NETSCOUT SYSTEMS INC
Form 10-K
May 24, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended March 31, 2013

OR

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

For the transition period from _________ to _________

Commission file number 0000-26251

NETSCOUT SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**04-2837575**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

310 Littleton Road, Westford, MA 01886

(978) 614-4000

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

Common Stock, $0.001 Par Value

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

None

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

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 x

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 ¨

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

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

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

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

(Do not check if a smaller reporting company)

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

The aggregate market value of common stock held by non-affiliates of the registrant as of September 30, 2012 (based on the last reported sale price on the Nasdaq Global Market as of such date) was approximately $984,699,852. As of May 16, 2013, there were 41,385,750 shares of the registrant s common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

(1) Portions of the Registrant s Proxy Statement for the fiscal year 2013 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K. Except as expressly incorporated by reference, the proxy statement is not deemed to be part of this report.

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NETSCOUT SYSTEMS, INC.

FORM 10-K

FOR THE FISCAL YEAR ENDED MARCH 31, 2013

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PART I

Item 1. Business

Overview

We provide the equipment that allows our customers to ensure that applications are running smoothly across their networks. We design, develop, manufacture, market, license, sell and support market leading application and network performance management and service assurance solutions focused on assuring service delivery quality, performance and availability for some of the world s largest, most demanding and complex internet protocol (IP) based service delivery environments. We manufacture and market these products in integrated hardware and software solutions that are used by commercial enterprises, large governmental agencies and telecommunication service providers worldwide.

With a sustained history of 29 years of technology innovation, we continue to lead the market and are changing how organizations manage and optimize the delivery of business applications and services and assure user experience across global IP networks. We have continually improved our product portfolio to meet the needs of organizations by providing solutions to manage dynamic network and application environments and by improving user experience by assuring service availability, quality and reliability. Our solution is a highly scalable and flexible real-time service delivery management platform that supports a wide-range of enterprise information technology (IT) operations and management organizations including network operations, application managers, network operations centers, network engineering, security operations and service delivery teams. In addition, within the service provider segment, our solutions support a broad range of operational users including the network operations, network engineering, service operations, application groups, customer care, marketing, chief technology officers and advance engineering groups.

Our solutions use advanced packet flow technologies to enable organizations to gain greater, more granular visibility into the interdependencies of network and application behavior to effectively monitor, analyze and assure the end-to-end performance of data and unified communication (UC) business services. Our value proposition to our customers is to identify service delivery issues early to enable the identification and prevention of significant service degradations or failures before large numbers of users are affected. As a result of our highly scalable and extensible unified service delivery management (USDM) framework, organizations gain visibility into user experience and the interrelated performance of applications and networks to better understand their service delivery environment. This view visibly enables a more active management strategy and enhances operational agility enabling the IT operations and management organization to:

- Optimize service delivery performance and increase efficiency and use of existing infrastructure;
- Protect the user experience and assure business service continuity;
- Simplify managing complex service delivery environments and reduce operations and support cost and complexity; and
- Ultimately lower the overall total cost of IT operations.

We market and distribute our products globally through our own direct sales force and through strategic channel partners that include distributors, value added resellers and systems integrators. We have two primary customer groups which include both the enterprise and service provider markets. For our enterprise markets, we focus on the Global 5000, which includes industries such as financial, healthcare, manufacturing, retail, technology, utilities, education, and the public sector, which includes agencies of federal, state and local governments. In the service provider customer group, we sell to mobile operators, wireline operators and cable multi-service operators globally.

In July 2012, we acquired certain assets, technology and employees from Accanto Systems, S.r.l. (Accanto). The technology acquired is consistent with our packet-flow strategy and brings important voice service

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monitoring capabilities that will strengthen our USDM strategy. In October 2012, we acquired ONPATH Technologies, Inc. (ONPATH) to expand our leadership position in the network monitoring switch market. The acquisition is intended to accelerate time-to-market for industry-leading ultra low latency and high density network monitoring switch solutions.

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

Industry Background

Large enterprises, public sector agencies, and telecommunication service providers are critically dependent upon their data networks and the Internet to generate and deliver information and business services to their customers, suppliers, investors, employees, and citizens. These mission critical data networks have taken new and strategic roles within these organizations, including carrying voice and video traffic, and serving as the platform for the next generation of massively distributed, virtualized and service-oriented application architectures. Application architectures are changing as well, with an increasing trend towards data center consolidation and private and hybrid cloud service delivery models. Furthermore, rapidly advancing server technology and exploding multimedia applications continue to drive growth in traffic levels which have spawned a new wave of infrastructure upgrades. In parallel, the service provider market continues to undergo fundamental changes with the accelerating transition to IP based services, requiring new network infrastructures and presenting new and daunting challenges for assessing and assuring service quality. The combination of these fundamental trends has created increasing levels of complexity coupled with growing business dependence requiring IT organizations to take a different approach to managing their service delivery networks to assure an always-on, anywhere access to business service delivery.

NetScout is in a unique position, addressing both the enterprise and service provider markets. Building on our common packet-flow technology foundation, we have developed substantial expertise in assuring IP network-based service delivery that has enabled us to develop a highly scalable solution that not only addresses the needs of both the enterprise and the service provider markets, but also allows us to transfer this knowledge and technology development between these customer groups.

Enterprise Markets

In today s dynamic business environment, the IP network is increasingly being viewed as a strategic and critical success factor for many organizations. The IT mission is focused on reducing the cost of IT while increasing IT performance, improving operational efficiencies and delivering the highest quality and availability of IT services possible. This, coupled with the ever changing technology landscape and the continued increasing complexity of IT infrastructure, drives the need for a more automated and unified approach to managing service delivery. As a result, IT management must reduce the cost of service delivery, address increasing complexity, scale globally and adapt to emerging technologies such as cloud services, virtualization and unified communication services.

The result is increasingly large, geographically dispersed, and complex networks and infrastructures that are challenging to manage and that make obtaining consistent performance and service levels difficult to assure. Application and network malfunctions, resource contention, and infrastructure and application mis-configurations can all cause service disruptions, lost revenue and customer dissatisfaction. Within the enterprise environment, NetScout s nGenius® and Sniffer technologies enable IT organizations to protect and improve service delivery quality with a proactive model that is able to identify and address business service performance issues before they become serious and impact large numbers of users. Some of the current enterprise IT initiatives our solutions support include:

- **Data Center Modernization & Virtualization** We enable IT organizations to manage the delivery of services across virtual and physical environments, providing a comprehensive, unified view of application and network performance. Intelligent early warning of emerging issues with the ability to analyze both physical and virtual services within the data center enables organizations to optimize datacenter infrastructure investments, protect against service degradations, and simplify the operation of complex, multi-tier application environments.

Unified Communications We deliver deep application-level unified visibility into voice, data and video services side-by-side in order to understand the interrelationships of all services that traverse the network infrastructure and assess quality and performance of the delivery of these services. Application-level visibility enables the UC team to assess beyond typical network performance to see into voice or video quality to best assess the true user experience.

Branch Office & WAN We bring extended visibility into the performance of applications and networks at and between locations, including cloud-based services, with a unified view of end-to-end service delivery enabling collaborative problem-solving and uniform planning, enabling IT organizations to reduce the cost of managing their remote sites.

Enterprise Mobility IT operations and management teams are confronted with supporting a wide range of new devices on corporate networks. Although IT loses direct control of the environment, user performance expectations remain consistent with corporate-supplied devices. We provide service assurance across the infrastructure and applications supporting a broad range of service delivery strategies including wireless service delivery to enable intelligent early warning and rapid-response troubleshooting, regardless of the connected devices.

Process Improvement & ITIL Initiatives We deliver real-time and historical information that provides the necessary insight to restore service, manage capacity, and understand the users quality of experience. The USDM approach enabled by the nGenius solution empowers IT organizations to collaborate more meaningfully while reducing the overall costs of IT operations through a unified platform delivering a common set of metrics and insight across disparate IT departments. The nGenius solution also provides IT organizations a highly efficient service-oriented workflow that aligns with Information Technology Infrastructure Library (ITIL) process models.

Telecommunication Service Provider Markets

Our opportunity in the service provider market stems from the industry s transformation to next generation all-IP networks driven by migration to third generation and Long-term Evolution (LTE) technologies. Most carriers are moving from legacy circuit switched environments, where each user connection or service uses a dedicated circuit with dedicated bandwidth, to highly dynamic packet switched IP-based environments. The value of IP is that service providers gain a high degree of efficiency and provisioning flexibility for services over shared facilities with security and service quality capabilities coming from the underlying network equipment technology rather than through dedicated connections. As service providers transform their operations using the power of the modern IP network, they are confronted with new challenges in assuring services over an increasingly dynamic operating environment. As a result, service providers now require a much higher level of understanding of the traffic flows in a true multi-service delivery environment.

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

For Mobile Operators The fundamental transformation of the mobile network to all-IP enables mobile operators to build highly-scalable service delivery environments to offer new services to meet the growing subscriber demand for data, voice and video-centric services and to consolidate and

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simplify network operations. However, to capitalize fully on the value of IP and the significant market opportunities, mobile operators need detailed IP packet-level insight and core-to-access visibility.

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

Products & Technology Overview

nGenius Service Assurance Solution

The nGenuis Service Assurance Solution delivers comprehensive, high definition visibility into end-to-end performance of the network, applications, services and users using a family of unified software-based analytics modules and rich packet-flow based metadata. The nGenius Service Assurance Solution provides the following capabilities:

- Service visualization and intelligent early warning;
- Application and network performance management;
- Service and policy validation;
- Service optimization and capacity planning;
- Advanced trending and reporting capabilities; and
- Deep forensics and historical analysis.

