

EXTREME NETWORKS INC  
Form 10-Q  
January 30, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2018

OR

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

For the transition period from                      to

Commission file number 000-25711

EXTREME NETWORKS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE

[State or other jurisdiction

of incorporation or organization]

77-0430270

[I.R.S Employer

Identification No.]

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6480 Via Del Oro,

San Jose, California

95119

[Address of principal executive office] [Zip Code]

Registrant's telephone number, including area code: (408) 579-2800

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes 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 or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" and "an emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by checkmark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares of the Registrant's Common Stock, \$.001 par value, outstanding at January 24, 2019, was 116,759,619

EXTREME NETWORKS, INC.

FORM 10-Q

QUARTERLY PERIOD ENDED

December 31, 2018

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## EXTREME NETWORKS, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

(Unaudited)

	December 31, 2018	June 30, 2018
<b>ASSETS</b>		
Current assets:		
Cash	\$ 140,643	\$ 121,139
Accounts receivable, net of allowance for doubtful accounts of \$1,678 at December 31, 2018 and \$1,478 at June 30, 2018	144,909	212,423
Inventories	58,297	63,867
Prepaid expenses and other current assets	39,088	30,484
Total current assets	382,937	427,913
Property and equipment, net	74,499	78,519
Intangible assets, net	63,544	77,092
Goodwill	137,799	139,082
Other assets	53,170	47,642
Total assets	\$ 711,949	\$ 770,248
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$ 9,009	\$9,007
Accounts payable	34,977	75,689
Accrued compensation and benefits	46,500	50,351
Accrued warranty	12,808	12,807
Deferred revenue	138,239	130,865
Other accrued liabilities	70,035	81,153
Total current liabilities	311,568	359,872
Deferred revenue, less current portion	47,854	43,660
Long-term debt, less current portion	174,246	188,749
Deferred income taxes	1,699	6,135
Other long-term liabilities	60,711	59,100
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Convertible preferred stock, \$.001 par value, issuable in series, 2,000 shares		
authorized; none issued	—	—
	119	116

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Common stock, \$.001 par value, 750,000 shares authorized; 119,089 and 116,124 shares issued, respectively; 116,723 and 116,124 shares outstanding, respectively		
Additional paid-in-capital	962,924	942,397
Accumulated other comprehensive loss	(2,725 )	(1,703 )
Accumulated deficit	(829,447 )	(828,078 )
Treasury stock at cost: 2,366 and 0 shares, respectively	(15,000 )	-
Total stockholders' equity	115,871	112,732
Total liabilities and stockholders' equity	\$ 711,949	\$ 770,248

See accompanying notes to condensed consolidated financial statements.

## EXTREME NETWORKS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2018	2017	2018	2017
Net revenues:				
Product	\$ 189,567	\$ 174,850	\$ 367,287	\$ 339,624
Service	63,113	56,273	125,279	103,214
Total net revenues	252,680	231,123	492,566	442,838
Cost of revenues:				
Product	86,487	78,472	170,030	158,517
Service	24,894	23,665	49,166	42,954
Total cost of revenues	111,381	102,137	219,196	201,471
Gross profit:				
Product	103,080	96,378	197,257	181,107
Service	38,219	32,608	76,113	60,260
Total gross profit	141,299	128,986	273,370	241,367
Operating expenses:				
Research and development	52,204	45,907	103,445	80,192
Sales and marketing	68,342	65,659	135,924	121,220
General and administrative	13,886	11,669	26,657	23,854
Acquisition and integration costs, net of bargain purchase gain	67	34,115	2,613	38,359
Restructuring charges, net of reversals	474	—	1,282	—
Amortization of intangibles	1,575	2,746	3,716	4,360
Total operating expenses	136,548	160,096	273,637	267,985
Operating income (loss)	4,751	(31,110 )	(267 )	(26,618 )
Interest income	643	717	1,037	1,364
Interest expense	(3,066 )	(2,504 )	(6,592 )	(4,719 )
Other (expense) income, net	(399 )	(643 )	88	2,484
Income (loss) before income taxes	1,929	(33,540 )	(5,734 )	(27,489 )
(Benefit ) provision for income taxes	(5,270 )	(1,617 )	(3,868 )	58
Net income (loss)	\$ 7,199	\$ (31,923 )	\$ (1,866 )	\$ (27,547 )
Basic and diluted net (loss) income per share:				
Net income (loss) per share - basic	\$ 0.06	\$ (0.28 )	\$ (0.02 )	\$ (0.24 )
Net income (loss) per share - diluted	\$ 0.06	\$ (0.28 )	\$ (0.02 )	\$ (0.24 )
Shares used in per share calculation - basic	117,544	113,621	117,456	112,931
Shares used in per share calculation - diluted	119,544	113,621	117,456	112,931

See accompanying notes to condensed consolidated financial statements.





