ATRIX LABORATORIES INC
Form 10-Q
July 24, 2001

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2001

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission File Number 0-18231

ATRIX LABORATORIES, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	84-1043826
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2579 MIDPOINT DRIVE FORT COLLINS, COLORADO 80525
(Address of principal executive office) (Zip Code)

Registrant's telephone number, including area code: (970) 482-5868

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 X No
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The number of shares outstanding of the registrant's common stock as of July 20, 2001 was 15,228,171.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ATRIX LABORATORIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Unaudited)

ASSETS

	June 30, 2001	Decembe
CURRENT ASSETS:		
Cash and cash equivalents	$ 19,073,358	$ 4
Marketable securities available for sale, at fair market value	37,175,684	28
Notes receivable - stock subscription and license fee	--	23
Accounts receivable, net of allowance for doubtful accounts of $169,431 and $209,659	2,957,232	2
Interest receivable	417,274	
Inventories	2,787,987	1
Prepaid expenses and deposits	1,416,461	1
Total current assets	63,827,996	62
PROPERTY, PLANT AND EQUIPMENT, NET	7,478,584	6
OTHER ASSETS:		
Intangible assets, net of accumulated amortization of $2,906,694 and $2,399,431	3,748,208	4
Deferred finance costs, net of accumulated amortization of $197,742 and $628,379	185,684	
Other assets, net	3,933,892	4
TOTAL ASSETS	$ 75,240,472	$ 74

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:		
Accounts payable - trade	$ 2,929,231	$ 2
Interest payable	54,939	
Accrued salaries and payroll taxes	362,857	
Other accrued liabilities	145,035	
Deferred revenue	4,538,294	2
Total current liabilities	8,030,356	5
DEFERRED REVENUE	28,036,666	24
CONVERTIBLE SUBORDINATED NOTES PAYABLE	9,711,000	36
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY:		
Preferred stock, $.001 par value; 5,000,000 shares authorized		
Series A preferred stock, $.001 par value, 200,000 shares authorized and no shares issued or outstanding	--	
Series A convertible exchangeable preferred stock, $.001 par value, 20,000 shares authorized; 12,439 and 12,015 shares issued and outstanding Liquidation preference $12,827,827 and $12,397,505	12	
Common stock, $.001 par value; 45,000,000 shares authorized; 15,204,402 and 13,341,681 shares issued and outstanding	15,204	
Additional paid-in capital	148,171,512	113

Accumulated other comprehensive loss	(555,204)	
Accumulated deficit	(118,169,074)	(105
Total shareholders' equity	29,462,450	7
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 75,240,472	$ 74

See notes to the consolidated financial statements.

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ATRIX LABORATORIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED JUNE 30, 2001 AND 2000
(Unaudited)

	2001	2000 (RESTATED)
REVENUE:		
Net sales and royalties	$ 1,344,803	$ 1,663,336
Contract research and development revenue	2,128,653	222,278
Licensing, marketing rights and milestone revenue	791,812	468,444
Total revenue	4,265,268	2,354,058
OPERATING EXPENSES:		
Cost of goods sold	609,284	663,860
Research and development	6,340,777	3,609,631
Administrative and marketing	1,431,123	1,187,401
Total operating expenses	8,381,184	5,460,892
LOSS FROM OPERATIONS	(4,115,916)	(3,106,834)
OTHER INCOME (EXPENSE):		
Equity in loss of joint venture	(1,016,018)	--
Investment income	706,936	373,752
Interest expense	(175,839)	(646,603)
Debt conversion expense	(9,184)	--
Other	(22,615)	39,400
Net other expense	(516,720)	(233,451)
LOSS BEFORE EXTRAORDINARY ITEM	(4,632,636)	(3,340,285)
Extraordinary loss on extinguished debt	(6,724)	--
NET LOSS BEFORE PREFERRED STOCK DIVIDEND	(4,639,360)	(3,340,285)
Accretion of dividend on preferred stock	(217,086)	--
NET LOSS APPLICABLE TO COMMON STOCK	$ (4,856,446)	$ (3,340,285)

Basic and diluted earnings per common share:		
Loss before extraordinary item	$ (.31)	$ (.29)
Extraordinary item	--	--
Net loss before preferred stock dividend	(.31)	(.29)
Accretion of dividend on preferred stock	(.01)	--
Net loss applicable to common stock	$ (.32)	$ (.29)
Basic and diluted weighted average common shares outstanding	15,127,406	11,463,355

See notes to the consolidated financial statements.

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ATRIX LABORATORIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000
(Unaudited)

	2001	2000 (RESTATED)
REVENUE:		
Net sales and royalties	$ 2,576,323	$ 2,820,652
Contract research and development revenue	3,432,933	760,150
Licensing, marketing rights and milestone revenue	1,509,084	936,888
Total revenue	7,518,340	4,517,690
OPERATING EXPENSES:		
Cost of goods sold	1,043,486	1,123,084
Research and development	13,104,238	7,330,384
Administrative and marketing	2,701,500	2,211,568
Total operating expenses	16,849,224	10,665,036
LOSS FROM OPERATIONS	(9,330,884)	(6,147,346)
OTHER INCOME (EXPENSE):		
Equity in loss of joint venture	(1,516,661)	--
Investment income	1,455,979	888,038
Interest expense	(490,582)	(1,296,460)
Debt conversion expense	(2,048,347)	--
Other	(23,312)	78,122
Net other expense	(2,622,923)	(330,300)
LOSS BEFORE EXTRAORDINARY ITEM AND CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	(11,953,807)	(6,477,646)

Extraordinary loss on extinguished debt	(288,355)	--
Cumulative effect of change in accounting principle	--	(20,611,526)
NET LOSS BEFORE PREFERRED STOCK DIVIDEND	(12,242,162)	(27,089,172)
Accretion of dividend on preferred stock	(430,322)	--
NET LOSS APPLICABLE TO COMMON STOCK	$(12,672,484)	$(27,089,172)
Basic and diluted earnings per common share:		
Loss before extraordinary item and cumulative effect of change in accounting principle	$ (.82)	$ (.56)
Extraordinary item	(.02)	--
Cumulative effect of change in accounting principle	--	(1.80)
Net loss before preferred stock dividend	(.84)	(2.36)
Accretion of dividend on preferred stock	(.03)	--
Net loss applicable to common stock	$ (.87)	$ (2.36)
Basic and diluted weighted average common shares outstanding	14,655,378	11,457,533

See notes to the consolidated financial statements.

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ATRIX LABORATORIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2001
(Unaudited)

	Preferred Stock		Common Stock	
	Shares	Amount	Shares	Amount
BALANCE, DECEMBER 31, 2000	12,015	$ 12	13,341,681	$ 13,342
Comprehensive loss:				
Net loss	--	--	--	--
Other comprehensive loss:				
- Cumulative foreign currency translation adjustments	--	--	--	--
- Unrealized loss on investments	--	--	--	--
Net comprehensive loss				
Issuance of Series A convertible exchangeable preferred stock to Elan for accrued dividends	424	--	--	--
Accretion on preferred stock	--	--	--	--
Issuance of common stock to extinguish debt	--	--	1,482,031	1,482
Issuance of common stock to				

MediGene	--	--	233,918	234
Non-qualified stock compensation	--	--	--	--
Exercise of non-qualified stock options	--	--	5,000	5
Exercise of stock options	--	--	114,074	114
Issuance for employee stock purchase plan	--	--	1,198	1
Issuance of restricted stock	--	--	26,500	26
BALANCE, JUNE 30, 2001	12,439	$ 12	15,204,402	$ 15,204

	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Shareholders' Equity
BALANCE, DECEMBER 31, 2000	$ 113,763,660	$ (471,306)	$(105,496,590)	$ 7,809,118
Comprehensive loss:				
Net loss	--	--	(12,672,484)	(12,672,484)
Other comprehensive loss:				
- Cumulative foreign currency translation adjustments	--	(39,046)	--	(39,046)
- Unrealized loss on investments	--	(44,852)	--	(44,852)
Net comprehensive loss				(12,756,382)
Issuance of Series A convertible exchangeable preferred stock to Elan for accrued dividends	--	--	--	--
Accretion on preferred stock	430,322	--	--	430,322
Issuance of common stock to extinguish debt	28,525,865	--	--	28,527,347
Issuance of common stock to MediGene	3,779,766	--	--	3,780,000
Non-qualified stock compensation	116,524	--	--	116,524
Exercise of non-qualified stock options	29,995	--	--	30,000
Exercise of stock options	1,242,035	--	--	1,242,149
Issuance for employee stock purchase plan	16,715	--	--	16,716
Issuance of restricted stock	266,630	--	--	266,656
BALANCE, JUNE 30, 2001	$ 148,171,512	$ (555,204)	$(118,169,074)	$ 29,462,450

See notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000
(Unaudited)

	2001
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net loss applicable to common stock	$(12,672,484)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:	
Accretion of dividend on preferred stock	430,322
Depreciation and amortization	1,189,378
Equity in loss of joint venture	1,516,661
Loss on sale of property, plant and equipment	23,392
Loss on sale of marketable securities	--
Provision for bad debts	(40,228)
Write-off of obsolete patents	497
Stock compensation	116,524
Debt conversion expense	2,048,347
Extraordinary loss on extinguished debt	288,355
Cumulative effect of change in accounting principle	--
Net changes in operating assets and liabilities:	
Accounts receivable	(358,524)
Note receivable - license fee	8,000,000
Interest receivable	54,927
Inventories	(871,070)
Prepaid expenses and deposits	(332,118)
Accounts payable	(531,952)
Interest payable	136,096
Accrued salaries and payroll taxes	85,547
Other accrued liabilities	(115,559)
Deferred revenue	5,360,108
Net cash provided by (used in) operating activities	4,328,219
CASH FLOWS FROM INVESTING ACTIVITIES:	
Acquisition of property, plant and equipment	(1,323,557)
Investments in intangible assets	(206,368)
Proceeds from sale of property, plant and equipment	904
Proceeds from sale of marketable securities	--
Proceeds from maturity of marketable securities	18,740,841
Investment in marketable securities	(27,066,960)
Net cash provided by (used in) investing activities	(9,855,140)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from issuance of equity securities	5,335,521
Note receivable - stock subscription	15,000,000
Net cash provided by financing activities	20,335,521
NET EFFECT OF EXCHANGE RATE ON CASH	(219,572)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	14,589,028
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	4,484,330

CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 19,073,358
Supplemental cash flow information:	
Cash paid for interest	$ 354,486

Non-cash activities:

During the six months ended June 30, 2001, the Company issued common stock valued at $28,527,347 to extinguish $26,479,000 of the convertible subordinated notes.

See notes to the consolidated financial statements.

ATRIX LABORATORIES, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2001 AND 2000

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited consolidated financial statements of Atrix Laboratories, Inc. and subsidiaries have been prepared in accordance with generally accepted accounting principles for interim consolidated financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments considered necessary (which consist of normal recurring accruals) for a fair presentation have been included. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2000, filed with the Securities and Exchange Commission in the Company's Annual Report on Form 10-K.

Atrix Laboratories, Inc. was formed in August 1986 as a Delaware corporation. In November 1998, the Company acquired ViroTex. In June 1999, the Company organized its wholly owned subsidiary Atrix Laboratories Limited, which is based in London, England. In February 2000, the Company organized its wholly owned subsidiary Atrix Laboratories GmbH, which is based in Frankfurt, Germany, to conduct its European operations. Collectively, Atrix Laboratories and its subsidiaries are referred to as Atrix or the Company. In June 2000, the Company entered into a research joint venture, Transmucosal Technologies, Ltd., with Elan International Services, Ltd. ("Elan"), a wholly owned subsidiary of Elan Corporation, plc, to develop oncology and pain management compounds. Drug delivery of these compounds will utilize the Company's patented ATRIGEL and BEMA drug delivery systems and Elan's nanoparticulate delivery technology.

Atrix is an emerging specialty pharmaceutical company focused on advanced drug delivery. With five unique patented drug delivery technologies, the Company is currently developing a diverse portfolio of products, including proprietary oncology, pain management, growth hormone releasing peptide-1 and dermatology products. The Company also partners with several large pharmaceutical and biotechnology companies to apply its proprietary technologies to new chemical entities or to extend the patent life of existing products. The Company has strategic alliances with several large pharmaceutical companies to use its drug delivery technologies and expertise in the development of new products.

On June 29, 2001, Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations" was approved by the Financial Accounting Standards Board (FASB). SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Goodwill and certain intangible assets will remain on the balance sheet and not be amortized. On an annual basis, and when there is reason to suspect that their values have been diminished or impaired, these assets must be tested for impairment, and write-downs may be necessary. The Company is required to implement SFAS No. 141 on July 1, 2001 and it has not determined the impact, if any, that this statement will have on its consolidated financial position or results of operations.

On June 29, 2001, SFAS No. 142, "Goodwill and Other Intangible Assets" was approved by the FASB. SFAS No. 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Amortization of goodwill, including goodwill recorded in past business combinations, will cease upon adoption of this statement. The Company is required to implement SFAS No. 142 on January 1, 2002 and it has not determined the impact, if any, that this statement will have on its consolidated financial position or results of operations.

Effective in the fiscal fourth quarter of 2000, the Company changed its method of accounting for nonrefundable technology access fees and milestone payments to recognize such payments as revenue over the term of the related agreements. The change in accounting principle is based on guidance provided in the Securities and Exchange Commission's Staff Accounting Bulletin No. 101 - Revenue Recognition in Financial Statements. Previously, the Company recognized $24,100,000 for nonrefundable technology access fees and milestone payments as revenue when received and when the Company fulfilled all contractual obligations relating to the fees and milestone payments. There was approximately $20,612,000 cumulative effect for this change in accounting principle that was reported as a charge in the year ended December 31, 2000. The cumulative effect was recorded as deferred revenue that will be recognized as revenue over the remaining contractual terms for each of the specific agreements.

The following represents the Consolidated Statement of Operations for the three and six months ended June 30, 2000 as previously reported, the adjustments for the adoption of SAB No. 101, and the resulting Consolidated Statement of Operations as restated for that adoption.

