

EXTREME NETWORKS INC
Form 10-K
August 23, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended June 30, 2012

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____.

Commission file number 000-25711

Extreme Networks, Inc.
(Exact name of Registrant as specified in its charter)

Delaware 77-0430270
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

3585 Monroe Street 95051
Santa Clara, California (Zip Code)
(Address of principal executive offices)
Registrant's telephone number, including area code: (408) 579-2800

Securities registered pursuant to Section 12(b) of the Act: None

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

Common stock, \$.001 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past

90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or

information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large Accelerated Filer o

Accelerated Filer x

Non-Accelerated Filer o

Smaller reporting company o

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

The aggregate market value of voting stock held by non-affiliates of the Registrant was approximately \$164.4 million as of December 30, 2011, the last business day of the Registrant’s most recently completed second fiscal quarter, based upon the per share closing price of the Registrant’s common stock as reported on The NASDAQ Global Market reported on such date. For purposes of this disclosure, shares of common stock held or controlled by executive officers and directors of the registrant and by persons who hold more than 5% of the outstanding shares of common stock have been treated as shares held by affiliates. This calculation does not reflect a determination that certain persons are affiliates of the Registrant for any other purpose.

94,528,405 shares of the Registrant’s Common stock, \$.001 par value, were outstanding as of August 6, 2012.

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates by reference from the definitive proxy statement for the Company’s 2012 Annual Meeting of Stockholders to be filed with the Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

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FORWARD LOOKING STATEMENTS

This annual report on Form 10-K, including the following sections, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, particularly, our expectations regarding results of operations, our ability to expand our market penetration, our ability to expand our distribution channels, customer acceptance of our products, our ability to meet the expectations of our customers, product demand and revenue, cash flows, product gross margins, our expectations to continue to develop new products and enhance existing products, our expectations regarding the amount of our research and development expenses, our expectations relating to our selling, general and administrative expenses, our efforts to achieve additional operating efficiencies and to review and improve our business systems and cost structure, our expectations to continue investing in technology, resources and infrastructure, our expectations concerning the availability of products from suppliers and contract manufacturers, anticipated product costs and sales prices, our expectations that we have sufficient capital to meet our requirements for at least the next twelve months, and our expectations regarding materials and inventory management. These forward-looking statements involve risks and uncertainties, and the cautionary statements set forth below and those contained in the section entitled “Risk Factors” identify important factors that could cause actual results to differ materially from those predicted in any such forward-looking statements. We caution investors that actual results may differ materially from those projected in the forward-looking statements as a result of certain risk factors identified in this Form 10-K and other filings we have made with the Securities and Exchange Commission. More information about potential factors that could affect our business and financial results is set forth under “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

PART I

Item 1. Business

Overview

Extreme Networks, Inc., together with its subsidiaries, (collectively referred to as Extreme and as we, us and our) is a leading provider of network infrastructure equipment and services for enterprises, data centers, and service providers. Our customers include businesses, hospitals, schools, hotels, telecommunications companies and government agencies around the world. Since our founding in 1996, our vision has been a world enabled by a unified network based upon Ethernet that simplifies each element and component of the network, and through simplification, provides services at a lower cost. As networks internal to businesses, between businesses and the Internet itself become more pervasive and critical to a wide variety of business and social communications, the volume and the demands of applications, data, users and devices on networks continue to increase. Our vision focuses on the design and delivery of easily deployable, highly scalable, secure and comprehensively managed networks which are reliable, fast, flexible and cost-effective. We primarily sell our products through an ecosystem of our channel partners who combine our Ethernet products with their offerings to create compelling information technology solutions for end user customers.

Industry Background

The networking industry has undergone significant changes in the last few years. With the mobilization of the workforce, the virtualization of the data center, and the demand for anywhere, anytime connectivity, across any device, Ethernet is the common technology across both enterprises and service providers. Extreme Networks' strategy, product portfolio, and research and development are aligned with the following trends:

Ethernet. Through its scalability, adaptability, and cost-effectiveness, has solidified its role as the basis for both public and private networks. At the same time, the enterprises and service providers expect the technology to follow a price-performance curve that mandates continued innovation by Ethernet vendors.

Mobile Workforce. Employees expect high-quality and secure access to corporate resources in a Bring Your Own Device (“BYOD”) world across a diversity of endpoints such as laptops, tablets, and smart phones, whether they are within the corporate firewall or on-the-go. IT departments focus their investment decisions on this mobile workforce, taking a unified view of wireless access, the campus core, and the data center. Networking vendors offer end-to-end solutions that permit IT managers to meet employee expectations and to maximize IT return on investment.