EXTREME NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(In thousands)

(Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2018	2017	2018	2017
Net income (loss)	\$7,199	\$ (31,923 )	\$ (1,866 )	\$ (27,547 )
Other comprehensive income (loss), net of tax:				
Available for sale securities:				
Change in unrealized gains on available for sale securities	—	54	—	237
Net change in foreign currency translation adjustments	(28 )	432	(525 )	787
Other comprehensive income (loss), net of tax:	(28 )	486	(525 )	1,024
Total comprehensive income (loss)	\$7,171	\$ (31,437 )	\$ (2,391 )	\$ (26,523 )

See accompanying notes to condensed consolidated financial statements.

## EXTREME NETWORKS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended December 31, 2018		December 31, 2017	
Cash flows from operating activities:				
Net loss	\$(1,866 )		\$(27,547 )	
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:				
Depreciation	13,476		8,093	
Amortization of intangible assets	13,552		11,023	
Provision for doubtful accounts	861		1,180	
Stock-based compensation	15,525		11,828	
Deferred income taxes	(6,516 )		(2,135 )	
Unrealized/realized (gain) loss on equity investment	274		(3,757 )	
Realized gain on bargain purchase	—		(4,920 )	
Non-cash interest	1,532		510	
Other non-cash items	(344 )		1,308	
Changes in operating assets and liabilities, net of acquisitions				
Accounts receivable	66,568		(11,188 )	
Inventories	5,570		(449 )	
Prepaid expenses and other assets	(12,390 )		1,188	
Accounts payable	(40,050 )		17,547	
Accrued compensation and benefits	(3,851 )		3,734	
Deferred revenue	11,568		4,446	
Other current and long-term liabilities	(2,298 )		3,387	
Net cash provided by operating activities	61,611		14,248	
Cash flows from investing activities:				
Capital expenditures	(11,140 )		(13,309 )	
Business acquisitions	—		(97,581 )	
Proceeds from sale of investment	727		4,922	
Net cash used in investing activities	(10,413 )		(105,968 )	
Cash flows from financing activities:				
Borrowings under Term Loan	—		100,000	
Repayments of debt	(14,750 )		(8,686 )	
Loan fees on borrowings	(545 )		(1,494 )	
Repurchase of stock	(15,000 )		—	
Proceeds from issuance of common stock, net of tax withholding	5,005		(1,536 )	
Capital lease financing	(183 )		—	
Contingent consideration obligations	(3,856 )		—	
Deferred payments on an acquisition	(2,000 )		—	

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Net cash (used in) provided by financing activities	(31,329 )	88,284
Foreign currency effect on cash	(365 )	94
Net increase (decrease) in cash	19,504	(3,342 )
Cash and cash equivalents at beginning of period	121,139	130,450
Cash and cash equivalents at end of period	\$ 140,643	\$ 127,108

See accompanying notes to the condensed consolidated financial statements.

EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business and Basis of Presentation

Extreme Networks, Inc., together with its subsidiaries (collectively referred to as “Extreme” or the “Company”), is a leader in providing software-driven networking solutions for enterprise customers. The Company conducts its sales and marketing activities on a worldwide basis through distributors, resellers and the Company’s field sales organization. Extreme was incorporated in California in 1996 and reincorporated in Delaware in 1999.

The unaudited condensed consolidated financial statements of Extreme included herein have been prepared under the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted under such rules and regulations. The condensed consolidated balance sheet at June 30, 2018 was derived from audited financial statements as of that date but does not include all disclosures required by generally accepted accounting principles for complete financial statements. These interim financial statements and notes should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2018.

The unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations and cash flows for the interim periods presented and the financial condition of Extreme at December 31, 2018. The results of operations for the three and six months ended December 31, 2018 are not necessarily indicative of the results that may be expected for fiscal 2019 or any future periods.

Fiscal Year

The Company uses a fiscal calendar year ending on June 30. All references herein to “fiscal 2019” or “2019” represent the fiscal year ending June 30, 2019. All references herein to “fiscal 2018” or “2018” represent the fiscal year ended June 30, 2018.

Principles of Consolidation

The consolidated financial statements include the accounts of Extreme and its wholly-owned subsidiaries. All inter-company accounts and transactions have been eliminated.

The Company predominantly uses the United States Dollar as its functional currency. The functional currency for certain of its foreign subsidiaries is the local currency. For those subsidiaries that operate in a local currency functional environment, all assets and liabilities are translated to United States Dollars at current month end rates of exchange; and revenue and expenses are translated using the monthly average rate.

Accounting Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

2. Summary of Significant Accounting Policies

For a description of significant accounting policies, see Note 3, Summary of Significant Accounting Policies, to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2018. There have been no material changes to the Company's significant accounting policies since the filing of the Annual Report on Form 10-K.

#### Recently Adopted Accounting Pronouncements

In January 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, which provides guidance for the recognition, measurement, presentation, and disclosure of financial assets and liabilities. The guidance was adopted effective July 1, 2018 and the Company reclassified a \$0.5 million unrealized gain, net of tax, related to its available-for-sale investments from accumulated other comprehensive loss to accumulated deficit as a cumulative-effect adjustment in the accompanying condensed consolidated balance sheets. Future changes in fair value will be included in earnings in each period.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments to provide guidance on the classification of eight cash flow issues in order to reduce diversity in practice. The Company adopted the new guidance effective July 1, 2018. The amendments in this update have been applied on a retrospective transition method to each period presented. The adoption of this guidance did not have a material effect on the Company's presentation of cash flows.

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740) - Intra-Entity Transfers of Assets Other Than Inventory, which requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Historically GAAP had prohibited the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold outside the consolidated group. The new guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The Company adopted ASU 2016-16 effective July 1, 2018 on a modified retrospective basis. The adoption of this guidance did not have a material effect on the Company's financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting, which amends the scope of modification accounting for share-based payment arrangements and provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under Topic 718. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The Company adopted this guidance effective July 1, 2018, on a prospective basis. The adoption of this guidance did not have a material effect on the Company's financial statements.

#### Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which requires the identification of arrangements that should be accounted for as leases by lessees. In general, for lease arrangements exceeding a twelve-month term, these arrangements must now be recognized as assets and liabilities on the balance sheet of the lessee. Under Topic 842, a right-of-use asset and lease obligation will be recorded for all leases, whether operating or financing, while the statement of operations will reflect lease expense for operating leases and amortization/interest expense for financing leases. The balance sheet amount recorded for existing leases at the date of adoption of Topic 842 must be calculated using the applicable incremental borrowing rate at the date of adoption. In addition, Topic 842 is applied on the modified retrospective method through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements and footnote disclosures. The Company believes that Topic 842 will have a material impact on its financial position, as a result of recognizing right-of-use assets and lease liabilities on its consolidated balance sheets. In addition, in December 2018, the FASB issued ASU No. 2018-20, Leases (Topic 842), which includes narrow-scope improvements for lessors to increase transparency and comparability about leasing transactions. The Company continues to evaluate the impact these new standards will have on its condensed consolidated statement of operations and statement of cash flows. This guidance will become effective for the Company beginning with its fiscal year 2020, beginning on July 1, 2019.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, which is intended to allow companies to better align risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results by expanding and refining hedge accounting for both nonfinancial and financial risk components and aligning the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. In addition, in October 2018, the FASB issued ASU 2018-16, Derivatives and Hedging (Topic 815), which amends Topic 815 to add the overnight index swap (OIS) rate based on the secured overnight financing rate as a fifth U.S. benchmark interest rate. These standards are effective

for interim and annual reporting periods beginning after December 15, 2018. The Company is continuing to evaluate the accounting, transition and disclosure requirements of these standards, but does not believe it will have a material impact on the Company's financial statements upon adoption. This guidance is effective for the Company beginning with its fiscal year 2020, beginning on July 1, 2019.