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ATRIX LABORATORIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED JUNE 30, 2000 AS PREVIOUSLY REPORTED AND RESTATED
(Unaudited)

	2000 (AS PREVIOUSLY REPORTED)	SAB NO. 101 ADJUSTMENTS	2000 (RESTATED)
REVENUE:			
Net sales and royalties	$ 1,663,336	$ --	$ 1,663,336
Contract research and development revenue	222,278	--	222,278
Licensing, marketing rights and milestone revenue	40,000	428,444	468,444

Total revenue	1,925,614	428,444	2,354,058
OPERATING EXPENSES:			
Cost of goods sold	663,860	--	663,860
Research and development	3,609,631	--	3,609,631
Administrative and marketing	1,187,401	--	1,187,401
Total operating expenses	5,460,892	--	5,460,892
INCOME (LOSS) FROM OPERATIONS	(3,535,278)	428,444	(3,106,834
OTHER INCOME (EXPENSE):			
Investment income	373,752	--	373,752
Interest expense	(646,603)	--	(646,603
Other	39,400	--	39,400
Net other expense	(233,451)	--	(233,451
NET LOSS	$ (3,768,729)	$ 428,444	$ (3,340,285
Basic and diluted earnings per common share:			
Net loss	$ (.33)		$ (.29
Basic and diluted weighted average common shares outstanding	11,463,355		11,463,355

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ATRIX LABORATORIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE SIX MONTHS ENDED JUNE 30, 2000 AS PREVIOUSLY REPORTED AND RESTATED
(Unaudited)

	2000 (AS PREVIOUSLY REPORTED)	SAB NO. 101 ADJUSTMENTS	2000 (RESTATED)
REVENUE:			
Net sales and royalties	$ 2,820,652	$ --	$ 2,820,65
Contract research and development revenue	760,150	--	760,15
Licensing, marketing rights and milestone revenue	105,000	831,888	936,88
Total revenue	3,685,802	831,888	4,517,69
OPERATING EXPENSES:			
Cost of goods sold	1,123,084	--	1,123,08
Research and development	7,330,384	--	7,330,38
Administrative and marketing	2,211,568	--	2,211,56

Total operating expenses	10,665,036	--	10,665,03
INCOME (LOSS) FROM OPERATIONS	(6,979,234)	831,888	(6,147,34
OTHER INCOME (EXPENSE):			
Investment income	888,038	--	888,03
Interest expense	(1,296,460)	--	(1,296,46
Other	78,122	--	78,12
Net other expense	(330,300)	--	(330,30
INCOME (LOSS) BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	(7,309,534)	831,888	(6,477,64
Cumulative effect of change in accounting principle	--	(20,611,526)	(20,611,52
NET LOSS	$ (7,309,534)	$(19,779,638)	$(27,089,17
Basic and diluted earnings per common share:			
Income (loss) before cumulative effect of change in accounting principle	$ (.64)		$ (.5
Cumulative effect of change in accounting principle	--		(1.8
Net loss	$ (.64)		$ (2.3
Basic and diluted weighted average common shares outstanding	11,457,533		11,457,53

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NOTE 2. PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of Atrix Laboratories, Inc., and its wholly owned subsidiaries Atrix Laboratories Limited and Atrix Laboratories, GmbH. All significant intercompany transactions and balances have been eliminated. While the Company owns 80.1% of Transmucosal Technologies' outstanding common stock, Elan and its subsidiaries have retained significant minority investor rights that are considered "participating rights" as defined in Emerging Issues Task Force Bulletin 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest, but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights." Accordingly, the Company accounts for its investment in Transmucosal Technologies under the equity method of accounting.

NOTE 3. INVENTORIES

Inventories are stated at the lower of cost, determined by the first-in, first-out (FIFO) method, or market. The inventory components at June 30, 2001 and December 31, 2000, are as follows:

	June 30, 2001	December 31, 2000
Raw materials	$1,982,248	$1,616,878
Work in process	495,473	144,723

Finished goods	310,266	179,328
	$2,787,987	$1,940,929

NOTE 4. PROPERTY, PLANT, AND EQUIPMENT

The components of net property, plant and equipment are as follows:

	June 30, 2001	December 31, 2000
Land	$ 1,071,018	$ 1,071,018
Building	3,616,693	3,610,068
Leasehold improvements	580,563	470,002
Furniture and fixtures	561,404	440,534
Machinery	5,756,210	5,038,815
Office equipment	1,100,188	813,317
Total property, plant and equipment	12,686,076	11,443,754
Accumulated depreciation and amortization	(5,207,492)	(4,625,382)
Property, plant and equipment, net	$ 7,478,584	$ 6,818,372

NOTE 5. NET INCOME (LOSS) PER COMMON SHARE

Basic net income (loss) per common share excludes dilution and is computed by dividing net income (loss) by the weighted-average number of common shares outstanding during the periods presented. Diluted net income (loss) per common share reflects the potential dilution of securities that could participate in the earnings. Stock options, warrants outstanding and their equivalents are included in diluted earnings per share computations through the "treasury stock method" unless they are antidilutive. Convertible securities are included in diluted earnings per share computations through the "if converted" method unless they are antidilutive. The effect of assuming conversion of the Series A convertible preferred stock is excluded from the diluted earnings per share computations since the conversion option commences July 18, 2002. Additionally, since the Company has not drawn any proceeds under the convertible promissory note agreement with Elan as of June 30, 2001, there was no effect on earnings per share computations pertaining to this convertible promissory note for the periods presented. Common share equivalents have been excluded from the computations in loss periods, as their effect would be antidilutive. For the six months ended June 30, 2001 and 2000, approximately 1.8 million and 1.9 million equivalent dilutive securities (primarily convertible notes and common stock options), respectively, have been excluded from the weighted-average number of common shares outstanding for the basic and diluted net earnings per common share computations as they are antidilutive.

NOTE 6. CONVERTIBLE SUBORDINATED NOTES PAYABLE

During the six months ended June 30, 2001, the Company completed a series of private transactions involving the exchange of 1,482,031 issued common shares for $26,479,000, or 53% of the original offering amount, of the 7% convertible subordinated notes. Of the 1,482,031 shares issued, 1,393,629 shares were valued at the conversion price of $19.00 per share and the remaining 88,402 were valued at the closing market price as of the various exchange dates. As a

result, the Company recognized an extraordinary loss of approximately $288,000, for the write-off of approximately $585,000 of pro rata unamortized deferred finance charges net of approximately $297,000 interest expense eliminated as a result of these exchanges. Additionally, as part of the 88,402 shares issued to induce conversion, debt conversion expense of approximately $2,048,000 was recognized in the six months ended June 30, 2001. As of June 30, 2001 and December 31, 2000, the convertible notes payable balance was $9,711,000 and $36,190,000, respectively.

NOTE 7. PENDING LEGAL ACTION

The Company has been involved in disputes with Block Drug Corporation, a wholly owned subsidiary of GlaxoSmithKline, concerning product pricing and the payments due to the Company upon achievement of milestones under the Company's commercialization agreement with Block. With

respect to product pricing, arbitration began in December 2000 to resolve the issue as to the minimum price Block must pay for products under the agreement. On April 20, 2001, the Company entered into a settlement agreement with Block resolving the pricing dispute over Block's sale of Atridox. The settlement agreement provides for the payment owed to the Company for sales of the product in 1999. A new pricing schedule for future purchases was also implemented.

With respect to milestone payments, the Company believes that under the agreement, the milestone for the FDA approval of the Atrisorb-Doxy Barrier product was achieved in 2000 and the corresponding payment of $1,000,000 is due. Block has not made this payment. Pursuant to the Company's agreement with Block, the Company will be entitled to an additional milestone payment of $2,000,000 upon Block's first commercial sale of the Atrisorb-Doxy Barrier product in the United States. The agreement provides that the first commercial sale of this product in the U.S. must occur within 120 days after FDA approval, subject to certain conditions that have been satisfied. The FDA approved the Atrisorb-Doxy Barrier product in September 2000. The Company has notified Block that it is in breach of the agreement for failure to commence marketing of the Atrisorb-Doxy Barrier product and on May 11, 2001 the Company filed a lawsuit in the U.S. District Court for the District of Colorado seeking injunctive relief based on Block's breach of the agreement. Block has initiated arbitration, and an arbitration hearing has been set for November 13, 2001. The Company intends to vigorously pursue its rights to these milestone payments.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion relates to the restated interim amounts for the period ended June 30, 2000, a result of the change in accounting principle for the recognition of revenue as discussed in Note 1 to the Consolidated Financial Statements of this report. The following Management's Discussion and Analysis of Financial Condition and Results of Operations as well as information contained elsewhere in this Report, contains statements that constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements include statements regarding the intent, belief or current

expectations of us, our directors or our officers with respect to, among other things: (i) whether we will receive, and the timing of, regulatory approvals or clearances to market potential products; (ii) the results of current and future clinical trials; (iii) the time and expenses associated with the regulatory approval process for products; (iv) the safety and effectiveness of our products and technologies; (v) the timing of new product launches; and (vi) expected future additional equity losses for Transmucosal Technologies, Ltd. The success of our business operations is in turn dependent on factors such as the receipt and timing of regulatory approvals or clearances for potential products, the effectiveness of our marketing strategies to market, our current and any future products, our ability to manufacture products on a commercial scale, the appeal of our mix of products, our success at entering into and collaborating with others to conduct effective strategic alliances and joint ventures, general competitive conditions within the biotechnology and drug delivery industry and general economic conditions. Forward-looking statements are not guarantees of future performance and involve risks and uncertainties. Actual results may differ materially from those projected in the forward-looking statements as a result of various factors, including those described below under the heading "Risk Factors."

OVERVIEW

We are an emerging specialty pharmaceutical company focused on advanced drug delivery. With five unique patented drug delivery technologies, we are currently developing a diverse portfolio of products, including proprietary oncology, pain management, growth hormone releasing peptide-1 and dermatology products. Our drug delivery systems deliver controlled amounts of drugs in time frames ranging from minutes to months to address a range of therapeutic and patient needs. ATRIGEL is our original proprietary sustained release biodegradable polymer drug delivery system. The ATRIGEL system may provide benefits over traditional methods of drug administration such as: safe and effective, wide array and ease of applications, site-specific or systemic delivery, customized release rates and biodegradability. With the acquisition of ViroTex in November 1998, we added four additional drug delivery systems: BEMA, MCA, BCP and SMP.

We also partner with large pharmaceutical and biotechnology companies to apply our proprietary technologies to new chemical entities or to extend the patent life of existing products. We have strategic alliances with several pharmaceutical companies including collaborations with Pfizer, Elan, Sanofi-Synthelabo, MediGene, Geneva Pharmaceuticals, Del Pharmaceuticals, Pharmacia & Upjohn Animal Health, Block Drug Company/GlaxoSmithKline, and J.B. Williams Company.

In January 2001, we purchased an exclusive option from Tulane University Health Science Center to license growth hormone releasing peptide-1, or GHRP-1, a patented growth-promoting compound. Previously we focused on reformulating existing compounds in our drug delivery technologies. The GHRP-1 represents our first chemical entity that we would acquire and develop for our own product portfolio, rather than in conjunction with an external partner. Possible applications of GHRP-1 include treatment of patients with AIDS or cancer, promotion of growth in children with short stature, or prevention of muscle wasting and frailty in aged individuals. We intend to deliver GHRP-1 for an extended period of time using our patented ATRIGEL drug delivery system.

In April 2001, we entered into an exclusive European marketing agreement with MediGene AG, a Germany based biotechnology company, for the Leuprogel products. In the agreement, valued at approximately $20 million, we received an up-front license fee payment of $2 million in April 2001 and will receive additional payments for certain clinical, regulatory and sales milestones. The $2 million license fee from MediGene will be recognized as revenue over a ten-year period using the straight-line method in accordance with

the Securities and Exchange Commission's Staff Accounting Bulletin No. 101 - Revenue Recognition in Financial Statements. Additionally, MediGene purchased shares of our common stock for $3.78 million at a premium to the market in April 2001 as part of the agreement, net of $220,000 for issuance costs, and will provide the resources needed to conduct clinical research and regulatory activities associated with seeking European marketing approvals.

In June 2001, we received $3 million for the filing of the New Drug Application, or NDA, for Leuprogel One-month product in accordance with the exclusive North American marketing agreement entered into with Sanofi-Synthelabo during December 2000. The agreement is valued at approximately $60 million, which includes a license fee, research and development support and payments for certain clinical, regulatory and sales milestones of the Leuprogel products upon approval for marketing by the FDA.

We continued to devote significant resources during the period ended June 30, 2001 for the research and development of our Leuprogel prostate cancer treatment products, our Atrisone acne treatment product, and our new GHRP-1 product. Research and development efforts with third-party partnerships, such as Pfizer, Geneva Pharmaceuticals, and our joint venture with Elan continued as well. We anticipate the commitment of significant resources for research and development activities will continue throughout 2001 for the expeditious advancement of our various products currently in development.

RESULTS OF OPERATIONS

THREE MONTHS ENDED JUNE 30, 2001 COMPARED TO
THREE MONTHS ENDED JUNE 30, 2000 (RESTATED)

Total revenues for the three months ended June 30, 2001 were approximately $4,265,000 compared to approximately $2,354,000 for the three months ended June 30, 2000, representing an 81% increase.

Product net sales and royalty revenue were approximately $1,345,000 during the three months ended June 30, 2001 compared to approximately $1,663,000 for the three months ended June 30, 2000, representing a 19% decrease. This decrease was primarily related to a reduction of approximately $161,000 in sales of our Doxirobe periodontal disease product, which is used in companion animals, as well as a reduction of approximately $121,000 in sales in our contract manufacturing business.

Contract research and development revenue represents revenue we received from grants, from unaffiliated third-parties and from our joint venture with Elan for performing contract research and development activities using our various patented drug delivery technologies. Contract research and development revenue was approximately $2,129,000 for the three months ended June 30, 2001 compared to approximately $222,000 for the three months ended June 30, 2000, representing an 859% increase. This increase is primarily related to the recognition of revenue for the three months ended June 30, 2001 of approximately $1,258,000 for oncology and pain management research activities with our joint venture, Transmucosal Technologies, Ltd., which commenced in October 2000, approximately $192,000 for dermatology research activities with Geneva Pharmaceuticals, which commenced in August 2000, and an increase of approximately $371,000 for research projects for Pfizer.

Licensing fees, marketing rights and milestone revenue recognized in

accordance with SAB No. 101 for the three months ended June 30, 2001 was approximately $792,000 compared to approximately $468,000 for the three months ended June 30, 2000, representing a 69% increase. This increase is primarily related to the recognition of approximately $295,000 in license fee revenue for our Leuprogel products under the Sanofi-Synthelabo December 2000 and MediGene April 2001 agreements. The Block agreement provides for potential milestone payments totaling up to $50 million to us over a three-to-five year period, as well as manufacturing margins and royalties on sales. Prior to 2001, we had received $24.1 million in milestone payments from Block. In February 2001, we received a $1,000,000 Atridox sales milestone payment from Block. These milestone payments will be recognized as revenue over a ten-year period using the straight-line method. We are currently in dispute with Block pertaining to two ATRISORB-DOXY milestone payments. See Part II, Item 1. Legal Proceedings. Additionally, the European Leuprogel license fee from MediGene for $2 million was received in April 2001 and will be recognized over a ten-year period in accordance with SAB No. 101.

Cost of goods sold recorded for the three months ended June 30, 2001 was approximately $609,000 compared to approximately $664,000 for the three months ended June 30, 2000, representing an 8% decrease. This decrease in cost of sales correlates primarily to the decline in sales revenue.

Research and development expenses for the three months ended June 30, 2001 were approximately $6,341,000 compared to approximately $3,610,000 for the three months ended June 30, 2000, representing a 76% increase. Approximately $1,149,000 of this increase was related to a progression through clinical trials for our Leuprogel for prostate cancer treatment products. Approximately $534,000 is related to oncology and pain management research activities with our joint venture, Transmucosal Technologies, Ltd. Dermatology research and development activities for Geneva Pharmaceuticals related projects increased approximately $324,000 for the second quarter of 2001. Additionally, Atrisone research and development expenditures increased approximately $555,000 for the three months ending June 30, 2001. Atrisone Phase III patient enrollment commenced in April 2001.

Administrative and marketing expenses for the three months ended June 30, 2001 were approximately $1,431,000 compared to approximately $1,187,000 for the three months ended June 30, 2000, representing a 21% increase. The increase was primarily related to an increase in legal expenses associated with general business planning and activities, including fees for patents/trademark searches and the Block dispute. See Part II, Item 1. Legal Proceedings.

We recognized a loss of approximately $1,016,000 for the three months ended June 30, 2001 for our 80.1% equity share in the loss of Transmucosal Technologies, our joint venture with Elan compared to -0- for the three months ended June 30, 2000. The joint venture was established in June 2000. Currently, the joint venture is developing two products using our BEMA drug delivery system. We expect to record additional equity losses for Transmucosal Technologies in the foreseeable future.