The nGenius Service Assurance Solution is a fully integrated platform that uses a number of specialized software analytics modules and distributed intelligent data sources consisting of:

nGenius Performance Manager Our core analytics module that analyzes and correlates the metadata delivered by a comprehensive range of nGenius intelligent data sources (hardware devices and software agents) for integrated application and service performance monitoring, response time analysis, troubleshooting, capacity planning and trending and reporting enabling end-to-end visibility and assurance of service delivery.

nGenius Service Delivery Manager A real-time business service dashboard that provides unified visibility into service delivery in the context of how services are delivered and consumed to produce timely, actionable management insight. Combining real-time and historical views of service domains the dashboard automates the detection of service quality problems and emerging security threats across physical, virtual, and cloud-based services from the application hosting environment, through the network, to the user.

nGenius Voice | Video Manager An advanced UC performance management and analysis analytics module enabling IT staff to proactively manage the performance and user experience for a broad range of collaboration-enabling real time communications services, such as telepresence, video, and voice. The solution delivers network performance and granular application-specific metrics for IP-based voice and video session transmission and conversation quality to reveal real-time service performance and the true user experience. As a result, IT organizations can achieve the required actionable visibility into the end-to-end behavior and quality UC applications and services.

nGenius Enterprise Intelligence Extends the session-level analysis capabilities of the nGenius Service Assurance Solution to provide granular hop-by-hop views into performance and latency of a

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users application session as complex application traffic crosses multiple data centers and cloud environments to provide a unified perspective of user experience. Leveraging the real-time data mining capabilities of NetScout s Adaptive Session Intelligence (ASI) technology, nGenius Enterprise Intelligence automates, accelerates and simplifies the creation of a true representation of an end-to-end user data or voice session.

nGenius Subscriber Intelligence Designed for mobile operators, nGenius Subscriber Intelligence provides datacenter-to-core-to-access visibility for managing mobile data sessions in general packet radio service (GPRS), in universal mobile telecommunications systems (UMTS), code division multiple access (CDMA) and LTE mobile networks. nGenius Subscriber Intelligence incorporates NetScout s ASI technology built into our nGenius InfiniStream appliances to provide unmatched, real-time correlation of related user plane and control plane sessions across both the core and access portions of the network.

nGenius Trading Intelligence A high-performance, latency-management solution purpose-built for trading environments that addresses the specialized visibility needs of exchanges and trading market firms. nGenius Trading Intelligence provides real-time visibility into complex trade order execution, market data feed latency and performance for trading environments enabling trade engineers to isolate delays, compare venue execution routes, monitor trade activity, and track client access to better optimize the performance of high-speed trading platforms.

Sniffer Analysis Software Suite The Sniffer Analysis Software Suite provides a direct connection to nGenius InfiniStream appliances for highly optimized forensic analysis and packet data mining to exploit fully the valuable information contained within network packets. The Sniffer Analysis software suite provides a powerful view deep into IP network packets revealing granular information about network and application interactions and response time and latency metrics to speed post event troubleshooting and support a wide-range of cybersecurity incident response and investigation analysis activities.

nGenius Performance Manager for Flows and nGenius Analytics for Flows nGenius Performance Manager and Analytics for Flows support Cisco NetFlow, sFlow, IP service level agreement data for analysis and reporting of performance problems, analysis and reporting for application utilization and conversation-level statistics and management information base (MIB II) data collected by nGenius Collectors.

Sniffer Portable Analyzer Product Family A stand-alone field service analysis module that provides portable network and application analysis capabilities for field troubleshooting activities. Built on widely deployed Sniffer technology, the software-based analysis tool is deployed on individual technician laptops to support segment-specific portable analysis and troubleshooting activities enabling the rapid isolation of issues for wired and wireless networks. The Sniffer Global version of the product is integrated with Cisco s Mobility Services Engine to enable location-based visibility for wireless end-points.

nGenius Intelligent Data Sources nGenius Intelligent data sources provide the capabilities of gathering and analyzing information rich packet-flow data from across the network to enable the granular analysis and reporting capabilities of the nGenius Service Assurance Solution. The nGenius Intelligent Data Sources consist of: (1) the nGenius InfiniStream appliances, which provide hardware-based data capture and metadata creation for the nGenius Service Assurance Solution and support 1 Gigabit and 10 Gigabit network connections and scale from one to 96 terabytes of packet storage capability; (2) the nGenius Virtual Agent, which enables granular network and application visibility from within virtual server environments; (3) the nGenius Integrated Agent, which integrates into network equipment, such as the Cisco® Integrated Services Router and Cisco Unified Computing express system to enable extended visibility into network and application performance from branch offices; and (4) nGenius Collectors, which support collection of network-based statistics from network equipment supporting standards-based data such as Cisco NetFlow, jFlow and sFlow.

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Adaptive Session Intelligence (ASI) Technology provides the extensible technology foundation for the nGenius Service Assurance Solution s rich real-time analytics capabilities. It enables the creation of statistical metadata, session transaction records and adaptive session traces enabling the monitoring of all users, all applications and all services consistently across the network. ASI technology is a critical differentiating technology that enables the performance at scale and real-time flexibility needed to address large and complex service delivery environments.

nGenius 1500 Series Packet Flow Switch The nGenius packet flow switch enables powerful aggregation and flexible intelligent filtering capabilities enable the network team to collect traffic from a single monitoring point and deliver this traffic to many devices eliminating the need for redundant tapping points or mirror/SPAN ports. This enables the IT organization to better capture targeted traffic to enable a more flexible and comprehensive approach to important packet-flow data. In addition to consolidating vendor complexity, this enables IT organizations to efficiently consolidate scarce and costly monitoring points and intelligently share valuable traffic flows across multiple management and cybersecurity tools consistently.

nGenius Forensic Intelligence Sold into very specialized markets addressing the law enforcement community, NetScout s nGenius Forensic Intelligence product supports lawful interception (LI) activity and interprets intercepted internet data and reconstructs all communications.

Product Enhancements and New Products

NetScout continuously enhances its solutions to meet the increasing demands and ever changing technology landscape of IP networks and service and applications. Typically, these types of changes result in modest increases in the functionality of the products that do not meet the criteria for capitalization. In recent years, we have also delivered major product upgrades across our product lines, more tightly integrating deep packet analysis and forensics into our top-down performance management workflows, improving the flexibility of our industry-leading intelligent early warning capabilities, and adding support for new sources of user experience and performance related metrics.

Specific new products introduced during our Fiscal Year 2013 include:

nGenius 3900 Series Packet Flow Switch Announced in January 2013, the nGenius 3900 series packet flow switch is a modular chassis-based network monitoring switch that expands upon NetScout s initial entry into the market with the nGenius 1500 series packet flow switch. The nGenius 3900 series packet flow switch enables scalable, highly available access to network traffic across distributed networks for use by the nGenius Service Assurance Solution or any network monitoring, performance management or security system. Based upon technology from the acquisition of ONPATH , the nGenius 3900 series packet flow switch delivers market-leading advances in performance and capacity with the highest 10 and 40 Gigabit Ethernet (GbE) port densities per rack unit, and per chassis, with an architecture ready to support 100 GbE interfaces. The nGenius 3900 series switch delivers intelligent traffic conditioning features on every port with sustained line rate performance, and ultra-low latency.

nGenius Forensic Intelligence Announced in April 2012, a new analysis module resulting from NetScout s acquisition of Fox Replay BV that enables network operations and information security teams to accelerate forensic analysis of network traffic with automated, accurate and contextual session reconstruction and visual replay for security-focused investigations.

Integration with third-party solutions

To have greater operational impact on assuring performance of applications and service delivery, NetScout has integrated its technology with third-party management consoles and business service management systems. This integration allows organizations to receive alarms on impending performance problems and to link into the

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nGenius solution in order to perform detailed problem analysis and troubleshooting. By providing seamless integration into management platforms, NetScout fills a significant gap in the third party product functionality and visibility into the interaction of applications, services and infrastructure resources from a packet-based network vantage point. NetScout collaborates with technology partners to provide integrated solutions and extend the value of the nGenius Service Assurance Solution for application and network performance management across the organization. Using packet-flow data, key performance indicators and other sources of performance information derived from the nGenius Service Assurance Solution, integrated solutions enhance an organization s ability to optimize, simplify and protect the service delivery environment.

Cisco Systems NetScout is a member of the Cisco Developer Network Program for Mobility, Unified Communications and Advanced Routing. NetScout has integrated its widely deployed nGenius probe technology into the Cisco Integrated Services Router (ISR) platform enabling our joint customers to leverage the end-to-end capabilities of our service assurance solution from the datacenter to the branch office. We have received certification of our compatibility and interoperability with Cisco s Unified Communications platform. NetScout has also integrated its Sniffer Global product with the Cisco 3300 series Mobility Services Engine, to provide contextual location information to simplify and improve management of wireless networks.

EMC® Ionix Control Center (formerly SMARTS®) NetScout is an EMC Corp. (EMC) Velocity2 partner and provides integration between the nGenius Service Assurance Solution and the EMC Ionix Service Assurance Manager, EMC Ionix IP Availability Manager and EMC Ionix Discovery Manager. Integration between the nGenius solution and EMC Ionix solution provides our joint customers with complementary visibility into the packet-flow data within the service delivery environment.

Hewlett-Packard Company NetScout is a Platinum Business Partner in Hewlett-Packard s (HP s) Enterprise Management Alliance Program, and provides integration between the nGenius Service Assurance Solution with HP Business Technology Optimization Software solutions including HP OpenView Network Node Manager, HP Business Availability Center and HP Operations Manager. Together the integrated solutions provide our joint customers a single-pane-of-glass approach to troubleshooting to speed problem identification and resolution and assure an excellent user experience. In addition, NetScout has integrated its nGenius Integrated agent into some of the HP Networking chassis switching products to provide visibility into network and application performance at the network edge.

IBM Tivoli NetScout is an International Business Machine (IBM®), PartnerWorld member, and has been awarded Ready for IBM Tivoli Software validation status to the nGenius service assurance solution for its integration with IBM Tivoli® NetView®, IBM Tivoli Enterprise Console® and IBM Tivoli Netcool®/OMNIbus. The integration between NetScout and IBM platforms provides our joint customers with expanded reach of IBM s Event Management Systems by combining integrated fault management and service delivery assurance into a single integrated console view with a seamless troubleshooting workflow.