In February 2018, the FASB issued ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220), this standard that allows the reclassification from AOCI to retained earnings for stranded tax effects resulting from the 2017 Tax Cuts and Jobs Act ("Tax Reform Act"). The amount of the reclassification is the effect of the change in the U.S. federal corporate income tax rate on the gross deferred tax amounts and related valuation allowances related to items remaining in AOCI. This standard is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period, for reporting periods for which financial statements have not yet been issued. The new standard is to be applied either in the period of adoption or retrospectively to each period (or periods) in which the effects of the change in the income tax rate in the Tax Reform Act are recognized. Management is currently evaluating implementation options and impact on the Company's financial statements and related disclosures. This guidance is effective for the Company beginning with its fiscal year 2020, beginning on July 1, 2019.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820), which removes, modifies and adds various disclosure requirements around the topic in order to clarify and improve the cost-benefit nature of disclosures. For example, disclosures around transfers between fair value hierarchy levels will be removed and further detail around changes in unrealized gains and losses for the period and unobservable inputs determining Level 3 fair value measurements will be added. This standard is effective for interim and annual reporting periods beginning after December 15, 2019, and early adoption is permitted. The Company is currently evaluating the impact the new standard will have on its condensed consolidated financial statements. This guidance is effective for the Company beginning with its fiscal year 2021, beginning on July 1, 2020.

In August 2018, the FASB issued ASU 2018-15, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40), which aligns the requirements for capitalizing implementation costs incurred in a service contract hosting arrangement with those of developing or obtaining internal-use software. This standard is effective for interim and annual reporting periods beginning after December 15, 2019, and early adoption is permitted. The Company is currently evaluating the impact the new standard will have on its condensed consolidated financial statements. This guidance is effective for the Company beginning with its fiscal year 2021, beginning on July 1, 2020.

### 3. Revenues

The Company accounts for revenue in accordance with ASC Topic 606, Revenue from Contracts with Customers, which the Company adopted on July 1, 2017, using the retrospective method. The Company derives the majority of its revenue from sales of its networking equipment, with the remaining revenue generated from service fees primarily relating to maintenance contracts with additional revenues from professional services, and training for its products. The Company sells its products and maintenance contracts direct to customers and to partners in two distribution channels, or tiers. The first tier consists of a limited number of independent distributors that stock its products and sell primarily to resellers. The second tier of the distribution channel consists of a non-stocking distributors and value-added resellers that sell directly to end-users. Products and services may be sold separately or in bundled packages.

#### Revenue Recognition

**Performance Obligations.** A performance obligation is a promise in a contract to transfer a distinct good or service to the customer and is the unit of account in Topic 606. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. Certain of the Company's contracts have multiple performance obligations, as the promise to transfer individual goods or services is separately identifiable from other promises in the contracts and, therefore, is distinct. For contracts with multiple performance obligations, the Company allocates the contract's transaction price to each performance obligation based on its relative standalone selling price. The stand-alone selling prices are determined based on the prices at which the Company separately sells these products. For items that are not sold separately, the Company estimates the stand-alone selling prices using the best estimated selling price approach.

The Company's performance obligations are satisfied at a point in time or over time as work progresses. Substantially all of the Company's product sales revenues as reflected on the condensed consolidated statements of operations for the three and six months ended December 31, 2018 and 2017 are recognized at a point in time. Substantially all of the Company's service revenue is recognized over time. For revenue recognized over time, the Company uses an input measure, days elapsed, to measure progress.

On December 31, 2018, the Company had \$186.1 million of remaining performance obligations, which is comprised of deferred maintenance revenue and services not yet delivered. The Company expects to recognize approximately 48



percent of its remaining performance obligations as revenue in fiscal 2019, an additional 35 percent in fiscal 2020 and 17 percent of the balance thereafter.

**Contract Balances.** The timing of revenue recognition, billings and cash collections results in billed accounts receivable and deferred revenue in the consolidated balance sheet. Services provided under renewable support arrangements of the Company are billed in accordance with agreed-upon contractual terms, which are typically at periodic intervals (e.g., quarterly or annually). The Company sometimes receives payments from its customers in advance of services being provided, resulting in deferred revenues. These liabilities are reported on the consolidated balance sheet on a contract-by-contract basis at the end of each reporting period.