Investment income for the three months ended June 30, 2001 was approximately $707,000 compared to approximately $374,000 for the three months ended June 30, 2000, representing an 89% increase. The increase was primarily the result of a net increase in our cash and cash equivalents and our marketable securities of approximately $28,019,000 for the second quarter of 2001 in comparison to the second quarter 2000. The increase in our cash and investment balances was primarily the result of receiving an $8 million license fee and a $15 million purchase of our common stock from Sanofi-Synthelabo in January 2001 in conjunction with the December 2000 agreement. Additionally, we received a $2 million payment from MediGene in April 2001 to license Leuprogel in Europe and a $3 million payment from Sanofi-Synthelabo in June 2001 for the NDA filing of Leuprogel One-month product.

Interest expense for the three months ended June 30, 2001 was approximately $176,000 compared to approximately $647,000 for the three months ended June 30, 2000, representing a 73% decrease. The reduction in interest expense was primarily the result of exchanging 1,482,031 shares of common stock for $26,479,000 of our 7% convertible subordinated notes since the period ended June 30, 2000.

We issued Series A convertible exchangeable preferred stock to Elan in July 2000 in connection with the formation of our joint venture with Elan. Related to this issuance, we recognized approximately $217,000 for accretion of dividend on preferred stock for the three months ended June 30, 2001.

For the reasons described above, we recorded a net loss applicable to common stock of approximately $4,856,000, or $.32 per share, for the three months ended June 30, 2001 compared to a net loss applicable to common stock of approximately $3,340,000, or $.29 per share, for the three months ended June 30, 2000.

SIX MONTHS ENDED JUNE 30, 2001 COMPARED TO
SIX MONTHS ENDED JUNE 30, 2000 (RESTATED)

Total revenues for the six months ended June 30, 2001 were approximately $7,518,000 compared to approximately $4,518,000 for the six months ended June 30, 2000, representing a 66% increase.

Product net sales and royalty revenue were approximately $2,576,000 during the six months ended June 30, 2001 compared to approximately $2,821,000 for the six months ended June 30, 2000. This 9% decrease was primarily related to a reduction of sales of approximately $209,000 for our Doxirobe periodontal disease treatment product, which is used in companion animals, as well as a reduction in sales of approximately $114,000 for our contract manufacturing business.

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Contract research and development revenue represents revenue we received from grants, from unaffiliated third parties and from our joint venture with Elan for performing contract research and development activities using our various patented drug delivery technologies. Contract research and development revenue was approximately $3,433,000 for the six months ended June 30, 2001 compared to approximately $760,000 for the six months ended June 30, 2000, representing a 352% increase. This increase is primarily related to the recognition of revenue of approximately $1,883,000 for oncology and pain management research activities with our joint venture, Transmucosal Technologies, Ltd., approximately $407,000 for dermatology research activities with Geneva Pharmaceuticals and approximately $258,000 for research projects with Pfizer.

Licensing, marketing rights and milestone revenue recognized in accordance with SAB No. 101 for the six months ended June 30, 2001 was approximately $1,509,000 compared to approximately $937,000 for the six months ended June 30, 2000, representing a 61% increase. This increase is primarily related to the recognition of approximately $495,000 in license fee revenue for our Leuprogel products under the Sanofi-Synthelabo December 2000 and MediGene April 2001 agreements. The Block agreement provides for potential milestone payments totaling up to $50 million to us over a three-to-five year period, as well as manufacturing margins and royalties on sales. Prior to 2001, we had received $24.1 million in milestone payments from Block. In February 2001, we

received a $1,000,000 Atridox sales milestone payment from Block. These milestone payments will be recognized as revenue over a ten-year period using the straight-line method. We are currently in a dispute with Block pertaining to two Atrisorb-Doxy milestone payments. See Part II, Item 1. Legal Proceedings. Additionally, the European Leuprogel license fee from MediGene for $2,000,000 was received in April 2001 and will be recognized over a ten-year period.

Cost of goods sold recorded for the six months ended June 30, 2001 was approximately $1,043,000 compared to approximately $1,123,000 for the six months ended June 30, 2000, representing a 7% decrease. This decrease in cost of sales correlates to the decline in sales revenue.

Research and development expenses for the six months ended June 30, 2001 were approximately $13,104,000 compared to approximately $7,330,000 for the six months ended June 30, 2000, representing a 79% increase. Approximately $2,878,000 of this increase was due to the rapid progress in our Leuprogel for prostate cancer treatment products. Approximately $773,000 is related to oncology and pain management research activities with our joint venture, Transmucosal Technologies, Ltd. Dermatology research and development activities for Geneva Pharmaceuticals related projects increased approximately $739,000. In January 2001, we purchased an exclusive option from Tulane University Heath Science Center to license growth hormone releasing peptide-1, or GHRP-1, a patented growth-promoting compound. Research and development activities for the GHRP-1 were approximately $818,000 for the six months ended June 30, 2001. Additionally, Atrisone research and development expenditures increased approximately $725,000. Atrisone Phase III patient enrollment commenced in April 2001.

Administrative and marketing expenses for the six months ended June 30, 2001 were approximately $2,702,000 compared to approximately $2,212,000 for the six months ended June 30, 2000, representing a 22% increase. The increase was primarily related to an increase in legal expenses associated with general business planning and activities, including fees for patents/trademark searches and the Block dispute. See Part II, Item 1 Legal Proceedings.

We recognized a loss of approximately $1,517,000 for the six months ended June 30, 2001 for our 80.1% equity share in the loss of Transmucosal Technologies, our joint venture with Elan, compared to -0- for the six months ended June 30, 2000. The joint venture was established in June 2000. Currently, the joint venture is developing two products using our BEMA drug delivery system. The BEMA with fentanyl compound targets breakthrough cancer pain and management of chronic pain. The second compound also utilizes our BEMA technology with an anti-emetic product, ondansetron, for the prevention of nausea associated with cancer chemotherapy. We expect to record additional equity losses for Transmucosal Technologies in the foreseeable future.

Investment income for the six months ended June 30, 2001 was approximately $1,456,000 compared to approximately $888,000 for the six months ended June 30, 2000, representing a 64% increase. The increase was primarily the result of a net increase in our cash and cash equivalents and our marketable securities of approximately $28,019,000 for the six months ended June 30, 2001 in comparison to the six months ended June 30, 2000. The increase in our cash and investment balances was primarily the result of receiving an $8,000,000 license fee and a $15,000,000 purchase of our common stock from Sanofi-Synthelabo in January 2001 in conjunction with the December 2000 agreement. Additionally, we received a $2,000,000 payment from MediGene in April 2001 to license Leuprogel in Europe and a $3,000,000 payment from Sanofi-Synthelabo in June 2001 for the NDA filing of the Leuprogel One-month product.

Interest expense for the six months ended June 30, 2001 was approximately $491,000 compared to approximately $1,296,000 for the six months

ended June 30, 2000, representing a 62% decrease. The reduction in interest expense was primarily the result of exchanges of common stock for $26,479,000 of our 7% convertible subordinated notes since the period ended June 30, 2000.

During the six months ended June 30, 2001, we completed a series of private transactions involving the exchange of 1,482,031 issued common shares for $26,479,000, or 53% of the original offering amount, of the 7% convertible subordinated notes. Of the 1,482,031 shares issued, 1,393,629 shares were valued at the conversion price of $19.00 per share and the remaining 88,402 were valued at the closing market price as of the various exchange dates. As a result, we recognized an extraordinary loss of approximately $288,000, for the write-off of approximately $585,000 of pro rata unamortized deferred finance charges net of approximately $297,000 interest expense eliminated as a result of these exchanges. Additionally, as part of the 88,402 shares issued to induce conversion, debt conversion expense of approximately $2,048,000 was recognized in the six months ended June 30, 2001. As of June 30, 2001 and December 31, 2000, the convertible notes payable balance was $9,711,000 and $36,190,000, respectively.

Effective in the fiscal fourth quarter of 2000, we changed our method of accounting for nonrefundable technology access fees and milestone payments to recognize such payments as revenue over the term of the related agreements. The change in accounting principle is based on guidance provided in the Securities and Exchange Commission's Staff Accounting Bulletin No. 101 - Revenue Recognition in Financial Statements. Previously, we recognized $24,100,000 for nonrefundable technology access fees and milestone payments as revenue when received and when we fulfilled all contractual obligations relating to the fees and milestone payments. We recorded approximately $20,612,000 cumulative effect for this change in accounting principle that was reported as a charge in the first quarter of 2000.

We issued Series A convertible exchangeable preferred stock to Elan in July 2000 in connection with the formation of our joint venture with

Elan. Related to this issuance, we recognized approximately $430,000 for accretion of dividend on preferred stock for the six months ended June 30, 2001.

For the reasons described above, we recorded a net loss applicable to common stock of approximately $12,672,000, or $.87 per share, for the six months ended June 30, 2001 compared to a net loss applicable to common stock of approximately $27,089,000, or $2.36 per share, for the six months ended June 30, 2000.

LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 2001, we had cash and cash equivalents of approximately $19,073,000, marketable securities (at fair market value) of approximately $37,176,000 and other current assets of approximately $7,579,000 for total current assets of approximately $63,828,000. Current liabilities totaled approximately $8,030,000, which resulted in working capital of approximately $55,798,000.

We have a revolving line of credit with a bank that expires in August 2001. Under the terms of the line of credit, we may borrow up to $1,000,000. Borrowings under the line bear interest at the prime rate and are subject to financial covenants requiring us to maintain certain levels of net worth and liquidity. As of June 30, 2001, we had no outstanding balance under this line of

credit.

In July 2000, Elan and our company formed Transmucosal Technologies, a joint venture to develop and commercialize oncology and pain management products. Subject to the satisfaction of certain conditions, Elan has agreed to loan us up to $8,010,000 under a convertible promissory note agreement in support of our 80.1% share of the joint venture's research and development costs. The note has a six-year term, will accrue interest at 7% per annum, compounded semi-annually and added to principal, and is convertible at Elan's option into our common stock at a $14.60 conversion price. The note also allows us to convert this debt into our common stock at the prevailing market price at maturity. As of June 30, 2001, we had not drawn any amounts under the note.

During the six months ended June 30, 2001, net cash provided by operating activities was approximately $4,328,000. This was primarily the result of the net loss for the period of approximately $12,672,000, adjusted for certain non-cash expenses, and changes in operating assets and liabilities as set forth in the consolidated statements of cash flows. We received an $8,000,000 license fee from Sanofi-Synthelabo in January 2001 for payment of the December 2000 Note Receivable - License Fee. Additionally, we recognized non-cash charges for debt conversion expense of approximately $2,048,000 and approximately $288,000 as an extraordinary loss on extinguished debt during the six months ended June 30, 2001 for the exchange of 1,482,031 shares of our common stock to extinguish approximately $26,479,000 our convertible subordinated notes. The increase of approximately $5,360,000 for deferred revenue included a $1 million payment from Block in February 2001 for an Atridox sales milestone payment, a $3 million payment in June 2001 from Sanofi-Synthelabo for our Leuprogel One-month NDA filing and a $2 million payment in April 2001 from MediGene for the execution of the collaboration license and supply agreement for exclusive marketing rights in Europe of our Leuprogel product.

Net cash used in investing activities was approximately $9,855,000 during the six months ended June 30, 2001, primarily as a result of approximately $27,067,000 for the purchase of six government bond investments and thirteen corporate note investments. This was offset by proceeds of approximately $18,741,000 for six called government bond investments.

Net cash provided by financing activities was approximately $20,336,000 during the six months ended June 30, 2001. We received $15,000,000 from Sanofi-Synthelabo in January 2001 for payment pertaining to Sanofi's common stock purchase in conjunction with the December 2000 collaboration, license and supply agreement. We received $3.78 million from MediGene for the issuance of our common stock in conjunction with the stock purchase agreement in April 2001. Additionally, approximately $1,242,000 was received for the issuance of common stock related to employee stock options.

In February 2001, we filed a shelf registration statement on Form S-3 with Securities and Exchange Commission registering 4,000,000 shares of our common stock for future issuance. The registration statement was declared effective by the SEC in June 2001.

Our long-term capital expenditure requirements will depend on numerous factors, including:

- the progress of our research and development programs,
- the time required to file and process regulatory approval applications,
- the development of our commercial manufacturing

facilities,

- our ability to obtain additional licensing arrangements, and
- the demand for our products.

We expect to continue to incur substantial expenditures for research and development, testing, regulatory compliance, market development in European countries, possible repurchases of our notes or common stock and to hire additional management, scientific, manufacturing and administrative personnel. We will also continue to expend a significant amount of funds in our ongoing clinical studies. Depending on the results of our research and development activities, we may determine to accelerate or expand our efforts in one or more proposed areas and may, therefore, require additional funds earlier than previously anticipated. Management believes that the existing cash and cash equivalent assets in addition to marketable security resources will be sufficient to fund our operations through 2001. However, we cannot assure you that underlying assumed levels of revenue and expense will prove accurate.

RECENT ACCOUNTING PRONOUNCEMENTS

Effective in the fiscal fourth quarter of 2000, we changed our method of accounting for nonrefundable technology access fees and milestone payments to recognize such payments as revenue over the term of the related agreements. The change in accounting principle is based on guidance provided in the Securities and Exchange Commission's Staff Accounting Bulletin No. 101 - Revenue Recognition in Financial Statements. Previously, we recognized $24,100,000 for nonrefundable technology access fees and milestone payments as revenue when received and when we fulfilled all contractual obligations relating to the fees and milestone payments. We recorded approximately $20,612,000 cumulative effect for this change in

accounting principle that was reported as a charge in the year ended December 31, 2000. The cumulative effect was recorded as deferred revenue that will be recognized as revenue over the remaining contractual terms for each of the specific agreements. During the year ended December 31, 2000, the impact of the change in accounting principle increased net loss applicable to common stock by approximately $18,734,000, or $1.58 per share. This amount is comprised of approximately $20,612,000, or $1.73 per share, cumulative effect of the change as described above, net of approximately $1,878,000, or $0.16 per share, recognized as revenue during the year ended December 31, 2000. The remainder of the related deferred revenue will be recognized as revenue approximately as follows: $1,885,000 for each year from 2001 through 2010 and $11,000 for each year from 2011 through 2015 and $2,000 in 2016.

In June 1998, SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, was issued which, as amended, was effective for all fiscal years beginning after June 15, 1999. SFAS No. 133 provides new standards for the identification, recognition and measurement of derivative financial instruments, including embedded derivatives. Historically, we have not entered into derivative contracts to hedge existing risks nor have we entered into speculative derivative contracts. Although our convertible debt and preferred stock include conversion features that are considered to be embedded derivatives, accounting for those instruments is not affected by SFAS No. 133. The adoption of SFAS No. 133 on January 1, 2001 did not result in a transition adjustment in the financial statements.

On June 29, 2001, Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations" was approved by the Financial Accounting Standards Board (FASB). SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Goodwill and certain intangible assets will remain on the balance sheet and not be amortized. On an annual basis, and when there is reason to suspect that their values have been diminished or impaired, these assets must be tested for impairment, and write-downs may be necessary. We are required to implement SFAS No. 141 on July 1, 2001 and we have not determined the impact, if any, that this statement will have on our consolidated financial position or results of operations.

On June 29, 2001, SFAS No. 142, "Goodwill and Other Intangible Assets" was approved by the FASB. SFAS No. 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Amortization of goodwill, including goodwill recorded in past business combinations, will cease upon adoption of this statement. We are required to implement SFAS No. 142 on January 1, 2002 and we have not determined the impact, if any, that this statement will have on our consolidated financial position or results of operations.