The Cloud. Data center architectures are influenced by the cloud and by the deployment of server virtualization. Enterprises have migrated applications and services to either private clouds, or public clouds offered by 3rd parties. In either case, the network infrastructure must adapt to this new dynamic environment. Intelligence and automation are key if enterprises are to derive maximum benefit from their cloud deployments. Ethernet, scaling from 10 Gigabits (G) to 40G and even 100G, provides the infrastructure for both private and public clouds. In addition, there is growing interest in Software Defined Network (SDN) approaches that may include technologies such as OpenFlow, OpenStack, and CloudStack.

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Public Network Evolution. 3G and 4G mobile networks now provide the necessary capacity and reach to enable employees to be productive away from the office and away from fixed networks. Mobile operators continue to invest in their next-generation networks, and Ethernet is the technology often used for their access networks, referred to as Mobile Backhaul.

Vendor Consolidation. Consolidation of vendors within the Ethernet networking market and between adjacent markets (storage, security, wireless & voice applications) continues to gain momentum. We believe that the underpinning technology for all of these adjacent markets is Ethernet. As a result, we believe that there will be continued mergers between adjacent market vendors to enable them to deliver complete and broad solutions to customers.

The Extreme Networks Strategy

With the proliferation of mobile users and their devices, within a campus or across continents, the challenges of operating and managing a network have changed. IT has rapidly evolved from a world of fixed to a new world of mobility where everything-people, devices, machines, and applications-are in motion. IT now has to support end users with smart phones, tablets, laptops and other wireless peripherals as well as their wired workstations. Users are beginning to define the services that IT must offer as they adopt tablets and their applications, and work on the go. Users know what they need to be productive, and they expect the network to help them achieve productivity.

Extreme Networks provides networks designed for mobility. Customers deploying our technology can know what resources are using the network, what they are requesting and where they are located, and can provide customized access to approved resources and content.

Our networks help enable granular visibility and control, higher performance and resource security.

Extreme Networks strategy is to offer sophisticated, open, and cost effective scalable networks, an alternative to single-sourced, highly proprietary networking equipment from other companies. Our commitment to open standards is manifested by demonstrated interoperability within both enterprise and service provider networks, and the active participation in key industry and standards associations.

Key elements of our strategy include:

• Provide simple, easy-to-use, high-performance, cost-effective switching solutions. We offer simple, easy-to-use, high performance and cost-effective switching solutions that meet the specific demands of the following customers:

Enterprises and cloud data centers use our products to deploy next generation virtualized and high-density server infrastructure solutions.

Enterprises, including large or medium sized businesses, schools, hospitals, hotels and government agencies, use our products for their campus access and backbone networks.

Mobile Operators deploy our products for mobile backhaul in support of mobile broadband.

Extend switching technology leadership. Our technological leadership is based on innovative switching technology, the depth and focus of our market experience and the ExtremeXOS® operating system - the software that runs on all of our Ethernet switches. Our standardization on a single network operating system, a primary merchant silicon vendor, and single Original Design Manufacturer (“ODM”) for our core products permit us to derive leverage from our engineering investment. We intend to invest our engineering resources to continue to create leading-edge technologies that will increase the performance and functionality of our products and as a direct result, the value of the Extreme Networks solution to our current and future customers. In addition, we look for maximum synergies from our engineering investment in our targeted verticals and when targeting new vertical market segments.

- Expand market penetration by targeting high-growth verticals. Within the campus, we focus on the mobile user, leveraging our automation capabilities and tracking wireless LAN growth. Our data center approach leverages our product portfolio to address the needs of managed hosting and cloud data center providers, while we deliver key components of mobile backhaul solutions to our network equipment partners. Within the campus we also target the

high-growth physical security market, converging technologies such as IP video across a common Ethernet infrastructure in conjunction with our technology partners

Leverage and expand multiple distribution channels. We distribute our products through select distributors, a large number of resellers and system-integrators worldwide and our large strategic partners. We maintain a field sales force to support our channel partners and to sell directly to certain strategic accounts. As an independent Ethernet switch

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vendor, we seek to provide products that, when combined with the offerings of our channel partners, create compelling solutions for end user customers.

Maintain and extend our Strategic Relationships. We have established strategic relationships with a number of industry-leading vendors to both provide increased and enhanced routes to market, but also to collaboratively develop unique solutions.