Revenue recognized for the three months ended December 31, 2018 and 2017 that was included in the deferred revenue balance at the beginning of each period was \$59.9 million and \$36.9 million, respectively. Revenue recognized for the six months ended December 31, 2018 and 2017 that was included in the deferred revenue balance at the beginning of each period was \$88.8 million and \$52.9 million, respectively.

**Contract Costs.** The Company recognizes the incremental costs of obtaining contracts as an expense when incurred if the amortization period of the assets that the Company otherwise would have recognized is one year or less. Management expects that commission fees paid to sales representative as a result of obtaining service contracts and contract renewals are recoverable and therefore the Company's capitalized balances in the amount of \$5.3 million and \$3.2 million at December 31, 2018 and 2017, respectively. Capitalized commission fees are amortized on a straight-line basis over the average period of service contracts of approximately three years, and are included in "Sales and marketing" in the accompanying condensed consolidated statements of operations. Amortization recognized during the three months ended December 31, 2018 and 2017, was \$0.7 million and \$0.5 million, respectively. Amortization recognized during the six months ended December 31, 2018 and 2017 was \$1.4 million and \$0.9 million, respectively. There was no impairment loss in relation to the costs capitalized.

**Estimated Variable Consideration.** There were no material changes in the current period to the estimated variable consideration for performance obligations which were satisfied or partially satisfied during previous periods.

#### Revenue by Category

The following table sets forth the Company's revenue disaggregated by sales channel and geographic region based on the customer's ship-to locations (in thousands):

	Three Months Ended December 31,			December 31,		
	2018			2017		
	Distributor	Direct	Total	Distributor	Direct	Total
<b>Americas:</b>						
United States	\$44,141	\$55,326	\$99,467	\$56,269	\$54,559	\$110,828
Other	8,269	5,380	13,649	1,155	5,698	6,853
Total Americas	52,410	60,706	113,116	57,424	60,257	117,681
EMEA	79,876	32,773	112,649	55,956	33,624	89,580
APAC	4,767	22,148	26,915	5,131	18,731	23,862
Total net revenues	\$137,053	\$115,627	\$252,680	\$118,511	\$112,612	\$231,123

	Six Months Ended December 31,			December 31,		
	2018			2017		
	Distributor	Direct	Total	Distributor	Direct	Total
<b>Americas:</b>						
United States	\$100,883	\$115,262	\$216,145	\$98,661	\$105,549	\$204,210
Other	12,762	10,904	23,666	15,491	12,093	27,584
Total Americas	113,645	126,166	239,811	114,152	117,642	231,794
EMEA	141,207	63,611	204,818	107,188	61,527	168,715
APAC:	7,116	40,821	47,937	8,395	33,934	42,329
Total net revenues	\$261,968	\$230,598	\$492,566	\$229,735	\$213,103	\$442,838

## Customer Concentrations

The Company performs ongoing credit evaluations of its customers and generally does not require collateral in exchange for credit.

The following table sets forth major customers accounting for 10% or more of the Company's net revenues:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2018	2017	2018	2017
Tech Data Corporation	22%	12%	19%	12%
Westcon Group Inc.	15%	14%	14%	15%
Jenne Corporation	12%	*	12%	10%

The following table sets forth major customers accounting for 10% or more of the Company's accounts receivable balance:

	December 31, 2018	June 30, 2018
Westcon Group Inc.	23%	*
Tech Data Corporation	22%	17%
Jenne Corporation	*	13%

\* Less than 10% of accounts receivable

#### 4. Business Combinations

##### Fiscal 2018 Acquisitions

##### Data Center Business

The Company completed its acquisition of the data center business (the "Data Center Business") of Brocade Communication Systems, Inc.'s ("Brocade") on October 27, 2017 (the "Data Center Closing Date"), pursuant to an Asset Purchase Agreement (the "Data Center Business APA") dated as of October 3, 2017, by and between the Company and Brocade for an aggregate purchase consideration of \$84.3 million. Under the terms and conditions of the Data Center Business APA, the Company acquired customers, employees, technology and other assets of the Data Center Business as well as assumed certain contracts and other liabilities of the Data Center Business.