RISK FACTORS

In addition to the other information contained in this Report, we caution stockholders and potential investors that the following important factors, among others, in some cases have affected, and in the future could affect, our actual results of operations and could cause our actual results to differ materially from those expressed in any forward-looking statements made by or on behalf of our company. The following information is not intended to limit in any way the characterization of other statements or information under other captions as cautionary statements for such purpose. These factors include:

- Delay, difficulty, or failure in obtaining regulatory approval or clearance to market additional products, including delays or difficulties in development because of insufficient proof of safety or efficacy.

- Substantial manufacturing and marketing expenses to be incurred in the commercial launch of the ATRIDOX and ATRISORB products and commercializing future products.

- Failure of corporate partners to develop or commercialize successfully our products or to retain and expand markets served by the commercial collaborations; conflicts of interest, priorities, and commercial strategies that may arise between our company and such corporate partners.

- Our limited experience in the sale and marketing of our products; dependence on Block to establish effective marketing, sales and distribution capabilities for the ATRIDOX, ATRISORB GTR Barrier, and ATRISORB-DOXY products in North America. Failure to internally develop marketing channels for the ATRISORB GTR Barrier, ATRISORB-DOXY and ATRIDOX products in Europe.

- Outcome of our disputes with Block, fees and expenses associated therewith and impact upon Block's marketing, sales and distribution of our products.

- The ability to obtain, maintain and protect intellectual property rights, and the cost of acquiring in-process technology and other intellectual property rights, either by license, collaboration or purchase of another entity.

- Limited experience in manufacturing products on a commercial scale, failure to manufacture present and future products in compliance with applicable regulations and at an acceptable cost.

- Product liability or other claims against us which may result in substantial damages or reduce demand for our products.

- Cancellation or termination of material collaborative agreements (including the Block agreement) and the resulting loss of research or other funding, or marketing, sales and distribution capabilities.

- Access to the pharmaceutical compounds necessary to successfully commercialize the ATRIGEL system, ATRIDOX and ATRISORB products or other products and delivery systems currently in development.

- Competitive or market factors that may limit the use or broad acceptance of our products.

- The ability to attract and retain highly qualified management and scientific personnel.

- Difficulties or high costs of obtaining adequate financing to fund future research, development and commercialization of products.

- The slow rate of acceptance of new products.

- The continued growth and market acceptance of our products and our ability to develop and commercialize new products in a timely and cost-effective manner.

- Exchange rate fluctuations that may adversely impact net income (loss).

- Our ability to enter into strategic alliances or collaborative arrangements with third parties to market and commercialize our products on favorable terms, if at all.

- The requirement that we must receive separate regulatory approval for each of our product candidates in each indication before we can sell them in North America or internationally.

- Our ability to successfully acquire and integrate technologies and businesses.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES CONCERNING MARKET RISKS.

We own financial instruments that are sensitive to market risks as part of our investment portfolio of cash equivalents and marketable securities. The investment portfolio is used to preserve our capital until it is required to fund operations, including our research and development activities. None of these market-risk sensitive instruments are held for trading purposes. We do not own derivative financial instruments in our investment portfolio. Due to the nature of our investment portfolio, the investment portfolio contains instruments that are primarily subject to interest rate risk. Our convertible subordinated notes are also subject to interest rate and equity price risks.

Interest Rate Risk. Our investment portfolio includes fixed rate debt instruments that are primarily United States government and agency bonds and corporate notes with maturity dates ranging from one to fifteen years. To mitigate the impact of fluctuations in cash flow, we maintain substantially all of our debt instruments as fixed rate. The market value of these bonds is subject to interest rate risk and could decline in value if interest rates increase. The portion maintained as fixed rate is dependent on many factors including judgments as to future trends in interest rates.

Our investment portfolio also includes equity interests in United States government and agency bond funds. The value of these equity interests is also subject to interest rate risk.

We regularly assess the above described market risks and have established policies and business practices to protect against the adverse effects of these and other potential exposures. Our investment policy restricts investments to U.S. Government or government backed securities, or high rated commercial paper and other high rated investments only. As a result, we do not anticipate any material credit losses in these areas.

For disclosure purposes, we use sensitivity analysis to determine the impacts that market risk exposures may have on the fair values of our debt and financial instruments. The financial instruments included in the sensitivity analysis consist of all of our cash and cash equivalents and short-term and long-term debt instruments.

To perform a sensitivity analysis, we assess the risk of loss in fair values from the impact of hypothetical changes in interest rates on market sensitive instruments. The fair values are computed based on the present value of future cash flows as impacted by the changes in the rates attributable to the market risk being measured. The discount rates used for the present value computations were selected based on market interest rates in effect at June 30, 2001. The fair values that result from these computations are compared with the fair values of these financial instruments at June 30, 2001. The differences in this comparison are the hypothetical gains or losses associated with each type of risk. The results of the sensitivity analysis at June 30, 2001 are as follows:

> Interest Rate Sensitivity: A 10% decrease in the levels of interest rates with all other variables held constant would result in an increase in the fair value of our financial instruments by approximately $285,000 per year. A 10% increase in the levels of interest rates with all other variables held constant would result in a decrease in the fair value of our financial instruments by approximately $285,000 per year. We maintain a portion of our financial instruments, including long-term debt instruments of approximately $7,915,000 at June 30, 2001, at variable interest rates. If interest rates were to increase or decrease 10%, the impact of such instruments on cash flows or earnings would not be material.

The use of a 10% estimate is strictly for estimation and evaluation purposes only. The value of our assets may rise or fall by a greater amount depending on actual general market performances and the value of individual securities we own.

The market price of our 7% convertible subordinated notes generally changes in parallel with the market price of our common stock. When our stock price increases, the price of these notes generally increases proportionally. Fair market price of the notes can be determined from quoted market prices, where available. The fair value of our long-term debt was estimated to be approximately $12,260,000 at June 30, 2001 and is higher than the carrying value

by approximately $2,549,000. Market risk was estimated as the potential decrease in fair value resulting from a hypothetical 1% increase in our weighted average long-term borrowing rate and a 1% decrease in quoted market prices, or approximately $194,220.

Exchange Rate Risk. We face foreign exchange rate fluctuations, primarily with respect to the British Pound and the Euro, as the financial results of our foreign subsidiaries are translated into United States dollars for consolidation. As exchange rates vary, these results, when translated may vary from expectations and adversely impact net income (loss) and overall profitability. The effect of foreign exchange rate fluctuation for the period ended June 30, 2001 was not material. Based on our overall foreign currency rate exposure at June 30, 2001, we do not believe that a hypothetical

10% change in foreign currency rates would materially affect our financial position.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

The Company has been involved in disputes with Block Drug Corporation, a wholly owned subsidiary of GlaxoSmithKline, concerning product pricing and the payments due to the Company upon achievement of milestones under the Company's commercialization agreement with Block. With respect to product pricing, arbitration began in December 2000 to resolve the issue as to the minimum price Block must pay for products under the agreement. On April 20, 2001, the Company entered into a settlement agreement with Block resolving the pricing dispute over Block's sale of Atridox. The settlement agreement provides for the payment owed to the Company for sales of the product in 1999. A new pricing schedule for future purchases was also implemented.

With respect to milestone payments, the Company believes that under the agreement, the milestone for the FDA approval of the Atrisorb-Doxy Barrier product was achieved in 2000 and the corresponding payment of $1,000,000 is due. Block has not made this payment. Pursuant to the Company's agreement with Block, the Company will be entitled to an additional milestone payment of $2,000,000 upon Block's first commercial sale of the Atrisorb-Doxy Barrier product in the United States. The agreement provides that the first commercial sale of this product in the U.S. must occur within 120 days after FDA approval, subject to certain conditions that have been satisfied. The FDA approved the Atrisorb-Doxy Barrier product in September 2000. The Company has notified Block that it is in breach of the agreement for failure to commence marketing of the Atrisorb-Doxy Barrier product and on May 11, 2001 the Company filed a lawsuit in the U.S. District Court for the District of Colorado seeking injunctive relief based on Block's breach of the agreement. Block has initiated arbitration, and an arbitration hearing has been set for November 13, 2001. The Company intends to vigorously pursue its rights to these milestone payments.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

For the six months ended June 30, 2001, the Company completed a series of private transactions involving the exchange of 1,482,031 issued common shares for $26,479,000, or 53% of the original offering amount, of the 7% convertible subordinated notes. Of the 1,482,031 shares issued, 1,393,629 shares were valued at the conversion price of $19.00 per share and the remaining 88,402 were valued at the closing market price as of the various exchange dates. Because these

transactions constituted an exchange of securities by us exclusively with existing security holders, where no commission or other remuneration was paid or given for soliciting such exchange, the transactions were exempt from registration under the Securities Act of 1933 under Section 3(a)(9) of the Securities Act.

In April 2001, the Company entered into a collaboration, license and supply agreement with MediGene AG under which MediGene was granted the exclusive right to market our Leuprogel products in Europe. In connection with the transaction, MediGene purchased 233,918 shares of our common stock for approximately $3.78 million, pursuant to a stock purchase agreement. This transaction was made in reliance on the exemption from the registration requirements of the Securities Act of 1933 provided by Section 4(2) of the Securities Act. This transaction was privately negotiated and the Company made no public solicitation in the placement of these securities.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

An annual meeting of the stockholders of the Company was held on May 7, 2001, in Fort Collins, Colorado, for the purpose of re-electing David R. Bethune, Dr. Richard L. Jackson, and Dr. Nicolas G. Bazan to the Board of Directors as Class B directors, approving the amendment of the 2000 Stock Incentive Plan, approving the amendment of the Company's Amended and Restated Certificate of Incorporation increasing the number of authorized capital shares, and ratifying the appointment of the Company's independent auditors.

The following votes were cast by the stockholders with respect to the election of directors:

	Shares Voted For	Shares Voted Against	Shares Voted Withhold	Shares Voted Abstained	Broker Non-Vote
David R. Bethune	13,126,764	689,674	--	--	--
Dr. Richard L. Jackson	13,298,781	517,657	--	--	--
Dr. Nicolas G. Bazan	13,194,906	621,532	--	--	--

The other directors whose term continues after the meeting are John E. Urheim, Sander A. Flaum, Dr. D. Walter Cohen, C. Rodney O'Connor, H. Stuart Campbell.

The following votes were cast by the stockholders with respect to the amendment to the 2000 Stock Incentive Plan.

Shares Voted For	Shares Voted Against	Shares Voted Withhold	Shares Voted Abstained	Broker Non-Vote
6,779,223	1,954,619	--	70,142	--

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The following votes were cast by the stockholders with respect to the amendment to the Company's Amended and Restated Certificate of Incorporation:

Shares Voted For	Shares Voted Against	Shares Voted Withhold	Shares Voted Abstained	Broker Non-Vote
7,766,664	969,846	--	67,474	--

The following votes were cast by the stockholders with respect to the resolution to ratify the Board of Directors' selection of Deloitte & Touche LLP as the Company's independent auditors for the fiscal year ending December 31, 2001:

Shares Voted For	Shares Voted Against	Shares Voted Withhold	Shares Voted Abstained	Broker Non-Vote
13,483,954	287,870	--	44,614	--

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

3.1 Certificate of Amendment to Amended and Restated Certificate of Incorporation (incorporated by reference to the Company's Registration Statement on Form S-3, file number 333-55634).

(b) Reports on Form 8-K. We filed the following Current Reports on Form 8-K during the quarter ended June 30, 2001:

- Current Report on Form 8-K dated April 4, 2001, filed with the Securities and Exchange Commission on June 20, 2001, under Item 5. Other Events, and Item 7. Exhibits.
- Current Report on Form 8-K dated April 20, 2001, filed with the Securities and Exchange Commission on April 24, 2001, under Item 5. Other Events, and Item 7. Exhibits.

SIGNATURES

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

ATRIX LABORATORIES, INC.

(Registrant)

July 24, 2001 By: /s/ David R. Bethune

David R. Bethune
Chairman of the Board of Directors and Chief Executive Officer

July 24, 2001 By: /s/ Brian G. Richmond

Brian G. Richmond
Chief Financial Officer and Assistant Secretary

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EXHIBIT INDEX

EXHIBIT NO.	DESCRIPTION
3.1	Certificate of Amendment to Amended and Restated Certificate of Incorporation (incorporated by reference to the Company's Registration Statement on Form S-3, file number 333-55634).

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$
490,888

10. DERIVATIVE FINANCIAL INSTRUMENTS
Derivatives Designated as Hedging Instruments
As of March 31, 2012, the Company’s derivative assets and liabilities primarily resulted from cash flow hedges related to its forecasted operating expenses transacted in local currencies. A substantial portion of the Company’s overseas expenses are and will continue to be transacted in local currencies. To protect against fluctuations in operating expenses and the volatility of future cash flows caused by changes in currency exchange rates, the Company has established a program that uses foreign

exchange forward contracts to hedge its exposure to these potential changes. The terms of these instruments, and the hedged transactions to which they relate, generally do not exceed 12 months and the maximum term is 18 months. Generally, when the dollar is weak, foreign currency denominated expenses will be higher, and these higher expenses will be partially offset by the gains realized from the Company's hedging contracts. Conversely, if the dollar is strong, foreign currency denominated expenses will be lower. These lower expenses will in turn be partially offset by the losses incurred from the Company's hedging contracts. The change in the derivative component in Accumulated other comprehensive (loss) income includes unrealized gains or losses that arose from changes in market value of the effective portion of derivatives that were held during the period, and gains or losses that were previously unrealized but have been recognized in the same line item as the forecasted transaction in current period net income due to termination or maturities of derivative contracts. This reclassification has no effect on total comprehensive income or equity.

The total cumulative unrealized loss on cash flow derivative instruments was $1.6 million and $5.2 million at March 31, 2012 and December 31, 2011, respectively, and is included in Accumulated other comprehensive loss in the accompanying condensed consolidated balance sheets. The net unrealized loss as of March 31, 2012 is expected to be recognized in income over the next twelve months at the same time the hedged items are recognized in income.

Derivatives not Designated as Hedges

A substantial portion of the Company's overseas assets and liabilities are and will continue to be denominated in local currencies. To protect against fluctuations in earnings caused by changes in currency exchange rates when remeasuring the Company's balance sheet, it utilizes foreign exchange forward contracts to hedge its exposure to this potential volatility.

These contracts are not designated for hedge accounting treatment under the authoritative guidance. Accordingly, changes in the fair value of these contracts are recorded in Other income, net.

Fair Values of Derivative Instruments

	Asset Derivatives (In thousands)				Liability Derivatives			
	March 31, 2012		December 31, 2011		March 31, 2012		December 31, 2011	
Derivatives Designated as Hedging Instruments	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Foreign currency forward contracts	Prepaid expenses and other current assets	$3,262	Prepaid expenses and other current assets	$2,762	Accrued expenses and other current liabilities	$4,974	Accrued expenses and other current liabilities	$8,252

	Asset Derivatives (In thousands)				Liability Derivatives			
	March 31, 2012		December 31, 2011		March 31, 2012		December 31, 2011	
Derivatives Not Designated as Hedging Instruments	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Foreign currency forward contracts	Prepaid expenses and other current assets	$125	Prepaid expenses and other current assets	$69	Accrued expenses and other current liabilities	$109	Accrued expenses and other current liabilities	$202

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The Effect of Derivative Instruments on Financial Performance

Derivatives in Cash Flow Hedging Relationships	For the Three Months Ended March 31, (In thousands)				
	Amount of Gain Recognized in Other Comprehensive Income (Effective Portion)		Location of Loss Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)	Amount of Loss Reclassified from Accumulated Other Comprehensive Loss (Effective Portion)	
	2012	2011		2012	2011
Foreign currency forward contracts	$3,561	$2,837	Operating expenses	$ (1,527)	$ (620)

There was no material ineffectiveness in the Company's foreign currency hedging program in the periods presented.

