect our intellectual property rights will be adequate to deter misappropriation of proprietary information, or that we will be able to detect unauthorized use by third parties and take appropriate steps to enforce our intellectual property rights. Further, we also license software from third parties for use as part of our products, and if any of these licenses were to terminate, we might experience delays in product shipment until we develop or license alternative software.

Others may claim that we infringe on their intellectual property rights.

From time to time we may be subject to claims by others that our products infringe on their intellectual property rights, patents, copyrights or trademarks. These claims, whether or not valid, could require us to spend significant sums in litigation, pay damages or royalties, delay product shipments, reengineer our products, rename our products and rebuild name recognition or acquire licenses to such third-party intellectual property. We may not be able to secure any required licenses on commercially reasonable terms or secure them at all. Any of these claims or resulting events could have a material and adverse impact on our business, operating results and financial condition.

The effectiveness of our disclosure and internal controls may be limited.

Our disclosure controls and procedures and internal control over financial reporting may not prevent all material errors and intentional misrepresentations. Any system of internal control can only provide reasonable assurance that all control objectives are met. Some of the potential risks involved could include, but are not limited to, management judgments, simple errors or mistakes and willful misconduct regarding controls or misinterpretation. Under Section 404 of the Sarbanes-Oxley Act we are required to evaluate and determine the effectiveness of our internal control over financial reporting. Compliance with this legislation requires management's attention and expense. Management's assessment of our internal control over financial reporting may or may not identify weaknesses that need to be addressed in our internal control system. If we are unable to conclude that our internal control over financial reporting is effective, investors could lose confidence in our reported financial information which could have an adverse effect on the market price of our stock or impact our borrowing ability. In addition, changes in operating conditions and changes in compliance with policies and procedures currently in place may result in inadequate internal control over financial reporting in the future.

We or our suppliers may be impacted by new regulations related to climate change.

We or our suppliers may become subject to new laws enacted with regards to climate change. In the event that new laws are enacted or current laws are modified in countries in which we or our suppliers operate, our flow of product may be impacted which could have a material and adverse effect on our financial condition and results of operations. Uncertainties of regulation of the Internet and data traveling over the Internet could have a material and adverse impact on our financial condition and results of operations.

Currently, few laws or regulations apply directly to access to or commerce on the Internet. We could be materially adversely affected by regulation of the Internet and Internet commerce in any country where we operate. Such regulations could include matters such as net neutrality. Further, governments may regulate or restrict the sales, licensing, distribution, and export or import of certain technologies to certain countries. The adoption of regulation of the Internet and Internet commerce could

Table of Contents

decrease demand for our products and, at the same time, increase the cost of selling our products, which could have a material and adverse effect on our financial condition and results of operations. In addition, the enactment of new federal, state, or foreign data privacy laws and regulations could cause customers not to be able to take advantage of all the features or capabilities of our products which in turn could reduce demand for certain of our products. If a security breach or cyber attack of our IT networks and systems, or any of our products, occurs, our operations could be interrupted, our products and services may be perceived as vulnerable, and our brand and reputation could be damaged, which could reduce revenue, increase expenses, and expose us to legal claims or regulatory actions. Although we believe we have sufficient controls and security measures in place to prevent such attacks, our IT networks and systems, and our products, may still be vulnerable to data theft, computer viruses, programming errors, attacks by third parties or similar problems. If we, or our customers using our products, were to experience a security breach or cyber attack, we could be required to incur substantial costs and liabilities, including but not limited to, expenses attributable to rectifying the security breach or cyber attack including the cost of repairing any damage to our, or our customers' systems, liability for stolen assets or information, lost revenue and income resulting from any system or product downtime, increased costs for cyber security protection, and damage to our reputation causing customers and possibly investors to lose confidence in us. Similarly, an actual or perceived breach of our customers' network security allowing access to our customers' data centers or other parts of their IT environments, regardless of whether the breach is attributable to our products, may cause contractual disputes and could require significant expenditures of our capital and diversion of our resources from development efforts.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We currently lease approximately 175,000 square feet of space in an office building in Westford, Massachusetts for our headquarters. The current lease will expire in September 2023, and we have an option to extend the lease for two additional five-year terms. We lease office space in twenty-nine international cities for our sales and support personnel, as well as 72,742 square feet of space in San Jose, California. We lease 63,296 square feet of office space for our engineering and support personnel in India. We believe that our existing facilities are adequate to meet our foreseeable requirements or that suitable additional or substitute space will be available on commercially reasonable terms.