IBM Sametime Through the nGenius Voice and Video Manager solution, NetScout integrates with IBM Sametime through an integrated client-side plug-in that provides quality metrics from desktop Sametime applications to measure and assure quality performance of the IBM Sametime® software helping to assure the delivery of unified, real-time communication and collaboration services from enterprise instant messaging and online meetings to telephony and video conferencing.

VMware vSphere NetScout is an Elite tier Technology Alliance Partner of VMware. nGenius Virtual Agent from NetScout is a virtualized implementation of the widely deployed nGenius Probe technology optimized for VMware that restores lost visibility to virtual environments. It seamlessly extends high-performance packet-flow analysis capabilities deeper into the data center and private clouds enabling IT organizations to achieve true end-to-end visibility of application traffic within and between virtual servers.

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Strategy

Enhancing shareholder value through sustained growth and increased profitability based on our continued market leadership is our primary objective. We continue to see a strong level of interest by the market for our products and technology as both enterprise and service provider customers struggle to keep up with the increasing complexity and volume of service traffic over IP networks. Both of these customer groups are looking for unified approaches that can scale to manage and assure the delivery of critical services over highly distributed IP networks. We intend to capitalize on this growing market demand regarding user experience in managing service delivery. We will pursue growth by increasing our ongoing business with our established customers, expanding our worldwide coverage and presence to add new customers, growing and establishing new relationships with technology alliance partners and driving greater value through strategic resellers and go to market partners. Key elements of our strategy include:

Drive technology innovation to extend our market leadership We are increasing our investment in research and development to expand and enhance our USDM capabilities that capitalize on our extensive experience with global enterprise and service provider organizations with very large, high-capacity IP-based networks. We intend to take advantage of our unique position in both the enterprise and service provider markets to cross-leverage our technology development for both markets to enable greater capabilities for our current and new customers. We will continue to enhance and extend our product line to meet the increasing challenges of managing a diverse range of services over an increasingly global network environment.

Continued portfolio enhancements We plan to continue to enhance our products and solutions to address the management challenges associated with virtualization, cloud computing, service-oriented architectures, VoIP, video, and Telepresence technologies. In addition, we will continue to drive our solutions to help IT organizations address the challenges of complex service delivery, datacenter consolidation, branch office consolidation and optimization, increasing mobility and the move to a more process-oriented operating environment.

Enabling pervasive visibility We intend to continue to expand our intelligent data source family to enable our customers to achieve more visibility in more places across their end-to-end network environment. We are expanding our nGenius InfiniStream appliance family to enable greater levels of storage and processing capacity and to expand our software-based nGenius Virtual Agent and nGenius Integrated Agent technology to enable wider deployment of our technology within virtual computing environments, network devices and computing platforms. We intend to continue to greatly enhance our ability to scale and to generate real-time metadata to meet the need for addressing a rapidly growing level of data traffic and an increasingly complex application environment. This includes extending and strengthening our market and technology lead by supporting new and innovative ways to address the ongoing technology challenges associated with the increasing volume of data traffic and enable scalable support for 40 Gigabit, 100 Gigabit topologies and increasing global deployments of IPv6.

Expand our customer base in both enterprise and service provider markets It is our intention to substantially grow our presence in both the enterprise and service provider markets. In the enterprise market, we are growing our installed base footprint to include a broader number of top-tier enterprise customers as well as extending to reach the mid-market enterprise customers. We intend to increase the use of our products across the IT organization to include new operational groups by expanding their capabilities and value. In the service provider market, we are expanding our presence through new service provider customer acquisitions as well as expanding our footprint further out into the radio access network, deeper into the core and into new datacenter expansions as cloud-based service offerings become increasingly strategic to enterprise and service providers.

Increase market relevance and awareness To generate increased demand for our products we will continue to promote and position our technology, products and solutions to both the enterprise and service provider market and drive our vision and strategy of USDM. In addition, we will continue to drive industry initiatives around managing service delivery.

Scale and grow our direct sales force Our direct sales force was structured to specifically and effectively target the enterprise and service provider markets. Each of these markets has different technology issues, challenges and sales cycles. Consequently, NetScout is very well positioned with a well aligned field organization that will enable us to better meet the needs of these two diverse markets.

Extend our technology partner alliance ecosystem We plan to continue to enhance our technology value, product capabilities and customer relevance through the continued integration of our products into technology partner products. This includes both interoperability integration efforts, as well as embedding our technology into alliance partner products to gain a more pervasive footprint across both enterprise and service provider networks.

Enhance and extend our training services We plan to extend and continue to enhance our training services to support our growing customer base in both the enterprise and service provider markets. We continue to enhance our training with personalized education programs to help our customers deploy and use our products more effectively. We have strengthened our classroom training and added web-based on-demand training programs. We also continue to enhance our certification programs designed to recognize network professionals who have demonstrated an in-depth understanding of nGenius and Sniffer products and technologies.

Sales and Marketing

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

Our sales force is organized into four main geographic teams covering sales around the globe: United States, Europe, Asia and the rest of the world. Revenue from sales outside the United States represented 25%, 25% and 27% of our total revenue in the fiscal years ended March 31, 2013, 2012 and 2011, respectively. Sales to customers outside the United States are primarily export sales through channel partners, who are generally responsible for distributing our products and providing technical support and service to customers within their territories. Sales arrangements are primarily transacted in United States dollars. Our reported international revenue does not include any revenue from sales to customers outside the United States that are shipped to our United States-based indirect channel partners. These domestic resellers fulfill customer orders based upon joint selling efforts in conjunction with our direct sales force and may subsequently ship our products to international locations; however, we report these shipments as United States revenue since we ship the products to a domestic location. We expect revenue from sales to customers outside the United States to continue to account for a significant portion of our total revenue in the future.

Our marketing organization drives our market strategy, product positioning and messaging and produces and manages a variety of programs such as advertising, trade shows, industry events, public and analyst relations, direct mail, seminars, sales promotions, and web marketing to promote the sale and acceptance of our solutions and to build the NetScout and nGenius brand names in the marketplace. Key elements of our marketing strategy focus on thought leadership, market education, go to market strategies, reputation management, demand generation, and the acceleration of our strategic selling relationships with local and global resellers, systems integrators, and our technology alliance partners.

Seasonality

We have experienced, and expect to continue to experience, quarterly variations in our order bookings as a result of a number of factors, including the length of the sales cycle, complexity of customer environments, new product introductions and their market acceptance and seasonal factors affected by customer projects and typical IT buying cycles. Due to these factors, we historically have experienced stronger bookings during our fiscal third and fourth quarters than in the first and second quarters. Net revenue can also be affected by unforeseen delays in product shipments due to issues such as on hand inventory, customer shipping instructions and acceptance requirements.

Support Services

Customer satisfaction is a key driver of NetScout s success. NetScout s MasterCare support programs offer customers various levels of high quality support services to assist in the deployment and use of our solutions. We have support personnel strategically deployed across the globe to deliver 24/7 toll-free telephone support to our premium MasterCare customers. Some of the support services, such as on-site support activities, are provided by qualified third party support partners. In addition many of our certified resellers provide Partner Enabled Support to NetScout end-users. This is especially prevalent in international locations where time zones and language, among other factors, make it more efficient for end-users to have the reseller provide initial support functions. MasterCare support also includes updates to our software and firmware at no additional charge, if and when such updates are developed and made generally available to our commercial customer base. If ordered, MasterCare support commences upon expiration of the standard warranty for software. For software, which also includes firmware, the standard warranty commences upon shipment and expires 90 days thereafter. With regard to hardware, the standard warranty commences upon shipment and expires 12 months thereafter. We believe our warranties are consistent with commonly accepted industry standards.

Research and Development

Our continued success depends significantly on our ability to anticipate and create solutions that will meet emerging customer requirements. We have invested significant financial resources and personnel into the development of our products and technology. Our continued investment in research and development is crucial to our business and our continued success in the market. We have assembled a team of highly skilled engineers with expertise in various technologies associated with our business and the technologies being deployed by our customers. These technologies and expertise include networks, protocols, applications, application delivery, WAN technologies, storage and systems management. As we have expanded our market to also include the wireless service provider sector, we have added a significant number of resources with expertise in service provider networks and technologies including GSM, UMTS, CDMA and LTE technologies. We plan to continue to expand our product offerings and capabilities in the near future, and, therefore, plan to continue to invest and dedicate significant resources to our research and development activities. In addition, as we continue to expand our position in the service provider market, we will need to continue to expand our offerings and focused capabilities for these customers. We will continue to make substantial investments in growing our service provider technology expertise to maintain and grow our market and technology lead for this rapidly growing market opportunity.

We predominantly develop our products internally, with some limited third party contracting. We have also acquired developed technology through business acquisitions. To promote industry standards and manifest technology leadership, we participate in and support the activities and recommendations of industry standards bodies, such as the Internet Engineering Task Force, the 3rd Generation Partnership Project and we also engage in

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close and regular dialogue with our key customers and alliance partners. These activities provide early insight into the direction of network and applications performance requirements for current and emerging technologies.

Manufacturing

Our manufacturing operations consist primarily of final product assembly, configuration and testing. We purchase components and subassemblies from suppliers and construct our hardware products in accordance with NetScout standard specifications. We inspect, test and use process control to ensure the quality and reliability of our products. In February 1998, we obtained ISO 9001 quality systems registration, a certification showing that our corporate procedures and manufacturing facilities comply with standards for quality assurance and process control. In July 2003, we obtained ISO 9001:2000 quality systems registration, a certification showing that our corporate procedures comply with standards for continuous improvement and customer satisfaction.