Derivatives Not Designated as Hedging Instruments	For the Three Months Ended March 31, (In thousands)		
	Location of (Loss) Gain Recognized in Income on Derivative	Amount of (Loss) Gain Recognized in Income on Derivative	
		2012	2011
Foreign currency forward contracts	Other income, net	$(176)	$866

Outstanding Foreign Currency Forward Contracts

As of March 31, 2012, the Company had the following net notional foreign currency forward contracts outstanding (in thousands):

Foreign Currency	Currency Denomination
Australian dollars	AUD 1,844
British pounds sterling	GBP 26,329
Canadian dollars	CAD 5,566
Chinese renminbi	CNY 14,627
Euro	EUR 47,368
Hong Kong dollars	HKD 49,600
Indian rupees	INR 529,806
Japanese yen	JPY 53,879
Singapore dollars	SGD 8,156
Swiss francs	CHF 30,740

11. INCOME TAXES

The Company's net unrecognized tax benefits totaled approximately $79.2 million as of March 31, 2012 and December 31, 2011, respectively. All amounts included in the balance at March 31, 2012 for tax positions would affect the annual effective tax rate. During the quarter ended March 31, 2012, the Company recognized $0.1 million of expense related to interest, which is included in Income tax expense. The Company has approximately $1.5 million for the payment of interest and penalties accrued at March 31, 2012.

The Company and one or more of its subsidiaries is subject to federal income taxes in the United States, as well as income taxes of multiple state and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years prior to 2004.

In June 2010, the Company reached a settlement in principle with the Internal Revenue Service ("IRS") regarding certain previously disclosed income tax deficiencies asserted in a Revenue Agent's Report (the "RAR"). Under the terms

of the settlement in principle, the Company would agree to an assessment of income tax deficiencies in full settlement of all open claims under the RAR and would resolve with finality for future years all of the transfer pricing issues raised in the RAR. Based on this, the Company incurred a charge of $13.1 million in 2010 in accordance with the authoritative guidance. Among

other things, the authoritative guidance requires application of a “more likely than not” threshold to the recognition and non-recognition of tax positions. It further requires that a change in management judgment related to prior years’ tax positions be recognized in the quarter of such change.

The final settlement requires the finalization of tax deficiency calculations with the IRS and a written agreement signed by the IRS. This process could take several more months to complete. There can be no assurances that a final written agreement will be obtained or that this matter will otherwise be resolved in our favor. An adverse outcome of this matter could have a material adverse effect on our results of operations and financial condition.

In the ordinary course of global business, there are transactions for which the ultimate tax outcome is uncertain; thus, judgment is required in determining the worldwide provision for income taxes. The Company provides for income taxes on transactions based on its estimate of the probable liability. The Company adjusts its provision as appropriate for changes that impact its underlying judgments. Changes that impact provision estimates include such items as jurisdictional interpretations on tax filing positions based on the results of tax audits and general tax authority rulings. Due to the evolving nature of tax rules combined with the large number of jurisdictions in which the Company operates, it is possible that the Company’s estimates of its tax liability and the realizability of its deferred tax assets could change in the future, which may result in additional tax liabilities and adversely affect the Company’s results of operations, financial condition and cash flows.

The Company is required to estimate its income taxes in each of the jurisdictions in which it operates as part of the process of preparing its condensed consolidated financial statements. At March 31, 2012, the Company had approximately $84.6 million in net deferred tax assets. The authoritative guidance requires a valuation allowance to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company reviews deferred tax assets periodically for recoverability and makes estimates and judgments regarding the expected geographic sources of taxable income and gains from investments, as well as tax planning strategies in assessing the need for a valuation allowance.

The Company maintains certain strategic management and operational activities in overseas subsidiaries and its foreign earnings are taxed at rates that are generally lower than in the United States. The Company does not expect to remit earnings from its foreign subsidiaries. The Company’s effective tax rate was approximately 19.3% and 17.1% for the three months ended March 31, 2012 and 2011, respectively. The increase in the effective tax rate when comparing the three months ended March 31, 2012 to the three months ended March 31, 2011 was primarily due to research and development tax credits not being extended in 2012, partially offset by a tax benefit related to the impairment of certain intangible assets.

The Company’s effective tax rate generally differs from the U.S. federal statutory rate of 35% due primarily to lower tax rates on earnings generated by the Company’s foreign operations that are taxed primarily in Switzerland. The Company has not provided for U.S. taxes for those earnings because it plans to reinvest all of those earnings indefinitely outside the United States.

12. TREASURY STOCK

Stock Repurchase Programs

The Company’s Board of Directors authorized an ongoing stock repurchase program with a total repurchase authority granted to the Company of $3.0 billion. The Company may use the approved dollar authority to repurchase stock at any time until the approved amount is exhausted. The objective of the Company’s stock repurchase program is to improve stockholders’ returns. At March 31, 2012, approximately $86.6 million was available to repurchase common stock pursuant to the stock repurchase program. All shares repurchased are recorded as treasury stock. A portion of the funds used to repurchase stock over the course of the program was provided by proceeds from employee stock option exercises and the related tax benefit.

The Company is authorized to make open market purchases of its common stock using general corporate funds. Additionally, from time to time, the Company may enter into structured stock repurchase arrangements with large financial institutions using general corporate funds in order to lower the average cost to acquire shares. These programs include terms that require the Company to make up-front payments to the counterparty financial institution and result in the receipt of stock during or at the end of the term of the agreement or the receipt of either stock or cash

at the maturity of the agreement, depending on market conditions. As of March 31, 2012, the Company did not have any prepaid notional amounts outstanding under structured stock repurchase programs and it did not make any up-front payments to financial institutions related to structured stock repurchase agreements in 2012.
During the three months ended March 31, 2012, the Company expended approximately $100.0 million on open market purchases, repurchasing 1,378,600 shares of outstanding common stock at an average price of $72.53.

During the three months ended March 31, 2011, the Company expended approximately $100.0 million on open market purchases, repurchasing 1,452,100 shares of outstanding common stock at an average price of $68.83.

Shares for Tax Withholding

During the three months ended March 31, 2012, the Company withheld 183,050 shares from stock units that vested, totaling $14.1 million, to satisfy minimum tax withholding obligations that arose on the vesting of stock units. During the three months ended March 31, 2011, the Company withheld 124,595 shares from stock units that vested, totaling $8.8 million, to satisfy minimum tax withholding obligations that arose on the vesting of stock units. These shares are reflected as treasury stock in the Company’s condensed consolidated balance sheets and the related cash outlays reduce the Company’s total stock repurchase authority.

13. COMMITMENTS AND CONTINGENCIES

Leases

The Company leases certain office space and equipment under various operating leases. In addition to rent, the leases require the Company to pay for taxes, insurance, maintenance and other operating expenses. Certain of these leases contain stated escalation clauses while others contain renewal options. The Company recognizes rent expense on a straight-line basis over the term of the lease, excluding renewal periods, unless renewal of the lease is reasonably assured.

The Company has operating lease obligations through 2018 related to two properties that are not utilized. At March 31, 2012, the total remaining obligation on these leases was approximately $5.1 million, of which $2.1 million was accrued as of March 31, 2012, and is reflected, as applicable, in Accrued expenses and other current liabilities and Other liabilities in the accompanying condensed consolidated balance sheets. In calculating these accruals, the Company made estimates, based on market information, including the estimated vacancy periods and sublease rates and opportunities. The Company periodically re-evaluates its estimates related to these vacant facilities.

Legal Matters

The Company accrues a liability for legal contingencies when it believes that it is both probable that a liability has been incurred and that it can reasonably estimate the amount of the loss. The Company reviews these accruals and adjusts them to reflect ongoing negotiations, settlements, rulings, advice of legal counsel and other relevant information. To the extent new information is obtained and the Company's views on the probable outcomes of claims, suits, assessments, investigations or legal proceedings change, changes in the Company's accrued liabilities would be recorded in the period in which such determination is made. For the matters referenced below, the amount of liability is not probable or the amount cannot be reasonably estimated; and, therefore, accruals have not been made. In addition, in accordance with the relevant authoritative guidance, for matters which the likelihood of material loss is at least reasonably possible, the Company provides disclosure of the possible loss or range of loss; however, if a reasonable estimate cannot be made, the Company will provide disclosure to that effect.

Due to the nature of the Company's business, it is subject to patent infringement claims, including current suits against it or one or more of its wholly-owned subsidiaries alleging infringement by various Company products and services. The Company believes that it has meritorious defenses to the allegations made in its pending cases and intends to vigorously defend these lawsuits; however, it is unable currently to determine the ultimate outcome of these or similar matters. In addition, the Company is a defendant in various litigation matters generally arising out of the normal course of business. Although it is difficult to predict the ultimate outcomes of these cases, the Company believes that it is not reasonably possible that the ultimate outcomes will materially and adversely affect its business, financial position, results of operations or cash flows.

Guarantees

The authoritative guidance requires certain guarantees to be recorded at fair value and requires a guarantor to make disclosures, even when the likelihood of making any payments under the guarantee is remote. For those guarantees and indemnifications that do not fall within the initial recognition and measurement requirements of the authoritative guidance, the Company must continue to monitor the conditions that are subject to the guarantees and indemnifications, as required under existing generally accepted accounting principles, to identify if a loss has been incurred. If the Company determines that it is probable that a loss has been incurred, any such estimable loss would be recognized. The initial recognition and measurement requirements do not apply to the provisions contained in the

majority of the Company's software license agreements that indemnify licensees of the Company's software from damages and costs resulting from claims alleging that the Company's software infringes the intellectual property rights of a third party. The Company has not made payments pursuant to these provisions. The Company has not identified any losses that are probable under these provisions and, accordingly, the Company has not recorded a liability related to these indemnification provisions.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Our operating results and financial condition have varied in the past and could in the future vary significantly depending on a number of factors. From time to time, information provided by us or statements made by our employees contain "forward-looking" information that involves risks and uncertainties. In particular, statements contained in this Quarterly Report on Form 10-Q, and in the documents incorporated by reference into this Quarterly Report on Form 10-Q, that are not historical facts, including, but not limited to, statements concerning new products, research and development, offerings of products and services, market positioning and opportunities, headcount, customer demand, distribution and sales channels, financial information and results of operations for future periods, product and price competition, strategy and growth initiatives, seasonal factors, international operations and expansion, investment transactions and valuations of investments and derivative instruments, reinvestment or repatriation of foreign earnings, fluctuations in foreign exchange rates, tax matters, the finalization of our tax settlement and written agreement with the IRS, the expected benefits of acquisitions, changes in domestic and foreign economic conditions and credit markets, liquidity, litigation and intellectual property matters, constitute forward-looking statements and are made under the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements are neither promises nor guarantees. Our actual results of operations and financial condition have varied and could in the future vary materially from those stated in any forward-looking statements. The factors described in Part I, Item 1A, "Risk Factors," in our Annual Report on Form 10-K for the year ended December 31, 2011, as may be updated in Part II, Item 1A in this Quarterly Report on Form 10-Q, among others, could cause actual results to differ materially from those contained in forward-looking statements made in this Quarterly Report on Form 10-Q, in the documents incorporated by reference into this Quarterly Report on Form 10-Q or presented elsewhere by our management from time to time. Such factors, among others, could have a material adverse effect upon our business, results of operations and financial condition. We caution readers not to place undue reliance on any forward-looking statements, which only speak as of the date made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made.

Overview

Management's discussion and analysis of financial condition and results of operations is intended to help the reader understand our financial condition and results of operations. This section is provided as a supplement to, and should be read in conjunction with, our financial statements and the accompanying notes to our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for the three months ended March 31, 2012. The results of operations for the periods presented in this report are not necessarily indicative of the results expected for the full year or for any future period, due in part to the seasonality of our business. Historically, our revenue for the fourth quarter of any year is typically higher than our revenue for the first quarter of the subsequent year.

We design, develop and market technology solutions that enable IT services to be securely delivered on demand – independent of location, device or network. Our customers achieve lower IT operating costs, increased information security, and greater business agility using Citrix technologies that enable mobile workstyles and power cloud services. We market and license our products directly to enterprise customers, over the web, and through systems integrators, or SIs. We also market and license our products indirectly through value-added resellers, or VARs, value-added distributors, or VADs, and original equipment manufacturers, or OEMs.

Executive Summary

We are a strategic technology provider transforming how people, business and IT work and collaborate in the Cloud Era. With our virtualization, networking and cloud technologies, we make complex enterprise IT simpler and more accessible for a diverse, global, and mobile workforce. We deliver a secure and familiar virtual workplace experience that powers mobile work styles and cloud services, so people can work and collaborate virtually anywhere, with anyone on virtually any device, simply accessing the services they need. These technologies give individuals more control over their work and life, while helping business and IT be more flexible and agile.

We believe our approach is unique in the market because we have combined innovative technologies in the area of desktop management, including desktop virtualization and application virtualization, marketed as our Desktop

Solutions, and cloud networking and cloud platform products, marketed as our Datacenter and Cloud Solutions. This combination allows us to deliver a comprehensive end-to-end application delivery solution, and one that we believe, when considered as a whole, is competitively differentiated by its feature set and interoperability.

In today's business environment, however, there is a sharp focus on IT products and services that can reduce cost and deliver a quick, tangible return on investment, or ROI. With our customers focused on economic value in technology solutions, we intend to continue highlighting our solutions' abilities to reduce IT costs, increase business flexibility and deliver ROI with a simpler more flexible approach to computing.

In 2011, we saw uncertainties surrounding IT spending, particularly in the European markets. In the first quarter of 2012, we have seen some improvement in the European markets; however we expect continued volatility in the spending environment in some European countries, especially in the public sector. In addition, we expect uneven sales demand from the U.S. federal government sector. This overall economic uncertainty may adversely affect sales of our products and services and may result in longer sales cycles, slower adoption of technologies and increased price competition, particularly in Europe and the U.S. federal government sector. Offsetting the uneven demand in some European countries and in the U.S. federal government sector, we anticipate increased demand from the Americas and Asia-Pacific regions.

In 2012, we hope to sustain the long-term growth of our businesses around the world by: expanding our go-to-market reach, customer touch points and consulting and tech support capacity; investing in product innovation, bringing new technologies to market and improving integration across our product portfolio to drive simplicity, differentiation and customer experience; and making selective and strategic acquisitions of technology, talent and/or businesses.

We continue to make strategic investments in research and development of existing and new products, and to invest in research and development of advanced and innovative technologies for future application, including increasing research and development capacity and headcount. We believe that delivering innovative and high-value solutions through our Enterprise division’s products and services and our Online Services division’s products is the key to meeting customer and partner needs and achieving our future growth. We plan to increase sales, consulting and technical support capacity and headcount to support larger strategic customer engagements. We also plan to increase our focus on SI partnerships as well as investing in new service provider channel programs that allow our partners to upgrade their capabilities in desktop virtualization, giving us more capacity to drive strategic desktop deals and to cross-sell networking, data sharing and collaboration.