Item 3. Legal Proceedings

From time to time, NetScout is subject to legal proceedings and claims in the ordinary course of business. In the opinion of management, the amount of ultimate expense with respect to any current legal proceedings and claims, if determined adversely, will not have a significant adverse effect on our financial condition, results of operations or cash flows.

Item 4. Mine Safety Disclosures

None.

Table of Contents

## PART II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

## Price Range of Common Stock

Our common stock trades on the Nasdaq Global Select Market, under the symbol NTCT. The following table sets forth, for the periods indicated, the high and low intraday sales prices for our common stock. Such information reflects inter-dealer price, without retail mark-up, markdown or commission and may not represent actual transactions.

Quarter Ended	High	Low
Fiscal Year 2014		
June 30, 2013	\$24.92	\$21.22
September 30, 2013	\$27.55	\$23.22
December 31, 2013	\$30.76	\$24.04
March 31, 2014	\$39.10	\$28.64
Fiscal Year 2015		
June 30, 2014	\$44.54	\$33.30
September 30, 2014	\$48.13	\$41.15
December 31, 2014	\$46.17	\$31.59
March 31, 2015	\$44.76	\$33.53

## Stockholders

At April 30, 2015, we had 71 stockholders of record. We believe that the number of beneficial holders of our common stock exceeds 14,000.

## Stock Performance Graph

This performance graph shall not be deemed "filed" for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities under that Section, and shall not be deemed to be incorporated by reference into any filing of NetScout under the Exchange Act or the Securities Act of 1933, as amended.

The Stock Performance Graph set forth below compares the yearly change in the cumulative total stockholder return on our common stock during the five year period from March 31, 2010 through March 31, 2015 with the cumulative total return of the Nasdaq Composite Index and the Nasdaq Computer & Data Processing Index. The comparison assumes \$100 was invested on March 31, 2010 in our common stock or in the Nasdaq Composite Index and the Nasdaq Computer & Data Processing Index and assumes reinvestment of dividends, if any.

The stock price performance shown on the graph below is not necessarily indicative of future price performance. Information used in the graph was obtained from Zacks Investment Research, Inc.



Table of Contents

## COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN

Assumes Initial Investment of \$100

	3/31/2010	3/31/2011	3/31/2012	3/31/2013	3/31/2014	3/31/2015
NetScout Systems, Inc.	\$100.00	\$184.72	\$137.53	\$166.13	\$254.09	\$296.48
NASDAQ Composite – Total Returns	\$100.00	\$117.06	\$131.47	\$140.86	\$183.38	\$216.60
NASDAQ Computer and Data Processing	\$100.00	\$116.54	\$125.84	\$134.91	\$177.53	\$194.25

## Dividend Policy

In fiscal years 2015 and 2014, we did not declare any cash dividends and do not anticipate declaring cash dividends in the foreseeable future. In addition, the terms of our credit facility limit our ability to pay cash dividends on our capital stock. It is our intention to retain all future earnings for reinvestment to fund our expansion and growth, as well as for our stock buyback program further described under Item 7 “Liquidity and Capital Resources.” Any future cash dividend declaration will be at the discretion of our Board of Directors and will depend upon, among other things, our future earnings, general financial conditions, capital requirements, existing bank covenants and general business conditions.

Table of Contents

## Purchases of Equity Securities by the Issuer

The following table provides information about purchases we made during the quarter ended March 31, 2015 of equity securities that are registered by us pursuant to Section 12 of the Exchange Act:

	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
1/1/2015 - 1/31/2015	48,303	\$ 35.36	44,100	
2/1/2015 - 2/28/2015	210,602	38.32	210,300	
3/1/2015 - 3/31/2015	245,600	42.31	245,600	
Total	504,505	\$ 39.98	500,000	\$ 68,507,458

We purchased an aggregate of 4,505 shares transferred to us from employees in satisfaction of minimum tax withholding obligations associated with the vesting of restricted stock units during the period. The purchases of (1) these restricted stock units reflected in the table do not reduce the maximum dollar value of shares that may be purchased under our previously announced stock repurchase program.

Table of Contents

## Item 6. Selected Financial Data

## SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated financial data set forth below should be read in conjunction with our audited consolidated financial statements and notes thereto and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included under Item 7 of this Annual Report on Form 10-K. The consolidated statement of operations data for the fiscal years ended March 31, 2015, 2014 and 2013 and the consolidated balance sheet data at March 31, 2015 and 2014 are derived from audited consolidated financial statements included under Item 8 of this Annual Report on Form 10-K. The consolidated statement of operations data for the fiscal years ended March 31, 2012 and 2011 and the consolidated balance sheet data at March 31, 2013, 2012 and 2011 have been derived from audited consolidated financial statements of NetScout that do not appear in this Annual Report on Form 10-K. The historical results are not necessarily indicative of the operating results to be expected in the future.