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

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

Customers

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

Backlog

We configure our products to customer specifications and generally deliver the final products to the customer within a relatively short time after receipt of the purchase order. These orders also often include service engagements and technical support coverage. Customers may reschedule or cancel orders prior to shipment with little or no penalty.

Our combined product backlog at March 31, 2013, consisting of unshipped orders and deferred product revenue, was an immaterial amount compared to $13.0 million at March 31, 2012. Due to the fact that most if not all of our customers have the contractual ability to cancel unshipped orders prior to shipment we cannot provide assurance that our product backlog at any point in time will ultimately become revenue.

Channels

We have implemented reseller specific programs to improve our reach to customers and extend our presence in new markets through channel partners. We sell through a broad range of channel partners including value added resellers, value added distributors, resellers, and system integrators, for both the enterprise and service provider markets. Sales to customers outside the United States are primarily export sales through channel partners. These channel partners help us market and sell our products to a broad array of organizations globally and allow us to better allocate and leverage our field sales force.

Historically and currently, we have used indirect distribution channels principally as intermediaries on contractual terms for customers with whom we have no contract. Our sales force meets with end user customers to present NetScout products and solutions, conduct demonstrations, provide evaluation equipment, recommend detailed product solutions, develop product deployment designs and timelines, and assist in establishing financial and other justification for the proposed solution. During this selling process a channel partner, who has contracts with both the end customer and NetScout, may be brought in to facilitate the transaction and to provide fulfillment services. In the case of international channel partners, those services usually also include currency translation and support. In the U.S., fulfillment services are usually limited to invoicing and cash collection. Under this approach, we have limited dependence upon channel partners for the major elements of the selling process. In many cases, there are multiple channel partners with the required contractual relationships, so dependence on any single channel partner is not significant.

Total revenue from indirect channels represented 49%, 54% and 59% of our total revenue for the fiscal years ended March 31, 2013, 2012 and 2011, respectively. We had no single customer or channel partner representing more than 10% of revenues in fiscal years 2013, 2012 or 2011.

Competition

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

We believe that we have a number of competitive advantages over these companies. We believe we have a significant advantage in scalability, comprehensiveness of data gathered, performance, ease-of-use, unified workflows and the ability to scale our solution to address large global deployments that encompass a large number of applications, services, locations and users. We have a unified architecture, compared to many vendors approach in combining disparate technology elements.

We believe we compete primarily on the basis of offering a complete and comprehensive service delivery management solution that enables IT organizations to addresses the challenges of managing and assuring the delivery of critical IT services and applications to predict, identify and resolve the root causes of poor performance of large-scale, distributed IP networking environments. We believe we are currently the only vendor providing a comprehensive and end-to-end service delivery management solution that is capable of addressing the needs of both enterprise and service provider customers and can scale to meet the enormous challenges of today s dynamic service delivery environments. This capability will be the most critical factor in managing mission critical applications in the much anticipated new public cloud IT paradigm of the future.

We believe other principal competitive factors in our market include scalability, ability to address a large number of applications, locations and users, product performance, the ability to easily deploy into existing network environments and the ability to administer and manage the solution. We believe that our solutions provide superior data and perform better than competitive products as measured by a broad range of metrics including the ability to recognize and track a large number of applications, scalability to support high and increasing levels of data and network traffic, the ability to look at both data and control plane traffic across an entire network and the ability to provide real-time information about service performance and real-time alerts to emerging service problems. Our ability to sustain such a competitive advantage depends on our ability to deliver continued technology innovation and adapt to meet the evolving needs of our customers.

In the enterprise market, our larger competitors include companies such as Computer Associates and OPNET Technologies, Inc. (recently acquired by Riverbed Technology Inc.), along with a number of smaller

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private companies and new market entrants. In addition, we both compete with and partner with large enterprise management vendors, such as IBM, HP, and EMC, who currently offer generalized performance management solutions but could provide enhanced solutions in the future. In the service provider market our primary large competitors include Tektronix, a division of Danaher, and JDSU, who provide operational management systems based primarily on monitoring legacy signaling data, along with a number of smaller private companies and new market entrants. Competitive factors in our industry are further described in Item 1A Risk Factors.

Intellectual Property Rights

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

NetScout uses contracts, statutory laws, domestic and foreign intellectual property registration processes, and international intellectual property treaties to police and protect its intellectual property portfolio and rights from infringement. From a contractual perspective, NetScout uses license agreements and non-disclosure agreements to control the use of our intellectual property and protect NetScout trade secrets from unauthorized use and disclosure. In addition to license agreements, NetScout relies on U.S. and international copyright law to protect against unauthorized copying of software programs, in the U.S. and abroad. NetScout has obtained U.S. and foreign trademark registrations to preserve and protect certain trademarks and trade names. NetScout has also filed and obtained U.S. patents and international counterparts to protect certain unique NetScout inventions from being unlawfully exploited by other parties. However, there is no assurance that pending or future patent applications will be granted, that we will be able to obtain patents covering all of our products, or that we will be able to license, if needed, patents from other companies on favorable terms or at all. Our proprietary rights are subject to other risks and uncertainties described under Item 1A Risk Factors.

Employees

As of March 31, 2013, we had a total of 983 employees, 637 of whom were employed in the United States, in the following departments:

Function	Number of employees
Sales and marketing	335
Research and development	358
Support services	142
General and administrative	118
Manufacturing	30
	983

Available information

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended (Exchange Act), are made available free of charge on or through our website at www.netscout.com as soon as reasonably practicable after such reports are filed with, or furnished to, the Securities and Exchange Commission (the SEC). None of the information posted on our website is incorporated by reference into this Annual Report.

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Corporate information

NetScout was incorporated in Delaware in 1984. Our corporate headquarters are located at 310 Littleton Road, Westford, Massachusetts, and our telephone number is (978) 614-4000. NetScout s internet address is http://www.netscout.com.

Item 1A. Risk Factors.

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

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

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

- technology spending by current and potential customers;
- uneven demand for service delivery and application performance management solutions;
- the timing and size of orders from customers, especially in light of our lengthy sales cycle;
- the timing and market acceptance of new products or product enhancements by us or our competitors;
- changes in the distribution channels through which our products are sold;
- the timing of hiring sales personnel and the speed at which such personnel become productive;
- our ability to anticipate or adapt effectively to developing markets and rapidly changing technologies;
- changes in the number and size of our competitors and changes in the prices of competitors products;
- the timing and impact of security-related threats and outbreaks (e.g., worms and viruses);

- customer ability to implement our products;

- changes in foreign currency exchange rates;

- attrition of key employees; and

- economic slowdowns and the occurrence of unforeseeable events, such as terrorist attacks, which contribute to such slowdowns.

Most of our expenses, such as employee compensation, benefits and rent, are relatively fixed in the short term. Moreover, our expense levels are based, in part, on our expectations regarding future revenue levels. As a

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result, if revenue for a particular quarter is below our expectations, we may not be able to reduce operating expenses proportionately for that quarter, and, therefore, this revenue shortfall would have a disproportionately negative impact on our operating results for that quarter.

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

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

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

- product performance, functionality and price;
- name and reputation of vendor;
- distribution strength; and
- alliances with industry partners.

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

As a result of these and other factors, we may not be able to compete effectively with our current or future competitors, which could have a material and adverse impact on our business, operating results and financial condition.

Our success depends, in part, on our ability to manage and leverage our distribution channels. Sales to our distribution channels, which include resellers, original equipment manufacturers, distributors, systems integrators and service providers, accounted for 49%, 54%, and 59% of our total revenue for the fiscal years ended March 31, 2013, 2012 and 2011, respectively. To increase our sales we need to continue to enhance our indirect sales efforts, to continue to manage and expand these existing distribution channels and to develop new indirect distribution channels. Our channel partners have no obligation to purchase any products from us. In addition, they could internally develop products that compete with our solutions or partner with our competitors or bundle or resell competitors solutions, possibly at lower prices. The potential inability to develop new relationships or to expand and manage our existing relationships with partners, the potential inability or unwillingness of our partners to market and sell our products effectively or the loss of existing partnerships could have a material and adverse impact on our business, operating results and financial condition.

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

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

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

Loss of key personnel could adversely impact our business. Our future success depends to a significant degree on the skills, experience and efforts of Anil Singhal, our President, Chief Executive Officer, and co-founder, and our other executive officers and senior managers to work effectively as a team. The loss of one or more of our key personnel could have a material and adverse impact on our business, operating results and financial condition.

The success of our business depends, in part, on the continued growth in the market for and the continued commercial demand for service delivery service assurance solutions focused on the performance monitoring and management of applications and networks. We derive all of our revenue from the sale of products and services that are designed to allow our customers to assure the delivery of services through the management of the performance of applications across IP networks. Therefore, we must be able to predict the appropriate features and prices for future products to address the market, the optimal distribution strategy and the future changes to the competitive environment. In order for us to be successful, our potential customers must recognize the value of more sophisticated application management solutions, decide to invest in the management of their networked applications and, in particular, adopt our management solutions. Any failure of this market to continue to be viable would materially and adversely impact our business, operating results and financial condition. Additionally, businesses may choose to outsource the operations and management of their networks to

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managed service providers. Our business may depend on our ability to continue to develop relationships with these service providers and successfully market our products to them.

We may not successfully complete acquisitions or integrate acquisitions we do make, which could impair our ability to compete and could harm our operating results. We may need to acquire complementary businesses, products or technologies to remain competitive or expand our business. We actively investigate and evaluate potential acquisitions of complementary businesses, products and technologies in the ordinary course of business. We may compete for acquisition opportunities with entities having significantly greater resources than us. As a result, we may not succeed in acquiring some or all businesses, products or technologies that we seek to acquire. Our inability to effectively consummate acquisitions on favorable terms could significantly impact our ability to compete effectively in our targeted markets and could negatively affect our results of operations.