Enterprise division

Our Desktop Solutions are built to transform and reduce the cost of traditional desktop management by virtualizing the desktop, with our XenDesktop product, and virtualizing applications, with our XenApp product, in a customer’s datacenter. We are moving the delivery of desktops and related applications to an on-demand service rather than the delivery of a device. We continue to see growing customer interest in XenDesktop and, in addition, by making the XenDesktop trade-up program a standard program, we are maximizing our XenApp install base and driving continued XenDesktop adoption. Further, we are helping customers accelerate the implementation of desktop virtualization enterprise-wide through our Desktop Transformation Model. Our Desktop Transformation Model has been enhanced by technologies originating from our acquisition of RingCube, which facilitates user personalization in virtual desktop deployments, and our App-DNA acquisition, which provides customers a means of analyzing an enterprise's application portfolio, offering deployment guidance and calculating project effort.

Our Datacenter and Cloud Solutions, including our cloud networking products and cloud platform products, can alter the traditional economics of the datacenter by providing greater levels of flexibility of computing resources, especially with respect to servers, improving application performance and thereby reducing the amount of processing power involved, and allowing easy reconfiguration of servers by permitting storage and network infrastructure to be added-in virtually rather than physically. Our cloud networking products are also enhancing our differentiation and driving customer interest around desktop virtualization as enterprises are finding good leverage in deploying these technologies together.

We continue to invest in innovative products and services for the Enterprise division through strategic acquisitions. During the first quarter of 2012, we acquired a privately-held company that expands our cloud platform and cloud networking business. In July 2011, we acquired Cloud.com, Inc., or Cloud.com, a privately-held market leading provider of software infrastructure platforms for cloud providers. Cloud.com's product lines help providers of all types deploy and manage simple, cost-effective cloud services that are scalable, secure, and open by design. In August 2011, we acquired RingCube, a privately-held company that specializes in user personalization technology for virtual desktops. In November 2011, we acquired App-DNA™, a privately-held leader in application migration and management. App-DNA's technology adds a significant component to our Desktop Transformation Model, which is aimed at helping customers speed deployments of desktop virtualization enterprise-wide. The App-DNA AppTitude™ product enables organizations to quickly and intelligently assess their application portfolio and migration plans.

Online Services division

Our Online Services division is focused on developing and marketing web-based access, support, collaboration and data sharing products. These products are primarily marketed via the web to large enterprises, medium and small businesses, prosumers and individuals. Our Online Services division's web collaboration products offer secure and cost-effective solutions that allow users to host and actively participate in online meetings, webinars and training sessions remotely and reduce costs associated with business travel. Our remote access solution offers a secure, simple and cost efficient way for users to access their desktops remotely, and our remote support solutions offer secure, on-demand support over the Internet.

In addition, we continue to grow our Online Services division by increasing our addressable market geographically and offering products that appeal to a wider range of customers. To accelerate the European expansion of our Online Services division, in February 2011, we acquired Netviewer AG, or Netviewer, a privately held European software as a service, or SaaS, vendor in collaboration and IT services. Netviewer is part of our Online Services division and has further enabled the extension of our SaaS leadership in Europe. In October 2011, we acquired Novel Labs, Inc., or ShareFile, a privately-held market leading provider of secure data sharing and collaboration. The ShareFile product line makes it easy for businesses of all sizes to securely store, sync and share business documents and files, both inside and outside the company. ShareFile's centralized cloud storage capability also allows users to share files across multiple devices and access them from any location.

In April 2012, we acquired all of the issued and outstanding securities of Podio ApS, or Podio, a privately held provider of a cloud-based collaborative work platform. Podio will become part of our Online Services division and is a natural extension of our web collaboration business, providing today's mobile and distributed workforce an easy, secure and social way to come together and work as teams.

Reclassifications

During the first quarter of 2012, we performed a review of the presentation of certain of our revenue categories and adopted a revised presentation, which we believe is more comparable to those presented by other companies in our industry and better reflects our evolving product and service offerings. As a result, technical support, hardware maintenance and software updates revenues, which were previously presented in Technical services and License updates are classified together as License updates and maintenance. A corresponding change was made to rename Cost of services revenues to Cost of services and maintenance revenues; however, there was no change in classification. Product training and certification and consulting services, which were previously presented in Technical services, are classified together as Professional services. Product licenses will be renamed to Product and licenses to more appropriately describe its composition of both software and hardware, however, there was no change in classification. The composition and classification of Software as a service remained unchanged. This change in presentation will not affect our total net revenues, total cost of net revenues or gross margin.

Additionally, during the first quarter of 2012, we revised our methodology for allocating certain IT support costs to more closely align these costs to the employees directly utilizing the related assets and services and to reflect how management assesses the cost of headcount. As a result, certain IT support costs have been reclassified from General and administrative expenses to Cost of services and maintenance revenues, Research and development expenses and Sales, marketing and services expenses based on the headcount in each of these functional areas. This change in presentation will not affect our income from operations or cash flows.

Conforming changes have been made for all prior periods presented. See Note 1 to our condensed consolidated financial statements for more information regarding the reclassifications described above.

Summary of Results

For the three months ended March 31, 2012 compared to the three months ended March 31, 2011, a summary of our results included:

- Product and licenses revenue increased 18.7% to $178.4 million;
- Software as a service revenue increased 21.0% to $120.7 million;
- License updates and maintenance revenue increased 19.5% to $264.5 million;
- Professional services revenue increased 32.8% to $25.9 million;
- Operating income decreased 0.2% to $80.8 million; and
- Diluted net income per share decreased 5.8% to $0.36.

The increase in our Product and licenses revenue was driven by increased sales of our Desktop Solutions products, led by XenDesktop, and our Datacenter and Cloud Solutions products, led by NetScaler. We currently target our Product and license revenue to increase when comparing the second quarter of 2012 to the first quarter of 2012. Our Software as a service revenue increased due to increased sales of our web collaboration products. The increase in License updates and maintenance revenue was primarily due to an increase in sales of our Subscription Advantage product, primarily driven by renewals, and an increase in maintenance revenues, primarily driven by increased sales of our Datacenter and Cloud Solutions products, led by NetScaler. Professional services revenue increased primarily due to

increases in consulting revenues related to increased implementation sales of our Enterprise division's products. We currently target that total revenue will increase when comparing the second quarter of 2012 to the first quarter of 2012, as well as when comparing the 2012 fiscal year to the 2011 fiscal year. The slight decrease in Operating income when comparing the first quarter of 2012 to the first quarter of 2011 was primarily due to an increase in amortization of intangible assets and stock-based compensation costs related to our recent acquisitions. The decrease in diluted net income per share is primarily due to the factors discussed above related to Operating income as well as

the increase in our effective tax rate which was primarily due to research and development tax credits not being extended in 2012, partially offset by a tax benefit related to the impairment of certain intangible assets.

2012 Acquisition

During the first quarter of 2012, we acquired all of the issued and outstanding securities of a privately-held company, or the 2012 Acquisition, for total cash consideration of approximately $24.6 million, net of $0.6 million of cash acquired. The 2012 Acquisition became part of our Enterprise division thereby expanding our cloud platform and cloud networking business. Transaction costs associated with the acquisition were approximately $0.5 million, of which we expensed $0.4 million during the three months ended March 31, 2012 and are included in General and administrative expense in our condensed consolidated statements of income. In addition, in connection with the 2012 Acquisition, we assumed non-vested stock units which were converted into the right to receive up to 13,481 shares of our common stock and assumed certain stock options which are exercisable for 12,017 shares of our common stock, for which the vesting period reset fully upon the closing of the transaction. We have included the effect of the 2012 Acquisition in our results of operations prospectively from the date of the acquisition, which effect was not material to our consolidated results.

2011 Acquisitions

Netviewer AG

In February 2011, we acquired all of the issued and outstanding securities of Netviewer, which we refer to as the Netviewer Acquisition, a privately held European SaaS vendor in collaboration and IT services. Netviewer became part of our Online Services division and the acquisition enables the extension of our Online Services business in Europe. The total consideration for this transaction was approximately $107.5 million, net of $6.3 million of cash acquired, and was paid in cash. In addition, in connection with the acquisition, we assumed non-vested stock units, which were converted into the right to receive up to 99,100 shares of our common stock, for which the vesting period reset fully upon the closing of the transaction. Transaction costs associated with the acquisition were approximately $3.1 million, of which we expensed $0.4 million during the first quarter of 2011 and is included in General and administrative expense in our condensed consolidated statement of income.

Cloud.com

In July 2011, we acquired all of the issued and outstanding securities of Cloud.com. Cloud.com became part of our Enterprise division and the acquisition further establishes us as a leader in infrastructure for the growing cloud provider market. The total consideration for this transaction was approximately $158.8 million, net of $5.6 million of cash acquired, and was paid in cash. Transaction costs associated with the acquisition were approximately $2.9 million. In addition, in connection with the acquisition we assumed non-vested stock units, which were converted into the right to receive up to 288,742 shares of our common stock and assumed certain stock options which are exercisable for 183,780 shares of our common stock, for which the vesting period reset fully upon the closing of the transaction. In the first quarter of 2012, we made a decision to contribute our CloudStack tradename acquired in conjunction with our acquisition of Cloud.com to the Apache Software Foundation and recorded a $5.2 million impairment charge which is included in Amortization of other intangible assets in our condensed consolidated statement of income.

RingCube

In August 2011, we acquired all of the issued and outstanding securities of RingCube. RingCube became part of our Enterprise division and the acquisition further solidifies our position in desktop virtualization. The total consideration for this transaction was approximately $32.2 million, net of $0.5 million of cash acquired, and was paid in cash. Transaction costs associated with the acquisition were approximately $0.6 million. In addition, in connection with the RingCube acquisition, we assumed non-vested stock units, which were converted into the right to receive up to 58,439 shares of our common stock, for which the vesting period reset fully upon the closing of the transaction.

ShareFile

In October 2011, we acquired all of the issued and outstanding securities of ShareFile. ShareFile initially became part of our Enterprise division and in the first quarter of 2012 it was moved to our Online Services division. The total consideration for this transaction was approximately $54.0 million, net of $1.7 million of cash acquired, and was paid in cash. Transaction costs associated with the acquisition were approximately $0.7 million. In addition, in connection

with the acquisition we assumed non-vested stock units, which were converted into the right to receive up to 180,697 shares of our common stock and assumed certain stock options which are exercisable for 390,775 shares of our common stock, for which the vesting period reset fully upon the closing of the transaction.

App-DNA

In November 2011, we acquired all of the issued and outstanding securities of App-DNA. App-DNA specializes in application migration and management and became part of our Enterprise division. The total consideration for this transaction was approximately $91.3 million, net of $3.2 million of cash acquired, and was paid in cash. Transaction costs associated with the acquisition were approximately $1.3 million. In addition, in connection with the acquisition we assumed non-vested stock units, which were converted into the right to receive up to 114,487 shares of our common stock, for which the vesting period reset fully upon the closing of the transaction.

Other Acquisition

During the first quarter of 2011, we acquired certain assets of a wholly-owned subsidiary of a privately-held company for total cash consideration of approximately $10.5 million. We accounted for this acquisition as a business combination in accordance with the authoritative guidance and it became part of our Enterprise division, thereby expanding our solutions portfolio for service providers and developing unique integrations with our application delivery solutions.

We have included the effects of all of the companies acquired in 2011 in our results of operations prospectively from the date of each acquisition.

Purchase of Non-Controlling Interest

Kaviza Inc.

In May 2011, we acquired all of the non-controlling interest of Kaviza Inc., or Kaviza, a provider of virtual desktop infrastructure solutions, for $17.2 million. In addition, we also deposited an additional $3.0 million to be held in escrow. As a result of this transaction, we have obtained a 100% interest in this subsidiary. In accordance with the authoritative guidance, the excess of the proceeds paid over the carrying amount of the non-controlling interest of Kaviza has been reflected as a reduction of additional paid-in capital. In addition, in connection with the purchase of the non-controlling interest of Kaviza, we assumed non-vested stock units which were converted into the right to receive up to 88,687 shares of our common stock and assumed certain stock options which are exercisable for 33,301 shares of our common stock, with existing vesting schedules.

Subsequent Events

In April 2012, we acquired all of the issued and outstanding securities of Podio ApS, or Podio, a privately-held provider of a cloud-based collaborative work platform. Podio will become part of our Online Services division. The total preliminary consideration for this transaction was approximately $43.6 million, net of $1.7 million of cash acquired, and was paid in cash. Transaction costs associated with the acquisition are currently estimated at $0.6 million, of which we expensed $0.5 million during the three months ended March 31, 2012 and are included in General and administrative expense in the accompanying condensed consolidated statements of income. In addition, in connection with the acquisition, we assumed non-vested stock units, which were converted into the right to receive up to 127,668 shares of our common stock, for which the vesting period reset fully upon the closing of the transaction.

Critical Accounting Policies and Estimates

Our discussion and analysis of financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. We base these estimates on our historical experience and on various other assumptions that we believe to be reasonable under the circumstances, and these estimates form the basis for our judgments concerning the carrying values of assets and liabilities that are not readily apparent from other sources. We periodically evaluate these estimates and judgments based on available information and experience. Actual results could differ from our estimates under different assumptions and conditions. If actual results significantly differ from our estimates, our financial condition and results of operations could be materially impacted. For more information regarding our critical accounting policies and estimates please refer to “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates” contained in our Annual Report on Form 10-K for the year ended December 31, 2011, or the Annual Report, and Note 2 to our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q. There have been no material changes to the critical

accounting policies disclosed in the Annual Report.

Results of Operations

The following table sets forth our condensed consolidated statements of income data and presentation of that data as a percentage of change from period-to-period (in thousands):

	Three Months Ended March 31,		Three Months Ended March 31, 2012 vs. March 31, 2011	
	2012	2011		
Revenues:				
Product and licenses	$178,364	$150,260	18.7	%
Software as a service	120,733	99,772	21.0	
License updates and maintenance	264,525	221,379	19.5	
Professional services	25,873	19,477	32.8	
Total net revenues	589,495	490,888	20.1	
Cost of net revenues:				
Cost of product and license revenues	18,804	14,041	33.9	
Cost of services and maintenance revenues	51,004	33,237	53.5	
Amortization of product related intangible assets	16,535	12,699	30.2	
Total cost of net revenues	86,343	59,977	44.0	
Gross margin	503,152	430,911	16.8	
Operating expenses:				
Research and development	103,622	90,548	14.4	
Sales, marketing and services	248,457	205,544	20.9	
General and administrative	59,856	50,403	18.8	
Amortization of other intangible assets	10,467	3,509	198.3	
Restructuring	—	24	*	
Total operating expenses	422,402	350,028	20.7	
Income from operations	80,750	80,883	(0.2	)
Interest income	3,078	3,939	(21.9	)
Other income, net	722	3,633	(80.1	)
Income before income taxes	84,550	88,455	(4.4	)
Income taxes	16,283	15,108	7.8	
Consolidated net income	68,267	73,347	(6.9	)
Less: Net loss attributable to non-controlling interest	—	156	*	
Net income attributable to Citrix Systems, Inc.	$68,267	$73,503	(7.1	)%

* not meaningful

Revenues

Net revenues of our Enterprise division include the following categories: Product and licenses, License updates and maintenance and Professional services.

Product and licenses primarily represents fees related to the licensing of the following major products:

- Our Desktop Solutions, comprised primarily of our desktop virtualization product, XenDesktop, and our application virtualization product, XenApp; and
- Our Datacenter and Cloud Solutions, comprised primarily of our cloud networking products, which include NetScaler, Branch Repeater and Access Gateway, and our Cloud platform products, which include XenServer, CloudStack and CloudPortal.

In addition, we offer incentive programs to our VADs and VARs to stimulate demand for our products. Product and license revenues associated with these programs are partially offset by these incentives to our VADs and VARs.