	Year Ended March 31,				
	2015	2014	2013 (1)	2012 (2)	2011
	(In thousands, except per share data)				
Statement of Operations Data:					
Revenue:					
Product	\$272,895	\$234,268	\$198,749	\$168,141	\$159,948
Service	180,774	162,379	151,801	140,538	130,592
Total revenue	453,669	396,647	350,550	308,679	290,540
Cost of revenue:					
Product	59,037	51,219	45,752	39,271	38,175
Service	35,524	33,294	28,256	26,401	23,186
Total cost of revenue	94,561	84,513	74,008	65,672	61,361
Gross profit	359,108	312,134	276,542	243,007	229,179
Operating expenses:					
Research and development	75,242	70,454	61,546	49,478	40,628
Sales and marketing	136,446	129,611	116,807	109,624	105,271
General and administrative	47,296	30,623	29,718	27,488	23,308
Amortization of acquired intangible assets	3,351	3,432	2,877	2,131	1,907
Restructuring charges	—	—	1,065	603	—
Total operating expenses	262,335	234,120	212,013	189,324	171,114
Income from operations	96,773	78,014	64,529	53,683	58,065
Interest and other expense, net	(1,808)	(158)	(793)	(2,765)	(1,772)
Income before income tax expense	94,965	77,856	63,736	50,918	56,293
Income tax expense	33,773	28,750	23,127	18,490	19,028
Net income	\$61,192	\$49,106	\$40,609	\$32,428	\$37,265
Basic net income per share	\$1.49	\$1.19	\$0.97	\$0.77	\$0.89
Diluted net income per share	\$1.47	\$1.17	\$0.96	\$0.76	\$0.87
Weighted average common shares outstanding used in computing:					
Net income per share—basic	41,105	41,366	41,665	42,035	42,059
Net income per share—diluted	41,637	41,955	42,322	42,750	42,973

(1) During the fiscal year ended March 31, 2013, NetScout completed the acquisitions of ONPATH Technologies, Inc. and Accanto Systems, S.r.l. for approximately \$51.8 million.

(2) During the fiscal year ended March 31, 2012, NetScout completed the acquisitions of Psytechnics, Ltd., Fox Replay BV and Simena LLC for approximately \$47.3 million collectively.



Table of Contents

	March 31,				
	2015	2014	2013(1)	2012 (2)	2011
	(In thousands)				
Balance Sheet Data:					
Cash, cash equivalents and short- and long-term marketable securities	\$264,857	\$218,794	\$154,091	\$213,516	\$228,478
Working capital	\$149,651	\$115,798	\$92,141	\$155,596	\$147,136
Total assets	\$669,049	\$607,763	\$552,176	\$567,757	\$527,570
Debt	\$—	\$—	\$—	\$62,000	\$68,106
Total stockholders' equity	\$435,750	\$409,161	\$371,903	\$342,369	\$319,559

(1) During the fiscal year ended March 31, 2013, NetScout completed the acquisitions of ONPATH Technologies, Inc. and Accanto Systems S.r.l. for approximately \$51.8 million, including \$527 thousand in cash.

(2) During the fiscal year ended March 31, 2012, NetScout completed the acquisitions of Psytechnics, Ltd., Fox Replay BV and Simena LLC for approximately \$47.3 million, including \$616 thousand in cash.

#### Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following information should be read in conjunction with the audited consolidated financial information and the notes thereto included in this Annual Report on Form 10-K. In addition to historical information, the following discussion and other parts of this Annual Report contain forward-looking statements that involve risks and uncertainties. You should not place undue reliance on these forward-looking statements. Actual events or results may differ materially due to competitive factors and other factors discussed in Item 1A. "Risk Factors" and elsewhere in this Annual Report. These factors may cause our actual results to differ materially from any forward-looking statement. Forward-looking statements do not contemplate the proposed acquisition.

#### Overview

We are an industry leader for advanced network, application and service assurance solutions, providing high-quality performance analytics and operational intelligence solutions that facilitate the evolution toward new computing paradigms, such as virtualization, mobility and cloud. We design, develop, manufacture, market, license, sell and support these products focused on assuring service delivery quality, performance and availability for some of the world's largest, most demanding and complex internet protocol (IP) based service delivery environments. We manufacture and market these products in integrated hardware and software solutions that are used by commercial enterprises, large governmental agencies and telecommunication service providers worldwide. We have a single operating segment and substantially all of our identifiable assets are located in the United States.