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

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

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

- difficulties in assimilating the acquired operations, technologies, personnel and products;
- difficulties in managing geographically dispersed operations;
- difficulties in assimilating diverse financial reporting and management information systems;
- difficulties in maintaining uniform standards, controls, procedures and policies;
- the diversion of management s attention from other business concerns;

use of cash to pay for acquisitions may limit other potential uses of our cash, including stock repurchases and retirement of outstanding indebtedness;

substantial accounting charges for restructuring and related expenses, write-off of in-process research and development, impairment of goodwill, amortization or impairment of intangible assets and share-based compensation expense;

the potential disruption of our business;

the potential loss of key employees, customers, distributors or suppliers;

the inability to generate sufficient revenue to offset acquisition or investment costs; and

the potential for delays in customer purchases due to uncertainty and the inability to maintain relationships with customers of the acquired businesses.

Failure to manage growth properly and to implement enhanced automated systems could adversely impact our business. The growth in size and complexity of our business and our customer base has been and

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

Our success depends, in part, on our ability to expand and manage our international operations. Sales to customers outside the United States accounted for 25%, 25%, and 27% of our total revenue for the fiscal years ended March 31, 2013, 2012 and 2011, respectively. We currently expect international revenue to continue to account for a significant percentage of total revenue in the future. We believe that we must continue to expand our international sales activities in order to be successful. Our international sales growth will be limited if we are unable to:

- expand international distribution channels;
- hire additional overseas sales personnel;
- adapt products for local markets and comply with foreign regulations; and
- manage geographically dispersed operations.

The major geographic areas outside of the United States in which we manage our business are Europe, Asia and the rest of the world. Our international operations, including our operations in the United Kingdom, mainland Europe, India, Asia-Pacific and other regions are generally subject to a number of risks, including:

- failure of local laws to provide the same degree of protection that the laws in the United States provide against infringement of our intellectual property;
- protectionist laws and business practices that favor local competitors;
- dependence on local indirect channel partners;
- conflicting and changing governmental laws and regulations;
- longer sales cycles;
- greater difficulty in collecting accounts receivable; and
- foreign currency exchange rate fluctuations and political and economic instability.

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

If we fail to develop our brand cost-effectively, our business may suffer. We believe that developing and maintaining awareness of our brand in a cost-effective manner is important to achieving widespread acceptance of our existing and future products and services and is an important element in attracting new customers. Furthermore, we believe that the importance of brand recognition will increase as competition in our market develops. Successful promotion of our brand will depend largely on the effectiveness of our marketing efforts and on our ability to provide reliable and useful products and services at competitive prices. Brand promotion activities may not yield increased revenue, and even if they do, any increased revenue may not offset the expenses we incurred in building our brand. If we fail to promote and maintain our brand successfully, or incur substantial expenses in an unsuccessful attempt to promote and maintain our brand, we may fail to attract enough new customers or retain our existing customers to the extent necessary to realize a sufficient return on our brand-building efforts, and this could have a material and adverse impact on our financial condition and results of operations.

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

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

The price of our common stock may decrease due to market volatility. The market price of our common stock has been volatile and may continue to fluctuate in response to a number of factors, some of which are beyond our control. Trading activity of our stock has historically been relatively thin, in part as a result of officers and directors and institutional shareholders holding a significant percentage of our stock. In addition, the market prices of securities of similarly sized technology companies have been volatile and have experienced fluctuations that often have been unrelated or disproportionate to the operating performance of these companies. Also, broad market fluctuations could adversely impact the market price of our common stock, which in turn could cause impairment of goodwill that could materially and adversely impact our financial condition and results of operations.

It is not uncommon when the market price of a stock has been volatile for holders of that stock to institute securities class action litigation against the company that issues that stock. If any of our stockholders brought such a lawsuit against us, even if the lawsuit is without merit, we could incur substantial costs defending the lawsuit beyond any insurance coverage which we may have for such risks. Such a lawsuit could also divert the time and attention of our management.

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

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

However, we may not be able to obtain additional capital when we want or need it, or capital may not be available on satisfactory terms. Furthermore, any additional capital may have terms and conditions that adversely affect our business, such as new financial or operating covenants, or that may result in additional dilution to our stockholders.

Our effective tax rate may increase or fluctuate, which could increase our income tax expense and reduce our net income. Our effective tax rate could be adversely affected by several factors, many of which are outside of our control, including:

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

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

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

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

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

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

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

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

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

Uncertainties of regulation of the Internet and data traveling over the Internet could have a material and adverse impact on our financial condition and results of operations. Currently, few laws or regulations apply directly to access to or commerce on the Internet. We could be materially adversely affected by regulation of the Internet and Internet commerce in any country where we operate. Such regulations could include matters such as net neutrality. Further, governments may regulate or restrict the sales, licensing, distribution, and export or import of certain technologies to certain countries. The adoption of regulation of the Internet and Internet commerce could decrease demand for our products and, at the same time, increase the cost of selling our products, which could have a material and adverse effect on our financial condition and results of operations. In addition, the enactment of new federal, state, or foreign data privacy laws and regulations could cause customers not to be able to take advantage of all the features or capabilities of our products which in turn could reduce demand for certain of our products.

A security breach or cyber attack of our networks could interrupt our operations or harm our reputation. Although we believe we have sufficient controls and security measures in place to prevent such attacks, our systems may still be vulnerable to data theft, computer viruses, programming errors, attacks by third parties or similar problems. If we were to experience a security breach or cyber attack, we could be required to incur substantial costs and liabilities, including but not limited to, expenses attributable to rectifying the security breach or cyber attack including the cost of repairing any damage to our systems, liability for stolen assets or information, lost revenue and income resulting from any system downtime, increased costs for cyber security protection, and damage to our reputation causing customers and possibly investors to lose confidence in us. Similarly, an actual or perceived breach of our customers network security allowing access to our customers data centers or other parts of their IT environments, regardless of whether the breach is attributable to our products, may cause contractual disputes and could require significant expenditures of our capital and diversion of our resources from development efforts.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We currently lease approximately 175,000 square feet of space in an office building in Westford, Massachusetts, for our headquarters. The current lease will expire in September 2023, and we have an option to extend the lease for two additional five-year terms. We lease office space in twenty eight international cities throughout the world for our sales and support personnel, as well as 72,742 square feet of space in San Jose, California. We lease 32,671 square feet of office space for our engineering and support personnel in India. We believe that our existing facilities are adequate to meet our foreseeable requirements or that suitable additional or substitute space will be available on commercially reasonable terms.

Item 3. Legal Proceedings

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

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In March 2012, NetScout uncovered and investigated, and in April 2012, disclosed to the U.S. Department of Justice and the California State Attorney General potential violations of federal and California state anti-trust laws. The potential violations involve a former employee and one or more third parties in connection with sales to state governmental agencies during fiscal year 2012. NetScout believes it did not benefit from any of the transactions uncovered and believes that the amounts involved are not material. The California State Attorney General is conducting an investigation into the matter. NetScout is cooperating fully and is providing all requested information. In general, the federal and state agencies have the authority to seek fines and other remedies for anti-trust violations; however, no charges or proceedings have been initiated by any governmental agency against NetScout and we have been informed by the Department of Justice that it does not intend to take any action against NetScout.

Item 4. Mine Safety Disclosures

None.

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PART II

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

Price Range of Common Stock

We completed our initial public offering on August 17, 1999. Since that time, our common stock has traded on the Nasdaq Global Market and its predecessor, the Nasdaq National Market, under the symbol NTCT. The following table sets forth, for the periods indicated, the high and low intraday sales prices for our common stock. Such information reflects inter-dealer price, without retail mark-up, markdown or commission and may not represent actual transactions.

Quarter Ended	High	Low
Fiscal Year 2012		
June 30, 2011	$ 27.83	$ 19.12
September 30, 2011	$ 21.25	$ 11.34
December 31, 2011	$ 18.63	$ 10.68
March 31, 2012	$ 22.49	$ 15.72
Fiscal Year 2013		
June 30, 2012	$ 21.85	$ 17.75
September 30, 2012	$ 26.59	$ 18.96
December 31, 2012	$ 26.31	$ 23.05
March 31, 2013	$ 28.28	$ 23.74

Stockholders

As of May 16, 2013, we had 86 stockholders of record. We believe that the number of beneficial holders of our common stock exceeds 5,700.

Stock Performance Graph

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

The Stock Performance Graph set forth below compares the yearly change in the cumulative total stockholder return on our common stock during the five year period from March 31, 2008 through March 31, 2013 with the cumulative total return of the Nasdaq Composite Index and the Nasdaq Computer & Data Processing Index. The comparison assumes $100 was invested on March 31, 2008 in our common stock or in the Nasdaq Composite Index and the Nasdaq Computer & Data Processing Index and assumes reinvestment of dividends, if any.

The stock price performance shown on the graph below is not necessarily indicative of future price performance. Information used in the graph was obtained from Zacks Investment Research, Inc., a source believed to be reliable, but NetScout is not responsible for any errors or omissions in such information.

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	3/31/2008	3/31/2009	3/31/2010	3/31/2011	3/31/2012	3/31/2013
NetScout Systems, Inc.	$ 100.00	$ 76.99	$ 159.03	$ 293.76	$ 218.69	$ 264.18
NASDAQ Composite Total Returns	$ 100.00	$ 67.76	$ 107.29	$ 125.74	$ 141.28	$ 151.71
NASDAQ Computer and Data Processing	$ 100.00	$ 73.87	$ 117.35	$ 136.76	$ 147.68	$ 158.31

Dividend Policy

In fiscal years 2013 and 2012, we did not declare any cash dividends and do not anticipate declaring cash dividends in the foreseeable future. In addition, the terms of our credit facility limit our ability to pay cash dividends on our capital stock. It is our intention to retain all future earnings for reinvestment to fund our expansion and growth. Any future cash dividend declaration will be at the discretion of our Board of Directors and will depend upon, among other things, our future earnings, general financial conditions, capital requirements, existing bank covenants and general business conditions.