Our Online Services division's revenues, which are recognized ratably over the contractual term, consist of fees related to our SaaS products including:

- Our web collaboration products, which primarily include our GoToMeeting, GoToWebinar, Hi-Def Audio and GoToTraining products;
- Our connectivity product, GoToMyPC;
- Our remote IT support products, which primarily include GoToAssist; and
- Our data sharing products, which primarily include our ShareFile products.

License updates and maintenance consists of:

- Our Subscription Advantage program, an annual renewable program that provides subscribers with automatic delivery of unspecified software upgrades, enhancements and maintenance releases when and if they become available during the term of the subscription, for which fees are recognized ratably over the term of the contract, which is typically 12 to 24 months; and
- Our maintenance fees, which include technical support and hardware and software maintenance, and which are recognized ratably over the contract term.

Professional services revenues are comprised of:

- Fees from consulting services related to implementation of our products, which are recognized as the services are provided; and
- Fees from product training and certification, which are recognized as the services are provided.

	Three Months Ended March 31,		Three Months Ended March 31, 2012 vs. March 31, 2011
	2012	2011	
	(In thousands)		
Product and licenses	$178,364	$150,260	$ 28,104
Software as a service	120,733	99,772	20,961
License updates and maintenance	264,525	221,379	43,146
Professional services	25,873	19,477	6,396
Total net revenues	$589,495	$490,888	$ 98,607

Product and Licenses

Product and licenses revenue increased for the three months ended March 31, 2012 compared to the three months ended March 31, 2011 primarily due to increased sales of our Desktop Solutions of $17.3 million, led by XenDesktop, and due to increased sales of our Datacenter and Cloud Solutions of $10.5 million, led by NetScaler. These increases in Product and licenses revenue were primarily due to the factors discussed in the Executive Summary section of the Overview above. We currently target Product and licenses revenue to increase when comparing the second quarter of 2012 to the second quarter of 2011 due to the factors discussed in the Executive Summary section of the Overview above.

Software as a service

Software as a service revenue increased for the three months ended March 31, 2012 compared to the three months ended March 31, 2011 primarily due to increased sales of our web collaboration products. We are currently targeting that Software as a service revenue will increase when comparing the second quarter of 2012 to the second quarter of 2011.

License Updates and Maintenance

License updates and maintenance revenue increased for the three months ended March 31, 2012 compared to the three months ended March 31, 2011 primarily due to an increase in sales of our Subscription Advantage product of $26.7 million, primarily driven by renewals, and an increase in maintenance revenues of $16.4 million, primarily driven by increased sales of our Datacenter and Cloud Solutions products, led by NetScaler. We are currently targeting that License updates and maintenance revenue will increase when comparing the second quarter of 2012 to the second quarter of 2011.

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Professional Services

Professional services revenue increased for the three months ended March 31, 2012 compared to the three months ended March 31, 2011 primarily due to increases in consulting revenues related to increased implementation sales of our Enterprise division's products. We currently target Professional services revenues to increase when comparing the second quarter of 2012 to the second quarter of 2011 consistent with the targeted increase in Product and licenses revenue described above.

Deferred Revenue

Deferred revenues are primarily comprised of License updates and maintenance revenue from our Subscription Advantage product as well as maintenance contracts for our software and hardware products. SaaS revenues from annual service agreements for our online services and Professional services revenues primarily related to our consulting contracts. Deferred revenues increased approximately $23.0 million as of March 31, 2012 compared to December 31, 2011 primarily due to an increase in new sales of our Subscription Advantage product, led by XenDesktop, of $11.6 million and increased sales of our SaaS products of $7.3 million. We currently anticipate that deferred revenues will continue to increase throughout 2012.

International Revenues

International revenues (sales outside the United States) accounted for approximately 44.5% of our net revenues for the three months ended March 31, 2012 and 42.4% of our net revenues for the three months ended March 31, 2011. See Note 9 to our condensed consolidated financial statements for detailed information on net revenues by geography.

Segment Revenues

Our revenues are derived from sales of Enterprise division products which include our Desktop Solutions, Datacenter and Cloud Solutions products and related professional services and from our Online Services division's web collaboration, connectivity, remote support and data sharing products. The Enterprise division and the Online Services division constitute our two reportable segments.

An analysis of our reportable segment net revenue is presented below (in thousands):

	Three Months Ended March 31,		Increase for the Three Months Ended March 31, 2012 vs. March 31, 2011	
	2012	2011		
Enterprise division	$468,762	$391,116	19.9	%
Online Services division	120,733	99,772	21.0	%
Net revenues	$589,495	$490,888	20.1	%

With respect to our segment revenues, the increase in net revenues for the comparative periods presented was due primarily to the factors previously discussed above. See Note 9 of our condensed consolidated financial statements for additional information on our segment revenues.

Cost of Net Revenues

	Three Months Ended March 31,		Three Months Ended March 31, 2012 vs. March 31, 2011
	2012	2011	
	(In thousands)		
Cost of product and license revenues	$18,804	$14,041	$4,763
Cost of services and maintenance revenues	51,004	33,237	17,767
Amortization of product related intangible assets	16,535	12,699	3,836
Total cost of net revenues	$86,343	$59,977	$26,366

Cost of product and license revenues consists primarily of hardware, product media and duplication, manuals, packaging materials, shipping expense and royalties. Cost of services and maintenance revenues consists primarily of compensation and other personnel-related costs of providing support related to hardware and software maintenance and consulting, as well as the costs related to providing our online services. Also included in Cost of net revenues is amortization of product related

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intangible assets.

Cost of product and license revenues increased for the three months ended March 31, 2012 compared to the three months ended March 31, 2011 primarily due to increased revenue of our Datacenter and Cloud products, many of which contain hardware components that have a higher cost than our other products. We currently anticipate Cost of product and license revenues will increase when comparing the second quarter of 2012 to the second quarter of 2011 consistent with the targeted increase in Product and licenses sales.

Cost of services and maintenance revenues increased for the three months ended March 31, 2012 compared to the three months ended March 31, 2011 by $9.5 million consistent with the increase in sales of maintenance and consulting related to our Enterprise products and $7.3 million primarily due to an increase in sales of our web collaboration products and continuing investment in infrastructure to support the voice and video offerings in our web collaboration products. We currently anticipate Cost of services and maintenance revenues will increase when comparing the second quarter of 2012 to the second quarter of 2011 consistent with the targeted increase in Software as a service and Professional services revenues as discussed above.

Gross Margin

Gross margin as a percentage of revenue was 85.4% for the three months ended March 31, 2012 and 88.3% for the three months ended March 31, 2011. The decrease in gross margin as a percentage of net revenue is primarily due to the increase in sales of products with a hardware component and increased sales of our services, both of which have a higher cost than our software products. When comparing the second quarter of 2012 to the second quarter of 2011, we expect a slight decline in gross margin.

Operating Expenses

Foreign Currency Impact on Operating Expenses

A substantial majority of our overseas operating expenses and capital purchasing activities are transacted in local currencies and are therefore subject to fluctuations in foreign currency exchange rates. In order to minimize the impact on our operating results, we generally initiate our hedging of currency exchange risks up to 15 months in advance of anticipated foreign currency expenses. When the dollar is weak, the resulting increase to foreign currency denominated expenses will be partially offset by the gain in our hedging contracts. When the dollar is strong, the resulting decrease to foreign currency denominated expenses will be partially offset by the loss in our hedging contracts. There is a risk that there will be fluctuations in foreign currency exchange rates beyond the timeframe for which we hedge our risk.

Research and Development Expenses

	Three Months Ended March 31,		Three Months Ended March 31, 2012 vs. March 31, 2011
	2012	2011	
	(In thousands)		
Research and development	$103,622	$90,548	$ 13,074

Research and development expenses consisted primarily of personnel-related costs and facility and equipment costs directly related to our research and development activities. We expensed substantially all development costs included in the research and development of our products.

Research and development expenses increased during the three months ended March 31, 2012 compared to the three months ended March 31, 2011 primarily due to an $8.6 million increase in compensation and other employee-related costs primarily related to increased headcount due to strategic hiring and acquisitions and an increase in stock-based compensation expense of $5.5 million primarily related to awards assumed in conjunction with our acquisitions.

Sales, Marketing and Services Expenses

	Three Months Ended March 31,		Three Months Ended March 31, 2012 vs. March 31, 2011
	2012	2011	
	(In thousands)		

Sales, marketing and services	$248,457	$205,544	$ 42,913

Sales, marketing and services expenses consisted primarily of personnel-related costs, including sales commissions, pre-sales support, the costs of marketing programs aimed at increasing revenue, such as brand development, advertising, trade shows, public relations and other market development programs and costs related to our facilities, equipment and information systems that are directly related to our sales, marketing and services activities.

Sales, marketing and services expenses increased during the three months ended March 31, 2012 compared to the three months ended March 31, 2011 primarily due to an increase in compensation, including variable compensation increases and employee-related costs, due to additional headcount in our sales force and technical services group, as well as from our recent acquisitions.

General and Administrative Expenses

	Three Months Ended		Three Months Ended March 31, 2012 vs. March 31, 2011
	March 31, 2012	2011	
	(In thousands)		
General and administrative	$59,856	$50,403	$9,453

General and administrative expenses consisted primarily of personnel-related costs and expenses related to outside consultants assisting with information systems, as well as accounting and legal fees.

General and administrative expenses increased for the three months ended March 31, 2012 compared to the three months ended March 31, 2011 primarily due to a $5.2 million increase in compensation and employee-related costs due to additional headcount, primarily in IT, as well as from our acquisitions. Also contributing to the increase in general and administrative expense is a $3.0 million increase in stock-based compensation primarily related to awards assumed in conjunction with our acquisitions. In addition, included in the General and administrative expenses for the three months ended March 31, 2012 was approximately $1.1 million in professional fees primarily related to acquisition and strategic investment activity.

2012 Operating Expense Outlook

When comparing the second quarter of 2012 to the first quarter of 2012, we are targeting Operating expenses to increase in Research and development as we continue to enhance existing technologies and bring to market new technologies and in Sales, marketing and services as we continue to focus on hiring to expand our go-to-market capacity and customer touch, as well as, increasing consulting and technical support capacity. In addition, we expect General and administrative expenses will increase slightly as we continue to make investments to support our growth when comparing the second quarter of 2012 to the first quarter of 2012.

Amortization of Other Intangible Assets

	Three Months Ended		Three Months Ended March 31, 2012 vs. March 31, 2011
	March 31, 2012	2011	
	(In thousands)		
Amortization of other intangible assets	$10,467	$3,509	$6,958

The increase in Amortization of other intangible assets when comparing the three months ended March 31, 2012 to the three months ended March 31, 2011 was primarily due to a $5.2 million impairment related to our decision to contribute our CloudStack tradename acquired in conjunction with our acquisition of Cloud.com to the Apache Software Foundation. Also contributing to the increase in Amortization of other intangible assets when comparing the three months ended March 31, 2012 to the three months ended March 31, 2011 is an increase in amortization related to other intangible assets acquired in conjunction with acquisitions made during 2011. For additional information regarding our acquisitions see Note 4 and for more information regarding our intangible assets see Note 8 to our condensed consolidated financial statements.

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Other Income, Net

	Three Months Ended March 31,		Three Months Ended March 31, 2012 vs. March 31, 2011
	2012	2011	
	(In thousands)		
Other income, net	$722	$3,633	$ (2,911)

Other income, net is primarily comprised of remeasurement of foreign currency transaction gains (losses) and realized gains (losses) related to changes in the fair value of our investments that have a decline in fair value that is considered other-than-temporary, if any, recognized gains (losses) related to investments and interest expense, which was not material for all periods presented. The decrease in Other income, net, during the three months ended March 31, 2012 compared to the three months ended March 31, 2011 is primarily due to a loss on remeasurement of our foreign currency transactions of $5.5 million, partially offset by a net gain recognized on cost method investments of $2.9 million. For more information on our cost method investments, see Note 5 to our condensed consolidated financial statements.

Income Taxes

As of March 31, 2012, our net unrecognized tax benefits totaled approximately $79.2 million. All amounts included in this balance affect the annual effective tax rate. During the quarter ended March 31, 2012, we recognized $0.1 million of expense related to interest, which is included in Income tax expense. We have approximately $1.5 million for the payment of interest and penalties accrued as of March 31, 2012.

We and certain of our subsidiaries are subject to U.S. federal income taxes, as well as income taxes of multiple state and foreign jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state and local, or non-U.S., income tax examinations by tax authorities for years prior to 2004.

In the ordinary course of global business, there are transactions for which the ultimate tax outcome is uncertain and judgment is required in determining the worldwide provision for income taxes. We provide for income taxes on transactions based on our estimate of the probable liability. We adjust our provision as appropriate for changes that impact our underlying judgments. Changes that impact provision estimates include such items as jurisdictional interpretations on tax filing positions based on the results of tax audits and general tax authority rulings. Due to the evolving nature of tax rules combined with the large number of jurisdictions in which we operate, it is possible that our estimates of our tax liability and the realizability of our deferred tax assets could change in the future, which may result in additional tax liabilities and adversely affect our results of operations, financial condition and cash flows.

In June 2010, we reached a settlement in principle with the IRS regarding certain previously disclosed income tax deficiencies asserted in a Revenue Agent’s Report, or RAR. Under the terms of the settlement in principle, we would agree to an assessment of income tax deficiencies in full settlement of all open claims under the RAR and would resolve with finality for future years all of the transfer pricing issues raised in the RAR. Based on this, we incurred a charge of $13.1 million in 2010 in accordance with the authoritative guidance. Among other things, the authoritative guidance requires application of a “more likely than not” threshold to the recognition and non-recognition of tax positions. It further requires that a change in management judgment related to prior years’ tax positions be recognized in the quarter of such change.

The final settlement requires the finalization of tax deficiency calculations with the IRS and a written agreement signed by the IRS. It is uncertain how long it will take to reach a final settlement with the IRS. There can be no assurances that a final written agreement will be obtained or that this matter will otherwise be resolved in our favor. An adverse outcome of this matter could have a material adverse effect on our results of operations and financial condition.

We are required to estimate our income taxes in each of the jurisdictions in which we operate as part of the process of preparing our condensed consolidated financial statements. At March 31, 2012, we had approximately $84.6 million in net deferred tax assets. The authoritative guidance requires a valuation allowance to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. We review deferred tax assets periodically for recoverability and make estimates and judgments regarding the expected geographic sources of taxable income and gains from investments, as well as tax

planning strategies in assessing the need for a valuation allowance.

We maintain certain strategic management and operational activities in overseas subsidiaries and our foreign earnings are taxed at rates that are generally lower than in the United States. We do not expect to remit earnings from our foreign subsidiaries. Our effective tax rate was approximately 19.3% for the three months ended March 31, 2012 and 17.1% for the

three months ended March 31, 2011. The increase in the effective tax rate when comparing the three months ended March 31, 2012 to the three months ended March 31, 2011 was primarily due to research and development tax credits not being extended in 2012, partially offset by a tax benefit related to the impairment of certain intangible assets. Our effective tax rate generally differs from the U.S. federal statutory rate of 35% due primarily to lower tax rates on earnings generated by our foreign operations that are taxed primarily in Switzerland. We have not provided for U.S. taxes for those earnings because we plan to reinvest all of those earnings indefinitely outside the United States. Our effective tax rate will fluctuate based on the mix of earnings from our U.S. and foreign jurisdictions. Accordingly, earnings from the production and distribution of our products and services through our foreign headquarters in Switzerland are currently taxed at lower income tax rates than earnings from our U.S. operations.