We have been a technology innovator for three-plus decades since our founding in 1984. Our solutions continue to change how organizations manage and optimize the delivery of business applications and services and assure user experience across global IP networks. We have continually enhanced and expanded our product portfolio to meet the needs of organizations by providing solutions to manage dynamic network and application environments and by improving user experience by providing high-value analytics that help validate and assure service availability, quality and reliability.

Our solutions are intended to help users in various roles to: quickly analyze data, achieve real-time visibility into and intelligence about their organization's operations, identify service delivery issues early, improve service levels, reduce operational costs, mitigate security risks, and drive better business decisions. Our value proposition to our customers is helping them to achieve their objectives regarding return on investments and risk mitigation as they develop their IT infrastructure to support their business needs. Our proactive intelligence and analytics provides our customer with knowledge regarding potential issues before their users are impacted.

Our mission is to enable information technology (IT) and service providers to realize maximum benefit with minimal risk from technology advances, like IP convergence, network function virtualization (NFV), software defined networking (SDN), virtualization, cloud, mobility, bring your own device (BYOD), web, and the evolving Internet by managing the inherent complexity in a cost-effective manner. Our Adaptive Session Intelligence (ASI) technology,

which we have developed in support of this mission, has the potential of not only expanding our leadership in the network performance management and application performance management (NPM+APM) space, but can also serve as a gateway for future intelligence solutions including cyber and business intelligence.

30

---

## Table of Contents

Many of the largest service providers, cloud based businesses, enterprise and government customers rely on us to assure service delivery and the user experience of their customers. Our customers are in just about every vertical market including financials, health care, utilities, internet, manufacturing, retail, as well as the service providers. We are a market leader in helping service provider's get a return on their 4G/LTE investment by providing them with the intelligence they need about aspects of service delivery from handset performance to user preferences to network speed.

Our operating results are influenced by a number of factors, including, but not limited to, the mix and quantity of products and services sold, pricing, costs of materials used in our products, growth in employee related costs, including commissions, and the expansion of our operations. Factors that affect our ability to maximize our operating results include, but are not limited to, our ability to introduce and enhance existing products, the marketplace acceptance of those new or enhanced products, continued expansion into international markets, development of strategic partnerships, competition, successful acquisition integration efforts, our ability to achieve expense reductions and make structural improvements and current economic conditions.

During Fiscal Year 2015, we continued to invest in development programs aimed at enhancing our range of offerings, including delivering new features and functionality for our nGeniusONETM platform that addresses the evolving requirements of our enterprise, service provider and government customers. The nGeniusONE platform is powered by Adaptive Session Intelligence™ (ASI) 2.0, NetScout's next generation Deep Packet Inspection (DPI) technology that exploits the inherent richness of packet-flow data to provide real-time, contextual analysis of service, network, and application performance. The patented ASI technology is a critical differentiating technology that enables the creation of statistical metadata, session transaction records and adaptive session traces enabling real-time, scalable monitoring of all users, all applications and all services consistently across the network. NetScout's solutions are used by customers to better understand and manage network and application performance, alert themselves to problems that impacting end users, validate services and network policy, plan and optimize network capacity, generate timely reports and conduct deep forensic and historical analysis.

On October 12, 2014, NetScout, Danaher, Newco Merger Sub and Merger Sub II, entered into the Merger Agreement pursuant to which NetScout will acquire the Communications Business in a Reverse Morris Trust transaction. For additional information regarding the proposed acquisition, see Note 20 of our Notes to Consolidated Financial Statements.

### Results Overview

We generated continued growth during the fiscal year ended March 31, 2015, with product revenue growth of 16% and overall revenue growth of 14% compared to the prior fiscal year. Our diluted net income per share for the fiscal year ended March 31, 2015 was \$1.47 per share, representing a \$0.30, or 26%, increase over the same period in the prior year. Our business has maintained strong gross profit margins. Our gross margin for the fiscal year ended March 31, 2015 remained flat at 79% compared to the same period in the prior year.

The combination of continued revenue growth, strong gross profit margins and a scalable infrastructure supported by prudent investment across key areas of our business, including research and development initiatives, and sales and marketing programs, has enabled us produce strong operating profit margins. Despite higher one-time expenses associated with the aforementioned planned acquisition of Danaher's Communications Business, our operating profit margin for the fiscal year ended March 31, 2015 was 21%, as compared to 20% for the same period in the prior year. We continue to maintain strong liquidity. At March 31, 2015, we had cash, cash equivalents and marketable securities of \$264.9 million. This represents an increase of \$46.1 million over the previous fiscal year ended March 31, 2014.