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Purchases of Equity Securities by the Issuer

The following table provides information about purchases we made during the quarter ended March 31, 2013 of equity securities that are registered by us pursuant to Section 12 of the Exchange Act (Dollars in millions, except per share data):

	Total Number of Shares Purchased(1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet be Purchased Under the Plans or Programs
1/1/2013 thru 1/31/2013	75,175	$ 25.89	68,000	1,425,707
2/1/2013 thru 2/28/2013	156,515	26.09	155,486	1,270,221
3/1/2013 thru 3/31/2013	26,514	25.83	26,514	1,243,707
Total	258,204	$ 26.01	250,000	1,243,707

(1) We purchased an aggregate of 8,204 shares transferred to us from employees in satisfaction of minimum tax withholding obligations associated with the vesting of restricted stock during the period. These purchases reflected in the table do not reduce the maximum number of shares that may be purchased under the plan.

(2) In July 2006, our Board authorized us to repurchase up to four million shares of our outstanding common stock with no pre-established end date.

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Item 6. Selected Financial Data

SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated financial data set forth below should be read in conjunction with our audited consolidated financial statements and notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations included under Item 7 of this Annual Report on Form 10-K. The consolidated statement of operations data for the fiscal years ended March 31, 2013, 2012 and 2011 and the consolidated balance sheet data as of March 31, 2013 and 2012 are derived from audited consolidated financial statements included under Item 8 of this Annual Report on Form 10-K. The consolidated statement of operations data for the fiscal years ended March 31, 2010 and 2009 and the consolidated balance sheet data as of March 31, 2011, 2010 and 2009 have been derived from audited consolidated financial statements of NetScout that do not appear in this Annual Report on Form 10-K. The historical results are not necessarily indicative of the operating results to be expected in the future.

	Year Ended March 31,				
	2013(1)	**2012(2)**	**2011**	**2010**	**2009**
	(In thousands, except per share data)				
Statement of Operations Data:					
Revenue:					
Product	$ 198,749	$ 168,141	$ 159,948	$ 142,113	$ 154,161
Service	151,801	140,538	130,592	118,229	113,443
Total revenue	350,550	308,679	290,540	260,342	267,604
Cost of revenue:					
Product	45,752	39,271	38,175	35,564	43,315
Service	28,256	26,401	23,186	20,500	20,824
Total cost of revenue	74,008	65,672	61,361	56,064	64,139
Gross profit	276,542	243,007	229,179	204,278	203,465
Operating expenses:					
Research and development	61,546	49,478	40,628	36,650	40,189
Sales and marketing	116,807	109,624	105,271	99,059	98,818
General and administrative	29,718	27,488	23,308	20,609	26,118
Amortization of acquired intangible assets	2,877	2,131	1,907	2,057	1,962
Restructuring charges	1,065	603			
Total operating expenses	212,013	189,324	171,114	158,375	167,087
Income from operations	64,529	53,683	58,065	45,903	36,378
Interest and other expense, net	(793)	(2,765)	(1,772)	(2,832)	(5,337)
Income before income tax expense	63,736	50,918	56,293	43,071	31,041
Income tax expense	23,127	18,490	19,028	15,154	10,993
Net income	$ 40,609	$ 32,428	$ 37,265	$ 27,917	$ 20,048
Basic net income per share	$ 0.97	$ 0.77	$ 0.89	$ 0.69	$ 0.51
Diluted net income per share	$ 0.96	$ 0.76	$ 0.87	$ 0.67	$ 0.49
Weighted average common shares outstanding used in computing:					
Net income per share basic	41,665	42,035	42,059	40,691	39,351
Net income per share diluted	42,322	42,750	42,973	41,915	40,925

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

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

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	2013(1)	2012(2)	March 31, 2011 (In thousands)	2010	2009
Balance Sheet Data:					
Cash, cash equivalents and short- and long-term marketable securities	$ 154,091	$ 213,516	$ 228,478	$ 170,551	$ 135,912
Working capital	$ 92,141	$ 155,596	$ 147,136	$ 91,174	$ 51,720
Total assets	$ 552,176	$ 567,757	$ 527,570	$ 482,601	$ 436,734
Debt	$	$ 62,000	$ 68,106	$ 79,356	$ 92,500
Total stockholders equity	$ 371,903	$ 342,369	$ 319,559	$ 266,843	$ 225,731

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

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

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

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

Overview

NetScout was founded in 1984 and is headquartered in Westford, Massachusetts. We design, develop, manufacture, market, sell and support market leading unified service delivery management, service assurance and application performance management solutions focused on assuring service delivery for the world s largest, most demanding and complex IP based service delivery environments. We manufacture and market these products in integrated hardware and software solutions that are used by commercial enterprises, large governmental agencies and telecommunication service providers worldwide. We have a single operating segment and substantially all of our identifiable assets are located in the United States.

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

Our key objectives have been to continue to gain market share in the wireless service provider market and to accelerate our enterprise growth by extending into the application performance management segment. A key common component of both initiatives has been our aggressive acquisition of the strongly complementary packet flow or monitoring switch technology.

On October 31, 2012, we completed the acquisition of ONPATH Technologies, Inc. (ONPATH), an established provider of scalable packet flow switching technology for high-performance networks for the aggregation and distribution of network traffic for data, voice, video testing, monitoring, performance management and cybersecurity deployments. ONPATH s packet flow switch technology is synergistic with our network monitoring switch strategy. The acquisition of the packet flow switch technology further strengthens our Unified Service Delivery Management strategy by enabling scalable access to all relevant network traffic across highly distributed network environments for use by any network monitoring, performance management and security system. ONPATH s test automation technology is used to monitor networks in test environments which simulate existing and planned network environments. We paid $36.8 million in cash for the acquisition of ONPATH and $4.2 million of additional compensation consideration which could be paid out in the future.

On July 20, 2012, we completed the acquisition of certain assets, technology and employees from Accanto Systems, S.r.l. (Accanto). Accanto provides service assurance for telecommunication service providers enabling carriers to monitor and manage the delivery of voice services over converged, next generation network architectures. This technology is synergistic with our packet flow strategy and brings voice service monitoring capabilities for legacy voice environments and for next generation network voice services, including voice over IP (VoIP) and voice over long-term evolution (VoLTE) for 4G wireless networks. We paid $15.0 million for the acquisition of Accanto.

At the end of our fiscal year ended March 31, 2012, we entered the market with the packet aggregation switch we acquired from Simena. During the second half of our fiscal year ended March 31, 2013, we added a high capacity, chassis-based packet flow switch line that we acquired from ONPATH in October 2012. The combination of these two products has provided us with a wide range of price/performance and scale, well suited for both large enterprise and service provider applications.

In the wireless service provider sector we continued to gain market share primarily driven by our leading 3G and LTE data service assurance solutions globally. Our strategy here has been to complement our solution portfolio with an integrated legacy and 3G/4G voice service assurance capability. A component of this strategy was the acquisition of Accanto earlier in the fiscal year ended March 31, 2013, providing us important voice service monitoring for legacy voice environments and next generation network voice services.

Overall, in the service provider market we continue to capitalize on major growth drivers. We have gained market share in the Tier 1 mobile packet switched core where we are servicing 2G/3G and now 4G infrastructures that are being driven further with capacity upgrades from existing customers. We have also been gaining new Tier 2 customers as we expand our presence both in the U.S. and around the world. We have been building our product to capture the carriers rapid expansion of IP Services where we have become a leader. A large business opportunity for us is the servicing of Diameter Routing Agents that is used in all IP networks such as Long-term Evolution (LTE) technologies and IP Multimedia Subsystem (IMS). We are playing a central role in managing the complexity of the surge of different devices from handhelds to tablets, and how those users attach to the network, in areas such as authentication, authorization, policy and charging. Another area of growth is RAN aggregation, where there is a major transformation of the access and backhaul areas of the network. Carriers are consolidating 2G, 3G, and 4G into one box, combined with new LTE rollouts. We are helping to manage the handset and cell tower issues. During our fiscal year ended March 31, 2014, we intend to work to expand our capabilities to provide end-to-end monitoring by adding significant enhancements and features to our product set.

Results Overview

We saw continued growth during the fiscal year ended March 31, 2013, with product revenue growth of 18% and overall revenue growth of 14% compared to the prior fiscal year. Our earnings per share for the fiscal year ended March 31, 2013 were $0.96 per share, representing a $0.20, or 26%, increase over the same period in the prior year. Our business maintained strong gross profit margins. Our gross margin for the fiscal year ended March 31, 2013 remained flat at 79% compared to the same period in the prior year.

We ended fiscal year 2013 with an immaterial amount of product backlog, compared to $13.0 million as of the end of fiscal year 2012.

At March 31, 2013, we had cash, cash equivalents and marketable securities of $154.1 million. This represents a decrease of $59.4 million over the previous fiscal year ended March 31, 2012. During the fiscal year ended March 31, 2013, we maintained our liquidity despite acquisitions of product technology as well as cash outflows as a result of our share repurchase program and the repayment of $62.0 million of long-term debt.

Use of Non-GAAP Financial Measures

We supplement the generally accepted accounting principles (GAAP) financial measures we report in quarterly earnings announcements, investor presentations and other investor communications by reporting the following non-GAAP measures: non-GAAP revenue, non-GAAP net income and non-GAAP net income per diluted share. Non-GAAP revenue eliminates the GAAP effects of acquisitions by adding back revenue related to deferred revenue revaluation. Non-GAAP net income includes the foregoing adjustment and also removes inventory fair value adjustments, expenses related to the amortization of acquired intangible assets, stock-based compensation, restructuring, certain expenses relating to acquisitions including compensation for post-combination services and business development charges, as well as early extinguishment of debt, net of related income tax effects. Non-GAAP diluted net income per share also excludes these expenses as well as the related impact of all these adjustments on the provision for income taxes.