Liquidity and Capital Resources

During the three months ended March 31, 2012, we generated operating cash flows of $243.1 million. These operating cash flows related primarily to an aggregate increase in operating assets and liabilities of $95.3 million, net of effects of our acquisitions. Also contributing to these cash inflows was net income of $68.3 million, adjusted for, among other things, non-cash charges, including depreciation and amortization expenses of $49.5 million and stock-based compensation expense of $30.6 million and the tax effect of stock-based compensation of $13.9 million. Our investing activities used $115.1 million of cash consisting primarily of cash paid for net purchases of investments of $67.9 million. Also contributing to these cash outflows was cash paid for acquisitions of $24.0 million and the purchase of property and equipment of $23.1 million. Our financing activities used cash of $71.7 million primarily due to stock repurchases of $100.0 million. This financing cash outflow was partially offset by proceeds received from the issuance of common stock under our employee stock-based compensation plans of $30.3 million.

During the three months ended March 31, 2011, we generated operating cash flows of $159.2 million. These operating cash flows related primarily to net income of $73.3 million, adjusted for, among other things, non-cash charges, including depreciation and amortization expenses of $35.8 million and stock-based compensation expense of $17.9 million and the tax effect of stock-based compensation of $15.5 million. Also contributing to these cash inflows was an aggregate increase in operating assets and liabilities of $32.9 million, net of effects of our acquisitions. These cash inflows were partially offset by operating outflows related to the excess benefit from the exercise of stock options of $15.5 million. Our investing activities provided $17.9 million of cash consisting primarily of cash received for net proceeds of investments of $166.5 million. This cash inflow was partially offset by cash paid for acquisitions of $118.4 million and the purchase of property and equipment of $26.8 million. Our financing activities used $61.8 million of cash primarily from expenditures on our stock repurchases of $100.0 million, partially offset by proceeds received from the issuance of common stock under our employee stock-based compensation plans of $42.3 million.

Historically, significant portions of our cash inflows were generated by our operations. We currently expect this trend to continue throughout 2012. We believe that our existing cash and investments, together with cash flows expected from operations, will be sufficient to meet expected operating and capital expenditure requirements for the next 12 months. We continue to search for suitable acquisition candidates and could acquire or make investments in companies we believe are related to our strategic objectives. We could from time to time seek to raise additional funds through the issuance of debt or equity securities for larger acquisitions.

Cash, Cash Equivalents and Investments

	March 31, 2012	December 31, 2011	2012 Compared to 2011
	(In thousands)		
Cash, cash equivalents and investments	$1,608,700	$1,477,601	$131,099

The increase in Cash, cash equivalents and investments when comparing March 31, 2012 to December 31, 2011, is primarily due to cash provided by our operating activities of $243.1 million and cash received from the issuance of common stock under our employee stock-based compensation plans of $30.3 million, partially offset by expenditures made on stock repurchases of $100.0 million, cash paid for acquisitions, net of cash acquired, of $24.0 million and purchases of property and equipment of $23.1 million. As of March 31, 2012, $697.2 million of the $1,608.7 million of Cash, cash equivalents and investments was held by our foreign subsidiaries. If these funds are needed for our operations in the United States, we would be required to accrue and pay U.S. taxes to repatriate these funds. Our

current plans are not expected to require repatriation of cash and investments to fund our U.S. operations and, as a result, we intend to permanently reinvest our foreign earnings. We generally invest our cash and cash equivalents in investment grade, highly liquid securities to allow for flexibility in the event of immediate cash needs. Our short-term and long-term investments primarily consist of interest-bearing securities.

Fair Value Measurements

The authoritative guidance defines fair value as an exit price, representing the amount that would either be received to sell an asset or be paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the guidance establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1. Observable inputs such as quoted prices in active markets for identical assets or liabilities;
- Level 2. Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3. Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Available-for-sale securities included in Level 2 are valued utilizing inputs obtained from an independent pricing service, or the Service, which uses quoted market prices for identical or comparable instruments rather than direct observations of quoted prices in active markets. The Service gathers observable inputs for all of our fixed income securities from a variety of industry data providers, for example, large custodial institutions and other third-party sources. Once the observable inputs are gathered by the Service, all data points are considered and an average price is determined. The Service’s providers utilize a variety of inputs to determine their quoted prices. These inputs may include interest rates, known historical trades, yield curve information, benchmark data, prepayment speeds, credit quality and broker/dealer quotes. Substantially all of our available-for-sale investments are valued utilizing inputs obtained from the Service and accordingly are categorized as Level 2. The Company periodically independently assesses the pricing obtained from the Service and historically has not adjusted the Service's pricing as a result of this assessment. Available-for-sale securities are included in Level 3 when relevant observable inputs for a security are not available.

Our assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the classification of assets and liabilities within the fair value hierarchy. In certain instances, the inputs used to measure fair value may meet the definition of more than one level of the fair value hierarchy. The input with the lowest level priority is used to determine the applicable level in the fair value hierarchy.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Our fixed income available-for-sale security portfolio generally consists of high quality, investment grade securities from diverse issuers with a minimum credit rating of A-/A3 and a weighted average credit rating of AA+/Aa1. We value these securities based on pricing from the Service, whose sources may use quoted prices in active markets for identical assets (Level 1 inputs) or inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs) in determining fair value, we classify all of our fixed income available-for-sale securities as Level 2. See Note 5 to our condensed consolidated financial statements for more information regarding our available-for-sale investments.

We measure our cash flow hedges, which are classified as prepaid expenses and other current assets and accrued expenses and other current liabilities, at fair value based on indicative prices in active markets (Level 2 inputs).

We have invested in convertible debt securities of certain early-stage entities that are classified as available-for-sale investments. As quoted prices in active markets or other observable inputs were not available for these investments, in order to measure them at fair value, we utilized a discounted cash flow model using a discount rate reflecting the market risk inherent in holding securities of an early-stage enterprise, adjusted by the probability-weighted exit possibilities associated with the convertible debt securities. Typically the discount rate used by us in measuring the fair value of investments in convertible debt securities of certain early-stage entities is commensurate with the nature and size of these entities. This methodology required us to make assumptions that were not directly or indirectly observable regarding the fair value of the convertible debt securities; accordingly it is a Level 3 valuation and is included in the table below.

Assets Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3)

	Investments (in thousands)
Balance at December 31, 2011	$3,696
Purchases of Level 3 securities	1,252
Transfers out of Level 3	(142)
Balance at March 31, 2012	$4,806

Accounts Receivable, Net

	March 31, 2012	December 31, 2011	2012 Compared to 2011
	(In thousands)		
Accounts receivable	$394,246	$488,356	$(94,110)
Allowance for returns	(1,602)	(1,361)	(241)
Allowance for doubtful accounts	(2,837)	(2,564)	(273)
Accounts receivable, net	$389,807	$484,431	$(94,624)

The decrease in Accounts receivable, net, when comparing March 31, 2012 to December 31, 2011 was primarily due to increased collections in the first quarter of 2012 on higher sales in the fourth quarter of 2011. The activity in our Allowance for returns was comprised primarily of $2.9 million of provisions for returns recorded in the three month period ended March 31, 2012, partially offset by $2.7 million in credits issued for returns during the three month period ended March 31, 2012. The activity in our Allowance for doubtful accounts was comprised primarily of $0.5 million in additional provisions for doubtful accounts during the three month period ended March 31, 2012, partially offset by $0.3 million of uncollectible accounts written off, net of recoveries during the three month period ended March 31, 2012. From time to time, we could maintain individually significant accounts receivable balances from our distributors or customers, which are comprised of large business enterprises, governments and small and medium-sized businesses. If the financial condition of our distributors or customers deteriorates, our operating results could be adversely affected.

Stock Repurchase Program

Our Board of Directors authorized an ongoing stock repurchase program with a total repurchase authority granted to us of $3.0 billion. We may use the approved dollar authority to repurchase stock at any time until the approved amounts are exhausted. The objective of our stock repurchase program is to improve stockholders' returns. At March 31, 2012, approximately $86.6 million was available to repurchase common stock pursuant to the stock repurchase program. All shares repurchased are recorded as treasury stock. A portion of the funds used to repurchase stock over the course of the program was provided by proceeds from employee stock option exercises and the related tax benefit.

We are authorized to make open market purchases of our common stock using general corporate funds. Additionally, from time to time, we may enter into structured stock repurchase arrangements with large financial institutions using general corporate funds in order to lower the average cost to acquire shares. These programs include terms that require us to make up-front payments to the counterparty financial institution and result in the receipt of stock during or at the end of the agreement or the receipt of either stock or cash at the maturity of the agreement, depending on market conditions.

During the three months ended March 31, 2012, we expended approximately $100.0 million on open market purchases, repurchasing 1,378,600 shares of outstanding common stock at an average price of $72.53.

During the three months ended March 31, 2011, we expended approximately $100.0 million on open market purchases, repurchasing 1,452,100 shares of outstanding common stock at an average price of $68.83.

Shares for Tax Withholding

During the three months ended March 31, 2012, we withheld 183,050 shares from stock units that vested, totaling $14.1 million, to satisfy minimum tax withholding obligations that arose on the vesting of stock units. During the three months ended March 31, 2011, we withheld 124,595 shares from stock units that vested, totaling $8.8 million, to

satisfy minimum tax withholding obligations that arose on the vesting of stock units. These shares are reflected as treasury stock in our condensed consolidated balance sheets and the related cash outlays reduce our total stock repurchase authority.

Office Leases

We have operating lease obligations through 2018 related to two properties that are not utilized. At March 31, 2012, the total remaining obligation on these leases was approximately $5.1 million, of which $2.1 million was accrued as of March 31, 2012, and is reflected, as applicable, in Accrued expenses and other current liabilities and Other liabilities in our condensed consolidated financial statements. In calculating this accrual, we made estimates, based on market information, including the estimated vacancy periods and sublease rates and opportunities. We periodically re-evaluate our estimates related to these vacant facilities.

Off-Balance Sheet Arrangements

We do not have any special purpose entities or off-balance sheet financing arrangements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes with respect to the information appearing in Part II, Item 7A, “Quantitative and Qualitative Disclosures About Market Risk,” of our Annual Report on Form 10-K for the year ended December 31, 2011.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of March 31, 2012, our management, with the participation of our President and Chief Executive Officer and our Executive Vice President, Operations, Chief Financial Officer and Treasurer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(b) promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Based upon that evaluation, our President and Chief Executive Officer and our Executive Vice President, Operations, Chief Financial Officer and Treasurer and concluded that, as of March 31, 2012, our disclosure controls and procedures were effective in ensuring that material information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, including ensuring that such material information is accumulated by and communicated to our management, including our President and Chief Executive Officer and our Executive Vice President, Operations, Chief Financial Officer and Treasurer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

During the quarter ended March 31, 2012, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We accrue a liability for legal contingencies when we believe that it is both probable that a liability has been incurred and that we can reasonably estimate the amount of the loss. We review these accruals and adjust them to reflect ongoing negotiations, settlements, rulings, advice of legal counsel and other relevant information. To the extent new information is obtained and our views on the probable outcomes of claims, suits, assessments, investigations or legal proceedings change, changes in our accrued liabilities would be recorded in the period in which such determination is made. For the matters referenced below, the amount of liability is not probable or the amount cannot be reasonably estimated; and, therefore, accruals have not been made. In addition, in accordance with the relevant authoritative guidance, for matters which the likelihood of material loss is at least reasonably possible, we provide disclosure of the possible loss or range of loss; however, if a reasonable estimate cannot be made, we will provide disclosure to that effect.

Due to the nature of our business, we are subject to patent infringement claims, including current suits against us or one or more of our wholly-owned subsidiaries alleging infringement by various Citrix products and services. We believe that we have meritorious defenses to the allegations made in our pending cases and intend to vigorously defend these lawsuits; however, we are unable currently to determine the ultimate outcome of these or similar matters. In addition, we are a defendant in various litigation matters generally arising out of the normal course of business. Although it is difficult to predict the ultimate outcomes of these cases, we believe that it is not reasonably possible that the ultimate outcomes will materially and adversely affect our business, financial position, results of operations or cash flows.

ITEM 1A. RISK FACTORS

There have been no material changes in our risk factors from those disclosed in Part 1, Item 1A, “Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, which was filed with the Securities and Exchange Commission on February 23, 2012.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Purchases of Equity Securities by the Issuer

Our Board of Directors has authorized an ongoing stock repurchase program with a total repurchase authority granted to us of $3.0 billion. The objective of the stock repurchase program is to improve stockholders’ returns. At March 31, 2012, approximately $86.6 million was available to repurchase common stock pursuant to the stock repurchase program. All shares repurchased are recorded as treasury stock. The following table shows the monthly activity related to our stock repurchase program for the quarter ended March 31, 2012:

	(a) Total Number of Shares (or Units) Purchased (1)(2)	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or approximate dollar value) of Shares (or Units) that may yet be Purchased under the Plans or Programs
January 1, 2012 through January 31, 2012	147,387	$65.10	147,387	$ 177,630
February 1, 2012 through February 29, 2012	836,381	72.44	836,381	117,695
March 1, 2012 through March 31, 2012	577,882	75.99	577,882	86,622
Total	1,561,650	$73.06	1,561,650	$ 86,622

(1)

Represents shares acquired in open market purchases. We expended approximately $100.0 million during the quarter ended March 31, 2012 for repurchases of our common stock. For more information see Note 12 to our condensed consolidated financial statements.

(2) Includes 183,050 shares withheld from stock units that vested in the first quarter of 2012 to satisfy minimum tax withholding obligations that arose on the vesting of stock units.

ITEM 5. OTHER INFORMATION

Our policy governing transactions in our securities by our directors, officers and employees permits our officers, directors and certain other persons to enter into trading plans complying with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended. The Company has been advised that the following executive officers and directors entered into new trading plans in the first quarter of 2012 in accordance with Rule 10b5-1 and our policy governing transactions in our securities: David

Friedman (our General Counsel and Senior Vice President, Human Resources), David Henshall (our Executive Vice President, Operations, Chief Financial Officer and Treasurer), Alvaro Monserrat (our Senior Vice President, Sales and Services), J. Gordon Payne (our Senior Vice President and General Manager, Desktop and Cloud Division) and Nanci Caldwell and Murray Demo (both of whom are members of our Board of Directors). We undertake no obligation to update or revise the information provided herein, including for revision or termination of an established trading plan.

ITEM 6. EXHIBITS

(a) List of exhibits

Exhibit No.	Description
10.1*	Form of Global Restricted Stock Unit Agreement under the Citrix Systems, Inc. Amended and Restated 2005 Equity Incentive Plan (Market and Service Condition)
31.1	Rule 13a-14(a) / 15d-14(a) Certification
31.2	Rule 13a-14(a) / 15d-14(a) Certification
32.1†	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101††	The following financial statements from Citrix Systems, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, as filed with the SEC on May 7, 2012, formatted in XBRL, as follows:
	(i) the Condensed Consolidated Balance Sheets
	(ii) the Condensed Consolidated Statement of Income
	(iii) the Condensed Consolidated Statements of Comprehensive Income
	(iv) the Condensed Consolidated Statements of Cash Flows
	(v) the Notes to Condensed Consolidated Financial Statements, tagged in summary and detail

* Indicates a management contract or a compensatory plan, contract or arrangement.

† Furnished herewith.

†† As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized on this 7th day of May 2012.

CITRIX SYSTEMS, INC.

By: /s/ DAVID J. HENSHALL
David J. Henshall
Executive Vice President, Operations, Chief Financial Officer and Treasurer
(Authorized Officer and Principal Financial Officer)

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