### Use of Non-GAAP Financial Measures

We supplement the generally accepted accounting principles (GAAP) financial measures we report in quarterly and annual earnings announcements, investor presentations and other investor communications by reporting the following non-GAAP measures: non-GAAP revenue, non-GAAP net income and non-GAAP net income per diluted share. Non-GAAP revenue eliminates the GAAP effects of acquisitions by adding back revenue related to deferred revenue revaluation. Non-GAAP net income includes the foregoing adjustment and also removes inventory fair value adjustments, expenses related to the amortization of acquired intangible assets, share-based compensation,

restructuring, certain expenses relating to acquisitions including compensation for post-combination services and business development charges, net of related income tax effects. Non-GAAP diluted net income per share also excludes these expenses as well as the related impact of all these adjustments on the provision for income taxes. These non-GAAP measures are not in accordance with GAAP, should not be considered an alternative for measures prepared in accordance with GAAP (revenue, net income and diluted net income per share), and may have limitations in that

31

---



Table of Contents

they do not reflect all our results of operations as determined in accordance with GAAP. These non-GAAP measures should only be used to evaluate our results of operations in conjunction with the corresponding GAAP measures. The presentation of non-GAAP information is not meant to be considered superior to, in isolation from, or as a substitute for results prepared in accordance with GAAP.

Management believes these non-GAAP financial measures enhance the reader's overall understanding of our current financial performance and its prospects for the future by providing a higher degree of transparency for certain financial measures and providing a level of disclosure that helps investors understand how we plan and measure our business. We believe that providing these non-GAAP measures affords investors a view of our operating results that may be more easily compared to our peer companies and also enables investors to consider our operating results on both a GAAP and non-GAAP basis during and following the integration period of our acquisitions. Presenting the GAAP measures on their own may not be indicative of our core operating results. Furthermore, management believes that the presentation of non-GAAP measures when shown in conjunction with the corresponding GAAP measures provide useful information to management and investors regarding present and future business trends relating to our financial condition and results of operations.

The following table reconciles revenue, net income and net income per share on a GAAP and non-GAAP basis for the years ended March 31, 2015, 2014 and 2013:

	Fiscal Year Ended March 31,		
	(Dollars in Thousands, Except per Share Data)		
	2015	2014	2013
GAAP revenue	\$453,669	\$396,647	\$350,550
Deferred revenue fair value adjustment	18	558	1,215
Non-GAAP revenue	\$453,687	\$397,205	\$351,765
GAAP net income	\$61,192	\$49,106	\$40,609
Deferred revenue fair value adjustments	18	558	1,215
Inventory fair value amortization	—	—	453
Share-based compensation expense	16,580	12,930	9,580
Amortization of acquired intangible assets	6,990	6,765	7,424
Business development and integration expense	11,956	523	1,618
Compensation for post combination services	1,414	2,215	2,721
Restructuring charges	—	—	1,065
Income tax adjustments	(13,810	) (7,879	) (8,671
Non-GAAP net income	\$84,340	\$64,218	\$56,014
GAAP diluted net income per share	\$1.47	\$1.17	\$0.96
Share impact of non-GAAP adjustments identified above	0.56	0.36	0.36
Non-GAAP diluted net income per share	\$2.03	\$1.53	\$1.32

Critical Accounting Policies

We consider accounting policies related to marketable securities, revenue recognition, valuation of goodwill, intangible assets and other acquisition accounting items, and share based compensation to be critical in fully understanding and evaluating our financial results. We apply significant judgment and create estimates when applying these policies.

Marketable Securities

We measure the fair value of our marketable securities at the end of each reporting period. Fair value is defined as the exchange price that would be received for an asset in the principal or most advantageous market for the asset in an orderly transaction between market participants on the measurement date. Marketable securities are recorded at fair value and have been classified as Level 1 or 2 within the fair value hierarchy. Fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in accessible active markets for identical assets or liabilities. Fair values determined by Level 2 inputs utilize data points that are observable such as quoted prices, interest rates and yield

curves.

32

---

Table of Contents

Investments and marketable securities are considered to be impaired when a decline in fair value below cost basis is determined to be other-than-temporary. We periodically evaluate whether a decline in fair value below cost basis is other-than-temporary by considering available evidence regarding these investments including, among other factors, the duration of the period that, and extent to which, the fair value is less than cost basis, the financial health of and business outlook for the issuer, including industry and sector performance and operational and financing cash flow factors, overall market conditions and trends and our intent and ability to retain our investment in the security for a period of time sufficient to allow for an anticipated recovery in market value. Once a decline in fair value is determined to be other-than-temporary, a write-down is recorded and a new cost basis in the security is established. Assessing the above factors involves inherent uncertainty. Write-downs, if recorded, could be materially different from the actual market performance of investments and marketable securities in our portfolio if, among other things, relevant information related to our investments and marketable securities was not publicly available or other factors not considered by us would have been relevant to the determination of impairment.