Provide high-quality customer service and support. We seek to enhance customer satisfaction and build customer loyalty through high-quality service and support. This includes a wide range of standard support programs that provide the level of service our customers require, from standard business hours to global 24-hour-a-day, 365-day-a-year real-time response support.

Products

Our products offer a resilient, intelligent and sustainable foundation for Enterprise IT. We build our products into vertical markets solutions for converged campus networks with user and device mobility, and for Data Center and Cloud administrators to virtualize their server and storage over a high-performance Ethernet infrastructure, and Service Providers to provide bandwidth and Service Level Agreements for Carrier Ethernet, 3G and 4G services.

Resilient. Customers can choose to deploy redundant management and fabric modules, hot swappable line cards, multi-speed stacking across 100 Megabits (M)/1G/10G/40G systems, redundant power supplies and fan trays delivering high hardware availability. These are supported by ExtremeXOS, our modular and fault-tolerant network operating system that spans our complete switching portfolio. Technologies supported include a variety of layer-2 resiliency protocols including multi-switch Link Aggregation (M-LAG), Ethernet Automatic Protection Switching (EAPS), MPLS/VPLS for high service availability, and layer-3 IPv4 and IPv6 routing protocols for high network availability. EAPS is an example of Extreme Networks innovation and allows network managers to configure their network infrastructure so that critical network communications can be rerouted within 50 milliseconds in the event of a network outage in most topologies. This level of high-speed communications 'reroute' is targeted for mission critical and demanding applications, including voice and video and maintains service delivery in the event of network outage. We further offer a versatile and flexible Quality of Service ("QoS") solution that allows network operators to configure bandwidth for mission critical applications and in doing so control the overall experience and the service-level of the communication flows. We have deep experience with communication quality controls, starting with our introduction to the market of the first broad QoS controls for Ethernet to the recent Data Center Bridging ("DCB") protocols for 'lossless' Ethernet that enables traditional storage networks to converge over a common Ethernet infrastructure. Our mobile backhaul products also support sophisticated timing functionality including Synchronous Ethernet and RFC1588, as well as Time Division Multiplexing ("TDM") interfaces for the transport of T1/E1 traffic across an Ethernet infrastructure.

- Intelligent. Based on a resilient ExtremeXOS foundation, our customers can take advantage of user, machine and application visibility and control from the networks infrastructure. Universal Port automatically detects new devices such as IP phones that plug-in to the network and can assign appropriate power, server and other configurations. The Identity Management engine allows tracking of users based on their login id and host machine, and assigning them to roles based on guest, contractor, or employee privilege. In the Data Center and Cloud, ExtremeXOS Network Virtualization (XNV) allows network administrators visibility into Virtual Machine (VM) movement and having virtual port-profiles follow VMs as they move within and across network switches. CLEAR-Flow, our wire-speed security rules engine, helps detect and mitigate traffic anomalies, including denial of service attacks. This user, machine, virtual machine, and traffic intelligence helps our customers fulfill the productivity promise from the exploding growth of mobility and cloud applications. These customers are further able to simplify provisioning and operations by leveraging extensibility capabilities inherent in ExtremeXOS including the ability to create custom scripts, dynamically load application modules, or moving to a dynamic extensible Markup Language (XML) from static SNMP

based management.

Sustainable. Our portfolio of switching hardware has been created with power consumption in mind. Our switches are designed to require less power to perform the network traffic switching function, and where Power over Ethernet (PoE) solutions have been deployed within the customers' network, features within the Extreme XOS operating system can intelligently control the delivery of power to the attached devices. In addition to lower power consumption, the air flow on our Data Center switches is built to integrate well with hot-aisle-cool-aisle designs to help minimize cooling costs.

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Vertical Market Solutions. Our hardware and software offerings can be combined into complete solutions targeted at specific high-growth vertical markets. These include Open Fabric, our architecture for open and scalable next-generation data center deployments that offer investment protection and provide a path to SDN. Extreme Network's All Ethernet Open Fabric is anchored by our BlackDiamond BDX switch, our Summit top-of-rack data center switches, RidgeLine management, and where required, products from technology partners. In the campus, our Intelligent Mobile Edge offering combines our Summit edge virtual chassis switches, our WLAN access point and controller portfolio, and our RidgeLine management platform offering rich user and device identity awareness.

Our product categories include:

Modular Ethernet switching systems. Our Black Diamond® products deliver modular or chassis-based Ethernet connectivity solutions for enterprises, data centers and service providers. These products have a range of management and line cards that allow our customers to flexibly configure and re-purpose the systems to meet specific needs. The Black Diamond products in conjunction with our ExtremeXOS operating system and our centralized management software product provide the density, performance and reliability required to serve in environments with demanding applications.