These non-GAAP measures are not in accordance with GAAP, should not be considered an alternative for measures prepared in accordance with GAAP (revenue, net income and diluted net income per share), and may have limitations in that they do not reflect all our results of operations as determined in accordance with GAAP. These non-GAAP measures should only be used to evaluate our results of operations in conjunction with the corresponding GAAP measures. The presentation of non-GAAP information is not meant to be considered superior to, in isolation from or as a substitute for results prepared in accordance with GAAP.

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

The following table reconciles revenue, net income and net income per share on a GAAP and non-GAAP basis for the years ended March 31, 2013, 2012 and 2011 (in thousands):

	Year Ended March 31,		
	2013	2012	2011
GAAP revenue	$ 350,550	$ 308,679	$ 290,540
Revenue impact of accounting change			(929)
Deferred revenue fair value adjustment	1,215	312	132
Non-GAAP revenue	$ 351,765	$ 308,991	$ 289,743
GAAP net income	$ 40,609	$ 32,428	$ 37,265
Revenue adjustments	1,215	312	(797)
Inventory fair value adjustment	453		
Share-based compensation expense	9,580	8,702	6,439
Amortization of acquired intangible assets	7,424	6,782	5,887
Business development and integration expense	1,618	4,715	755
Compensation for post combination services	2,721	438	
Restructuring charges	1,065	603	
Loss on extinguishment of debt		690	
Income tax adjustments	(8,671)	(7,700)	(4,668)
Non-GAAP net income	$ 56,014	$ 46,970	$ 44,881
GAAP diluted net income per share	$ 0.96	$ 0.76	$ 0.87
Share impact of non-GAAP adjustments identified above	0.36	0.34	0.17
Non-GAAP diluted net income per share	$ 1.32	$ 1.10	$ 1.04

Critical Accounting Policies

We consider accounting policies related to marketable securities, revenue recognition, valuation of goodwill, intangible assets and other acquisition accounting items, and share based compensation to be critical in fully understanding and evaluating our financial results. The application of these policies involves significant judgments and estimates by us.

Marketable Securities

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

Investments and marketable securities are considered to be impaired when a decline in fair value below cost basis is determined to be other-than-temporary. We periodically evaluate whether a decline in fair value below cost basis is other-than-temporary by considering available evidence regarding these investments including, among other factors, the duration of the period that, and extent to which, the fair value is less than cost basis, the financial health of and business outlook for the issuer, including industry and sector performance and operational and financing cash flow factors, overall market conditions and trends and our intent and ability to retain our investment in the security for a period of time sufficient to allow for an anticipated recovery in market value. Once a decline in fair value is determined to be other-than-temporary, a write-down is recorded and a new cost

basis in the security is established. Assessing the above factors involves inherent uncertainty. Write-downs, if recorded, could be materially different from the actual market performance of investments and marketable securities in our portfolio if, among other things, relevant information related to our investments and marketable securities was not publicly available or other factors not considered by us would have been relevant to the determination of impairment.

Revenue Recognition

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

Service revenue consists primarily of fees from customer support agreements, consulting and training. We generally provide software and hardware support as part of product sales. Revenue related to the initial bundled software and hardware support is recognized ratably over the support period. In addition, customers can elect to purchase extended support agreements for periods after the initial software warranty expiration. Support services generally include rights to unspecified upgrades (when and if available), telephone and internet-based support, updates and bug fixes. Revenue from customer support agreements is recognized ratably over the support period. Reimbursements of out-of-pocket expenditures incurred in connection with providing consulting services are included in services revenue, with the offsetting expense recorded in cost of service revenue. Training services include on-site and classroom training. Training revenues are recognized as the related training services are provided.

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

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

For multi-element arrangements comprised only of software products and related services, we allocate a portion of the total arrangement consideration to the undelivered elements, primarily support agreements and training, using VSOE of fair value for the undelivered elements. The remaining portion of the total arrangement consideration is allocated to the delivered software, referred to as the residual method. VSOE of fair value of the undelivered elements is based on the price customers pay when the element is sold separately. We review the separate sales of the undelivered elements on a quarterly basis and update, when appropriate, its VSOE of fair value for such elements to ensure that it reflects recent pricing experience. If we cannot objectively determine the

VSOE of the fair value of any undelivered software element, we defer revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements.

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

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

Valuation of Goodwill, Intangible Assets and Other Acquisition Accounting Items

The carrying value of goodwill was $202.5 million and $170.4 million as of March 31, 2013 and 2012, respectively. We have two reporting units: (1) Unified Service Delivery and (2) Test Automation. Goodwill is tested for impairment at a reporting unit level at least annually, or on an interim basis if an event occurs or circumstances change that would, more likely than not, reduce the fair value of the reporting segment below its carrying value. Because NetScout, and our two reporting units, did not experience any significant adverse changes in our business or reporting structures, we performed the qualitative Step 0 assessment. In performing the qualitative Step 0 assessment, we considered certain events and circumstances specific to the entity at the reporting unit level, such as macroeconomic conditions, industry and market considerations, overall financial performance and cost factors when evaluating whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. No indicators of impairment were noted as of January 31, 2013. Additionally, the market capitalization of NetScout as a whole significantly exceeded its carrying value.

The carrying value of intangible assets was $63.8 million and $54.7 million as of March 31, 2013 and 2012, respectively. Intangible assets acquired in a business combination are recorded under the acquisition method of accounting at their estimated fair values at the date of acquisition. We amortize intangible assets over their estimated useful lives, except for the acquired tradename which resulted from the Network General acquisition, which has an indefinite life and thus, is not amortized. The carrying value of the indefinite lived tradename is evaluated annually or more frequently if events or changes in circumstances indicate that the asset might be impaired.

During the fiscal year ended March 31, 2013, we early adopted authoritative guidance that gives entities an option to first assess qualitative factors to determine whether the existence of events and circumstances indicate that it is more likely than not that the indefinite-lived intangible asset is impaired. If based on its qualitative assessment an entity concludes that it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount, quantitative impairment testing is required. However, if an entity concludes otherwise, quantitative impairment testing is not required. We completed our annual impairment test of the indefinite lived intangible as of January 31, 2013 using the qualitative Step 0 assessment described above, which largely mirrors the Unified Service Delivery analysis, as the tradenames apply to a majority of the products and branding within that reporting unit. No impairment indicators were observed as of January 31, 2013.

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We have acquired five companies during the three year period ended March 31, 2013. The acquisition method of accounting requires that we estimate the fair value of the assets and liabilities acquired as part of these transactions. In order to estimate the fair value of acquired intangibles we use a relief from royalty model which requires management to estimate: future revenues expected to be generated by the acquired intangibles, a royalty rate which a market participant would pay related to the projected revenue stream, a present value factor which approximates a risk adjusted rate of return for a market participant purchasing the assets, and a technology migration curve representing a period of time over which the technology assets or some portion thereof are still being used. We are also required to develop the fair value for customer relationships acquired as part of these transactions which requires that we create estimates for the following items: a projection of future revenues associated with the acquired company s existing customers, a turnover rate for those customers, a margin related to those sales, and risk adjusted rate of return for a market participant purchasing those relationships.

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

Share-based Compensation

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

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

Based on historical experience, we assumed an annualized forfeiture rate of 0% for awards granted to our directors, and an annualized forfeiture rate of 10% for awards granted to our senior executives and remaining employees. We will record additional expense if the actual forfeitures are lower than estimated and will record a recovery of prior expense if the actual forfeitures are higher than estimated.

Results of Operations

Comparison of Years Ended March 31, 2013 and 2012

Revenue

Product revenue consists of sales of our hardware products and licensing of our software products. Service revenue consists of customer support agreements, consulting and training. No one direct customer or indirect channel partner accounted for more than 10% of our total revenue during the fiscal years ended March 31, 2013 and 2012.

	Fiscal Year Ended March 31, (Dollars in Thousands)					
	2013		2012		Change	
		% of Revenue		% of Revenue	$	%
Revenue:						
Product	$ 198,749	57%	$ 168,141	54%	$ 30,608	18%
Service	151,801	43	140,538	46	11,263	8%
Total revenue	$ 350,550	100%	$ 308,679	100%	$ 41,871	14%

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Product. The 18%, or $30.6 million, increase in product revenue was due to a $19.4 million increase in revenue from our general enterprise sector and an $18.8 million increase in our service provider sector. These increases were offset by a $7.6 million decrease in our government enterprise sector. Compared to the same period in the prior year, we realized a 7% increase in units shipped and a 6% increase in the average selling price per unit of our products. The increase in average selling price is due to product mix.

We expect continued growth in our fiscal year ended March 31, 2014 and expect our service provider sector to continue to be a significant driver of future growth.

Service. The 8%, or $11.3 million, increase in service revenue was due to a $10.8 million increase in revenue from maintenance contracts due to increased new maintenance contracts and renewals from a growing support base and a $1.7 million increase in premium support contracts. These were offset by a $1.3 million decrease in consulting revenue. We expect single digit percentage growth in our service revenues. We expect this to be generated by product revenue growth which increases our installed base and therefore our related maintenance contracts.

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

	Fiscal Year Ended March 31, (Dollars in Thousands)					
	2013		2012		Change	
		% of Revenue		% of Revenue	$	%
Indirect	$ 172,136	49%	$ 166,483	54%	$ 5,653	3%
Direct	178,414	51	142,196	46	36,218	25%
Total revenue	$ 350,550	100%	$ 308,679	100%	$ 41,871	14%

The 3%, or $5.7 million, increase in indirect channel revenue is the result of the increase in sales in Europe to our service provider customers. Sales to customers outside the United States are export sales typically through channel partners, who are generally responsible for distributing our products and providing technical support and service to customers within their territories. Our reported international revenue does not include any revenue from sales to customers outside the United States that are shipped to our United States-based indirect channel partners. These domestic resellers fulfill customer orders based upon joint selling efforts in conjunction with our direct sales force and may subsequently ship our products to international locations; however, we report these shipments as United States revenue since we ship the products to a domestic location. The 25%, or $36.2 million, increase in direct channel revenue is the result of increased domestic revenue from our service provider and domestic general enterprise customers.