**Revenue Recognition**

Product revenue consists of sales of our hardware products (which include required embedded software that works together with the hardware to deliver the hardware's essential functionality), licensing of our software products, and sale of hardware bundled with a software license. Product revenue is recognized upon shipment, provided that evidence of an arrangement exists, title and risk of loss have passed to the customer, fees are fixed or determinable and collection of the related receivable is probable. Because many of our solutions are comprised of both hardware and more than incidental software components, we recognize revenue in accordance with authoritative guidance on both hardware and software revenue recognition.

Service revenue consists primarily of fees from customer support agreements, consulting and training. We generally provide software and hardware support as part of product sales. Revenue related to the initial bundled software and hardware support is recognized ratably over the support period. In addition, customers can elect to purchase extended support agreements for periods after the initial software warranty expiration. Support services generally include rights to unspecified upgrades (when and if available), telephone and internet-based support, updates and bug fixes.

Reimbursements of out-of-pocket expenditures incurred in connection with providing consulting services are included in services revenue, with the offsetting expense recorded in cost of service revenue. Training services include on-site and classroom training. Training revenues are recognized as the related training services are provided.

Generally, our contracts are accounted for individually. However, when contracts are closely interrelated and dependent on each other, it may be necessary to account for two or more contracts as one to reflect the substance of the group of contracts.

Multi-element arrangements are concurrent customer purchases of a combination of our product and service offerings that may be delivered at various points in time. For multi-element arrangements comprised only of hardware products and related services, we allocate the total arrangement consideration to the multiple elements based on each element's selling price compared to the total relative selling price of all the elements. Each element's selling price is based on management's best estimate of selling price (BESP) paid by customers based on the element's historical pricing when VSOE or third party evidence (TPE) does not exist. We have established BESP for product elements as the average selling price the element was sold for over the past six quarters, whether sold alone or sold as part of a multiple element transaction. Our internal list price for products, reviewed quarterly by senior management, with consideration in regards to changing factors in our technology and in the marketplace, is generated to target the desired gross margin from sales of product after analyzing historical discounting trends. We review sales of the product elements on a quarterly basis and update, when appropriate, BESP for such elements to ensure that it reflects recent pricing experience. We have established VSOE for services related undelivered elements based on historical stand-alone sales.

For multi-element arrangements comprised only of software products and related services, we allocate a portion of the total arrangement consideration to the undelivered elements, primarily support agreements and training, using VSOE of fair value for the undelivered elements. The remaining portion of the total arrangement consideration is allocated to the delivered software, referred to as the residual method. VSOE of fair value of the undelivered elements is based on

the price customers pay when the element is sold separately. We review the separate sales of the undelivered elements on a quarterly basis and update, when appropriate, our VSOE of fair value for such elements to ensure that it reflects recent pricing experience. If we cannot objectively determine the VSOE of the fair value of any undelivered software element, we defer revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements.

33

---

Table of Contents

For multi-element arrangements comprised of a combination of hardware and software elements, the total arrangement consideration is bifurcated between the hardware and hardware related deliverables and the software and software related deliverables based on the relative selling prices of all deliverables as a group. Then, arrangement consideration for the hardware and hardware-related services is recognized upon delivery or as the related services are provided outlined above and revenue for the software and software-related services is allocated following the residual method and recognized based upon delivery or as the related services are provided.

Our product is distributed through our direct sales force and indirect distribution channels through alliances with resellers. Revenue arrangements with resellers are recognized on a sell-in basis; that is, when we deliver the product to the reseller. We record consideration given to a reseller as a reduction of revenue to the extent we have recorded revenue from the reseller. We do not offer contractual rights of return, stock balancing, or price protection to our resellers, and actual product returns from them have been insignificant to date. In addition, we have a history of successfully collecting receivables from the resellers. As a result, we do not maintain reserves for reseller product returns.

#### Valuation of Goodwill, Intangible Assets and Other Acquisition Accounting Items

The carrying value of goodwill was \$197.4 million and \$203.4 million at March 31, 2015 and 2014, respectively. We have two reporting units: (1) Unified Service Delivery and (2) Test Optimization. Goodwill is tested for impairment at a reporting unit level at least annually, or on an interim basis if an event occurs or circumstances change that would, more likely than not, reduce the fair value of the reporting segment below its carrying value.