- Stackable Ethernet switching systems. Our Summit® product family delivers Ethernet connectivity for the network edge, aggregation and core. Within the Summit family are products that offer a range of connection speeds (from 10 Megabit to 40 Gigabit), various physical presentations (copper and fiber) and options to deliver Power-over-Ethernet or unpowered standard Ethernet ports. As with the our Black Diamond products, the Summit products in conjunction with our ExtremeXOS operating system provide the features, performance and reliability required by our customers to deploy, operate and manage converged networking infrastructure.

Wireless Ethernet controllers and access points. In addition to our wired Ethernet switch portfolio, we offer our SummitWM family of wireless network controllers and associated Altitude™ access points to enable the deployment of nomadic and mobile converged network applications. Our wireless access products offer both indoor and outdoor 802.11abgn access points.

Centralized Management software. To provide a central configuration, status and alerting capability we offer our RidgeLine management software system. This system provides the ability to deploy, configure, monitor and support our complete range of switching technology to enable our customers to reduce the overall cost of network administration and operations. This software system can exist as a standalone management solution or it can operate as part of a larger infrastructure management environment, and includes features tailored to data center, campus, and service provider management.

Sales, Marketing and Distribution

We conduct our sales and marketing activities on a worldwide basis through a distribution channel utilizing distributors, resellers and our field sales organization. We primarily sell our products through an ecosystem of channel partners who combine our Ethernet products with their offerings to create compelling information technology solutions for end user customers. We utilize our field sales organization to support our channel partners and to sell direct to end-user customers, including some large global accounts.

Strategic Relationships. We have strategic relationships with Ericsson Enterprise AB, Motorola Inc., Netgear, Inc., Nokia Siemens Networks and others who sell our products as part of an overall solution.

Distributors. We have established several key relationships with leading distributors in the electronics and computer networking industries. Each of our distributors primarily resells our products to resellers. The distributors enhance our ability to sell and provide support to resellers, who may benefit from the broad service and product fulfillment capabilities offered by these distributors. One distributor, Westcon Group, Inc., accounted for 19%, 16%, and 16% of our net revenue in fiscal years 2012, 2011 and 2010, respectively. Distributors are generally given the right to return a portion of inventory to us for the purpose of stock rotation, to claim rebates for competitive discounts and participate in various cooperative marketing programs to promote the sale of our products and services. We defer recognition of revenue on all sales to distributors who maintain inventory of our products until the distributors sell the product, as

evidenced by monthly “sales-out” reports that the distributors provide to us, provided other revenue recognition criteria are met. (See “Revenue Recognition” in Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.)

Resellers. We rely on many resellers worldwide that sell directly to end-user customer. Our resellers include regional networking system resellers, resellers who focus on specific vertical markets, value added resellers, network integrators and wholesale resellers. We provide training and support to our resellers and our resellers generally provide the first level of contact to end-users of our products. Our relationships with resellers are on a non-exclusive basis. Our resellers are not given rights to

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return inventory and do not automatically participate in any cooperative marketing programs. We generally recognize product revenue from our reseller and end-user customers at the time of shipment, provided other revenue recognition criteria are met. When significant obligations or contingencies remain after products are delivered, such as installation or customer acceptance, revenue and related costs are deferred until such obligations or contingencies are satisfied. (See "Revenue Recognition" in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.)

Field Sales. We have trained our field sales organization to support and develop leads for our resellers and to establish and maintain key accounts and strategic end user customers. To support these objectives, our field sales force:

- assists end-user customers in finding solutions to complex network system and architecture problems;
- differentiates the features and capabilities of our products from competitive offerings;
- continually monitors and understands the evolving networking needs of enterprise and service provider customers;
- promotes our products and ensures direct contact with current and potential customers; and
- assists our resellers to drive to closure business opportunities.

As of June 30, 2012, our worldwide sales and marketing organization consisted of 266 employees, including directors, managers, sales representatives, and technical and administrative support personnel. We have domestic sales offices located in 10 states and international sales offices located in 23 countries.

Customers with 10% of net revenue or greater

The following table sets forth major customers accounting for 10% or more of our net revenue:

	Fiscal Year Ended			
	June 30, 2012	July 3, 2011	June 27, 2010	
Westcon Group Inc.	19	% 16	% 16	%
Scansource, Inc.	13	% 14	% 13	%
Ericsson AB	12	% 11	% *	
Tech Data Corporation	*	11	% 12	%

* Less than 10% of revenue