Total revenue by geography is as follows:

	Fiscal Year Ended March 31, (Dollars in Thousands)					
	2013		2012		Change	
		% of Revenue		% of Revenue	$	%
United States	$ 262,020	75%	$ 230,359	75%	$ 31,661	14%
International:						
Europe	42,884	12	32,998	10	9,886	30%
Asia	18,107	5	17,637	6	470	3%
Rest of the world	27,539	8	27,685	9	(146)	(1%)
Subtotal international	88,530	25	78,320	25	10,210	13%
Total revenue	$ 350,550	100%	$ 308,679	100%	$ 41,871	14%

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United States revenues increased 14%, or $31.7 million, as a result of an increase in our service provider and general enterprise sectors. The 13%, or $10.2 million, increase in international revenue is primarily due to an increase in our service provider sector in Europe as well as our general enterprise sector throughout the world. We expect revenue from sales to customers outside the United States to continue to account for a significant portion of our total revenue in the future. In accordance with United States export control regulations we do not sell to, or do business with, countries subject to economic sanctions and export controls.

Cost of Revenue and Gross Profit

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

	Fiscal Year Ended March 31, (Dollars in Thousands)					
	2013		2012		Change	
		% of Revenue		% of Revenue	$	%
Cost of revenue:						
Product	$ 45,752	13%	$ 39,271	13%	$ 6,481	17%
Service	28,256	8	26,401	8	1,855	7%
Total cost of revenue	$ 74,008	21%	$ 65,672	21%	$ 8,336	13%
Gross profit:						
Product $	$ 152,997	44%	$ 128,870	42%	$ 24,127	19%
Product gross profit %	77%		77%		%	
Service $	123,545	35%	114,137	37%	9,408	8%
Service gross profit %	81%		81%		%	
Total gross profit $	$ 276,542		$ 243,007		$ 33,535	14%
Total gross profit %	79%		79%		0%	

Product. The 17%, or $6.5 million, increase in cost of product revenue was primarily due to the 18%, or $30.6 million increase in product revenue for the fiscal year ended March 31, 2013 when compared to the fiscal year ended March 31, 2012. In addition, there was a $453 thousand increase due to the amortization of a fair value adjustment related to inventory recorded from the acquisition of ONPATH.

The product gross profit percentage remained flat at 77% during the fiscal year ended March 31, 2013 as compared to the same period in the prior year. Average headcount in cost of product revenue was 29 and 26 for the years ended March 31, 2013 and 2012, respectively.

Service. The 7%, or $1.9 million, increase in cost of service revenue was primarily due to a $1.7 million increase in employee related expenses resulting from increased headcount to support our growing installed base as well as increased incentive compensation. The 8%, or $9.4 million, increase in service gross profit corresponds with the 8%, or $11.3 million, increase in service revenue, offset by the 7%, or $1.9 million, increase in cost of services. The service gross profit percentage remained flat at 81% for the fiscal year ended March 31, 2013 when compared to the same period in the prior year. Average headcount in cost of service revenue was 139 and 125 for the years ended March 31, 2013 and 2012, respectively.

Gross profit. Our gross profit increased 14%, or $33.5 million. This increase is attributable to our increase in revenue of 14%, or $41.9 million, offset by a 13%, or $8.3 million, increase in cost of revenue. The gross margin percentage remained flat at 79% during the fiscal year ended March 31, 2013 when compared to the same period in the prior year. Overall we expect our gross margin percentage to remain relatively flat in future periods with increased sales volumes offset by corresponding increases in product and service costs.

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Operating Expenses

	Fiscal Year Ended March 31, (Dollars in Thousands)					
	2013		2012		Change	
		% of Revenue		% of Revenue	$	%
Research and development	$ 61,546	18%	$ 49,478	16%	$ 12,068	24%
Sales and marketing	116,807	33	109,624	35	7,183	7%
General and administrative	29,718	8	27,488	9	2,230	8%
Amortization of acquired intangible assets	2,877	1	2,131	1	746	35%
Restructuring charges	1,065		603		462	77%
Total operating expenses	$ 212,013	60%	$ 189,324	61%	$ 22,689	12%

Research and development. Research and development expenses consist primarily of personnel expenses, fees for outside consultants, overhead and related expenses associated with the development of new products and the enhancement of existing products.

The 24%, or $12.1 million, increase in research and development expenses is due to a $9.0 million increase in employee related expenses due to increased headcount and incentive compensation, a $1.2 million increase in compensation for post combination services related to the acquisitions of Simena, Replay and ONPATH, a $536 thousand increase in consulting costs, a $495 thousand increase in travel expenses, a $443 thousand increase in allocated overhead, a $417 thousand increase in rent expense, a $333 thousand increase in depreciation and a $259 thousand increase in meeting expenses. These were offset by a $1.5 million decrease in business development expenses. Average headcount in research and development was 338 and 291 for the fiscal years ended March 31, 2013 and 2012, respectively. We expect research and development expenses to decline as a percentage of sales in future periods as revenue growth offsets additional research and development headcount associated with our recent acquisitions.

Sales and marketing. Sales and marketing expenses consist primarily of personnel expenses, including commissions, overhead and other expenses associated with selling activities and marketing programs such as trade shows, seminars, advertising, and new product launch activities.

The 7%, or $7.2 million, increase in total sales and marketing expenses was due to a $2.3 million increase in employee related expenses due to increased headcount, a $1.6 million increase in marketing related expenses, a $1.1 million increase in sales meeting costs, a $1.0 million increase in depreciation expense, a $891 thousand increase in expenses related to the NetScout user conference as this was not held during the fiscal year ended March 31, 2012, a $581 thousand increase in recruitment and a $534 thousand increase in employee training. Average headcount in sales and marketing was 333 and 317 for the fiscal years ended March 31, 2013 and 2012, respectively.

General and administrative. General and administrative expenses consist primarily of personnel expenses for executive, financial, legal and human resource employees, overhead and other corporate expenditures.

The 8%, or $2.2 million, increase in general and administrative expenses was due to a $1.4 million increase in employee related expenses related to an increase in incentive compensation, a $973 thousand increase in deal related compensation associated with acquisitions and a $971 thousand increase in software license expenses. These expenses were offset by an $853 thousand decrease in business development costs associated with acquisitions. Average headcount in general and administrative was 115 and 117 for the fiscal years ended March 31, 2013 and 2012, respectively.

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Amortization of acquired intangible assets. Amortization of acquired intangible assets consists primarily of amortization of customer relationships related to the acquisitions of ONPATH, Accanto, Simena, Replay, Psytechnics and Network General Central Corporation (Network General).

The 35%, or $746 thousand, increase in amortization of acquired intangible assets is due to the increase of expense recorded related to the acquisitions of ONPATH, Accanto, Simena and Replay. The amortization related to the acquisitions ONPATH and Accanto were not recorded during the prior fiscal year ended March 31, 2012 as the acquisitions have occurred within the past twelve months. In addition, there were increases related to the acquisitions of Simena and Replay during the fiscal year ended March 31, 2013 as compared to the prior fiscal year primarily related to recording an entire year of amortization in the current year.

Restructuring charges. During the fiscal year ended March 31, 2013, we restructured part of our international sales organization related to an overlap of personnel acquired as part of the Accanto acquisition. As a result, we recorded $1.2 million of restructuring charges during the fiscal year ended March 31, 2013 related to severance costs.

Interest and Other Expense, Net

Interest and other expense, net includes interest earned on our cash, cash equivalents, marketable securities and restricted investments, interest expense and other non-operating gains or losses.

	Fiscal Year Ended March 31, (Dollars in Thousands)					
	2013		2012		Change	
		% of Revenue		% of Revenue	$	%
Interest and other expense, net	$ (793)	(0%)	$ (2,765)	(1%)	$ 1,972	71%

The 71%, or $2.0 million, decrease in interest and other income (expense), net was due to a $690 thousand decrease related to the loss on extinguishment of debt in connection with the refinancing of our previous credit facility during the fiscal year ended March 31, 2012, a $718 thousand decrease in foreign currency transaction expense, a $475 thousand decrease in interest expense due to a decrease in the interest rate as well as the payment of our outstanding debt during the fiscal year ended March 31, 2013. In addition, there was an $89 thousand increase in interest income.

Income Tax Expense

The annual effective tax rate for fiscal year 2013 is 36.3%, compared to an annual effective tax rate of 36.3% for fiscal year 2012. Generally, the annual effective tax rates differ from statutory rates primarily due to the impact of the domestic production activities deduction, the impact of state taxes, and federal, foreign and state tax credits.

	Fiscal Year Ended March 31, (Dollars in Thousands)					
	2013		2012		Change	
		% of Revenue		% of Revenue	$	%
Income tax expense	$ 23,127	7%	$ 18,490	6%	$ 4,637	25%

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Comparison of Years Ended March 31, 2012 and 2011

Revenue

Product revenue consists of sales of our hardware products and licensing of our software products. Service revenue consists of customer support agreements, consulting and training. No one direct customer or indirect channel partner accounted for more than 10% of our total revenue during fiscal years ended March 31, 2012 and 2011.

	Fiscal Year Ended March 31, (Dollars in Thousands)					
	2012		2011		Change	
		% of Revenue		% of Revenue	$	%
Revenue:						
Product	$ 168,141	54%	$ 159,948	55%	$ 8,193	5%
Service	140,538	46	130,592	45	9,946	8%
Total revenue	$ 308,679	100%	$ 290,540	100%	$ 18,139	6%

Product. The 5%, or $8.2 million, increase in product revenue was due to a $9.1 million increase in revenue from our service provider sector and a $400 thousand increase in revenue from our enterprise sector. These increases were offset by a $1.3 million decrease in our government sector. Compared to the same period in the prior year, we realized an 11% decrease in units shipped, while the average selling price per unit of our products increased approximately 17%. The increase in average selling price per unit is due to a shift in product mix from our lower priced