We performed the qualitative Step 0 assessment on our Unified Service Delivery reporting unit. In performing the qualitative Step 0 assessment, we considered certain events and circumstances specific to the entity at the reporting unit level, such as macroeconomic conditions, industry and market considerations, overall financial performance and cost factors when evaluating whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. No indicators of impairment were noted at January 31, 2015.

We performed the quantitative Step 1 assessment on our Test Optimization reporting unit. If the reporting unit's carrying value exceeds its fair value, we record an impairment loss equal to the difference between the carrying value of goodwill and its implied fair value. We estimate the fair values of our reporting units using discounted cash flow valuation models. Those models require estimates of future revenues, profits, capital expenditures, working capital, terminal values based on revenue multiples, and discount rates for each reporting unit. We estimate these amounts by evaluating historical trends, current budgets, operating plans and industry data. The estimated fair value of the Test Optimization reporting unit was approximately 120 percent greater than its carrying value as of January 31, 2015.

Additionally, the market capitalization of NetScout as a whole significantly exceeded its carrying value.

The carrying value of intangible assets was \$50.2 million and \$58.5 million at March 31, 2015 and 2014, respectively. Intangible assets acquired in a business combination are recorded under the acquisition method of accounting at their estimated fair values at the date of acquisition. We amortize intangible assets over their estimated useful lives, except for the acquired tradename which resulted from the Network General acquisition, which has an indefinite life and thus, is not amortized. The carrying value of the indefinite lived tradename is evaluated annually or more frequently if events or changes in circumstances indicate that the asset might be impaired.

Indefinite-lived intangible assets are tested for impairment at a reporting unit level at least annually, or on an interim basis if an event occurs or circumstances change that would, more likely than not, reduce the fair value of the reporting segment below its carrying value. To test impairment, we first assess qualitative factors to determine whether the existence of events and circumstances indicate that it is more likely than not that the indefinite-lived intangible asset is impaired. If based on our qualitative assessment we conclude that it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount, quantitative impairment testing is required. However, if we conclude otherwise, quantitative impairment testing is not required. We completed our annual impairment test of the indefinite lived intangible at January 31, 2015 using the qualitative Step 0 assessment described above, which largely mirrors the Unified Service Delivery analysis, as the tradenames apply to a majority of the products and branding within that reporting unit. No impairment indicators were observed as of January 31, 2015.



Table of Contents

We have acquired two companies during the three year period ended March 31, 2015. The acquisition method of accounting requires that we estimate the fair value of the assets and liabilities acquired as part of these transactions. In order to estimate the fair value of acquired intangible assets we use a relief from royalty model which requires management to estimate: future revenues expected to be generated by the acquired intangible assets, a royalty rate which a market participant would pay related to the projected revenue stream, a present value factor which approximates a risk adjusted rate of return for a market participant purchasing the assets, and a technology migration curve representing a period of time over which the technology assets or some portion thereof are still being used. We are also required to develop the fair value for customer relationships acquired as part of these transactions which requires that we create estimates for the following items: a projection of future revenues associated with the acquired company's existing customers, a turnover rate for those customers, a margin related to those sales, and a risk adjusted rate of return for a market participant purchasing those relationships.

The acquisition of Simena LLC on November 18, 2011 also contained contingent consideration based on the ultimate settlement of assets and liabilities acquired as part of transaction, and the former owners' future period of employment with the Company. Contingent consideration accounting requires the Company to estimate the probability of various settlement scenarios, the former owners' expected period of employment with NetScout, and a risk adjusted interest rate to present value to the payment streams.

**Share-based Compensation**

We recognize compensation expense for all share-based payments. Under the fair value recognition provisions, we recognize share-based compensation net of an estimated forfeiture rate and only recognize compensation cost for those shares expected to vest on a straight-line basis over the requisite service period of the award.

We are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the share-based compensation expense could be significantly different from what we have recorded in the current period.

Based on historical experience, we assumed an annualized forfeiture rate of 0% for awards granted to our directors, an annualized forfeiture rate of 2% for awards granted to our senior executives, and an annualized forfeiture rate of 5% for all remaining employees. We will record additional expense if the actual forfeitures are lower than estimated and will record a recovery of prior expense if the actual forfeitures are higher than estimated.

**Results of Operations****Comparison of Years Ended March 31, 2015 and 2014****Revenue**

Product revenue consists of sales of our hardware products and licensing of our software products. Service revenue consists of customer support agreements, consulting and training. During the fiscal year ended March 31, 2015, two direct customers accounted for more than 10% of total revenue, while no indirect channel partner accounted for more than 10% of total revenue. During the fiscal year ended March 31, 2014, one direct customer accounted for more than 10% of our total revenue, while no indirect channel partner accounted for more than 10% of total revenue.

Fiscal Year Ended March 31,

(Dollars in Thousands)

	2015	% of Revenue	2014	% of Revenue	Change \$	%	
Revenue:							
Product	\$272,895	60	% \$234,268	59	% \$38,627	16	%
Service	180,774	40	162,379	41	18,395	11	%
Total revenue	\$453,669	100	% \$396,647	100	% \$57,022	14	%

Product. The 16%, or \$38.6 million, increase in product revenue was due to a \$26.8 million increase in revenue from our service provider sector, a \$7.5 million increase in revenue from our government enterprise sector and a \$4.3 million increase in revenue from our general enterprise sector.

Compared to the same period in the prior year, we realized a 6% increase in units shipped and a 7% increase in the average selling price per unit of our products.

35

---



Table of Contents

We expect continued growth in our service provider sector through the fiscal year ending March 31, 2016. We also expect growth in our general enterprise market for the fiscal year ending March 31, 2016.

Service. The 11%, or \$18.4 million, increase in service revenue was due to a \$13.4 million increase in revenue from new maintenance contracts and renewals from a growing support base, a \$4.6 million increase in premium support contracts and a \$328 thousand increase in revenue from training. We expect single digit percentage growth in our service revenues through the fiscal year ending March 31, 2016. We expect this to be generated by product revenue growth which increases our installed base and therefore our related maintenance contracts.

Total product and service revenue from direct and indirect channels are as follows:

	Fiscal Year Ended March 31,				Change			
	(Dollars in Thousands)							
	2015	% of Revenue	2014	% of Revenue	\$	%		
Indirect	\$220,093	49	% \$195,484	49	% \$24,609	13	%	
Direct	233,576	51	201,163	51	32,413	16	%	
Total revenue	\$453,669	100	% \$396,647	100	% \$57,022	14	%	

The 16%, or \$32.4 million, increase in direct revenue is primarily the result of increased domestic revenue from our service provider customers. The 13%, or \$24.6 million, increase in indirect channel revenue is primarily the result of the increases in sales to our government enterprise sector in the United States and the service provider sector across international geographies. Sales to customers outside the United States are export sales typically through channel partners, who are generally responsible for distributing our products and providing technical support and service to customers within their territories. Our reported international revenue does not include any revenue from sales to customers outside the United States that are shipped to our United States-based indirect channel partners. These domestic resellers fulfill customer orders based upon joint selling efforts in conjunction with our direct sales force and may subsequently ship our products to international locations; however, we report these shipments as United States revenue since we ship the products to a domestic location.

Total revenue by geography is as follows:

	Fiscal Year Ended March 31,				Change			
	(Dollars in Thousands)							
	2015	% of Revenue	2014	% of Revenue	\$	%		
United States	\$348,354	77	% \$303,364	76	% \$44,990	15	%	
International:								
Europe	46,253	10	45,837	12	416	1	%	
Asia	27,685	6	20,646	5	7,039	34	%	
Rest of the world	31,377	7	26,800	7	4,577	17	%	
Subtotal international	105,315	23	93,283	24	12,032	13	%	
Total revenue	\$453,669	100	% \$396,647	100	% \$57,022	14	%	

United States revenues increased 15%, or \$45.0 million, primarily as a result of an increase in revenue from our service provider sector. The 13%, or \$12.0 million, increase in international revenue is primarily due to an increase in revenue from our service provider sector across international geographies. We expect revenue from sales to customers outside the United States to continue to account for a significant portion of our total revenue in the future. In accordance with United States export control regulations, we do not sell to, or do business with, countries subject to economic sanctions and export controls.



Table of Contents

## Cost of Revenue and Gross Profit

Cost of product revenue consists primarily of material components, manufacturing personnel expenses, packaging materials, overhead and amortization of capitalized software, acquired software and core technology. Cost of service revenue consists primarily of personnel, material, overhead and support costs.

	Fiscal Year Ended March 31, (Dollars in Thousands)				Change			
	2015	% of Revenue	2014	% of Revenue	\$	%		
Cost of revenue:								
Product	\$59,037	13	% \$51,219	13	% \$7,818	15	%	
Service	35,524	8	33,294	8	2,230	7	%	
Total cost of revenue	\$94,561	21	% \$84,513	21	% \$10,048	12	%	
Gross profit:								