The following table below summarizes the final allocation of the tangible and identifiable intangible assets acquired and liabilities assumed (in thousands):

	Final Allocation
Accounts receivables	\$ 33,488
Inventories	19,934
Prepaid expenses and other current assets	988
Property and equipment	(a) 20,220
Other assets	4,734
Accounts payable and accrued expenses	(16,494 )
Deferred revenue	(33,025 )
Net tangible assets acquired	29,845
Identifiable intangible assets	32,800
Goodwill	(a) 21,692
Total intangible assets acquired	54,492
Total net assets acquired	\$ 84,337

(a) Includes an adjustment after the measurement period to record \$1.3 million of additional property and equipment acquired at an international location.

Campus Fabric Business

The Company completed its acquisition of Avaya Inc.'s ("Avaya") fabric-based secure networking solutions and network security solutions business (the "Campus Fabric Business") on July 14, 2017, (the "Campus Fabric Business Closing Date") pursuant to an Asset Purchase Agreement (the "Campus Fabric Business APA") dated March 7, 2017. Under the terms and conditions of the Campus Fabric Business APA, the Company acquired the customers, employees, technology and other assets of the Campus Fabric Business, as well as assumed certain contracts and other liabilities of the Campus Fabric Business, for total consideration of \$79.4 million.

The following table below summarizes the final allocation of the tangible and identifiable intangible assets acquired and liabilities assumed (in thousands):

	Final Allocation
Accounts receivables	\$ 19,527
Inventories	14,165
Prepaid expenses and other current assets	240
Property and equipment	5,406
Other assets	7,009
Accounts payable and accrued expenses	(31,670 )
Deferred revenue	(8,994 )
Other long-term liabilities	(5,849 )
Net tangible assets acquired	(166 )
Identifiable intangible assets	41,300
In-process research and development	2,400
Goodwill	35,892
Total intangible assets acquired	79,592
Total net assets acquired	\$ 79,426

#### Capital Financing Business

On December 1, 2017, Company completed its acquisition of a capital financing business (the “CF Business”), pursuant to a Bill of Sale and Assignment and Assumption Agreement (the “Assumption Agreement”) between the Company and Broadcom. Under the terms and conditions of the Assumption Agreement, the Company acquired customers, employees, contracts and lease equipment of the CF Business equal to the earn out payments to Broadcom of 90% of acquired financing receivables to be collected commencing at the closing date.

Net assets acquired included financing receivables of \$13.7 million, lease equipment of \$3.5 million and identifiable intangible assets of \$0.8 million, and the fair value of the contingent consideration was \$13.0 million. As the preliminary fair value of the net assets acquired exceeded the fair value of the purchase consideration, the Company recorded a bargain purchase gain of \$5.0 million.

#### Pro forma financial information

The following unaudited pro forma results of operations are presented as though the acquisitions of the Data Center Business, CF Business and Campus Fabric Business had occurred as of the beginning of fiscal 2017 presented after giving effect to purchase accounting adjustments relating to inventories, deferred revenue, depreciation and amortization on acquired property and equipment and intangibles, acquisition costs, interest income and expense and related tax effects.

The pro forma results of operations are not necessarily indicative of the combined results that would have occurred had the acquisition been consummated as of the beginning of fiscal 2017, nor are they necessarily indicative of future operating results. The unaudited pro forma results do not include the impact of synergies, nor any potential impacts on current or future market conditions which could alter the unaudited pro forma results.

The unaudited pro forma financial information for the three and six months ended December 31, 2017, combines the historical results for Extreme for those periods, which include the results of the Data Center Business and CF Business subsequent to the acquisition date, with their historical results up to the acquisition date.

Pro forma results of operations from the Data Center Business, CF Business and Campus Fabric Business acquisitions included in the pro forma results of operations for the three and six months ended December 31, 2017, have not been adjusted for the adoption of Topic 606 because the Company determined it is impractical to estimate the impact of the adoption.

The following table summarizes the unaudited pro forma financial information (in thousands, except per share amounts):

	Three Months Ended December 31,	Six Months Ended December 31,
	2017	2017
Net revenues	\$ 252,532	\$ 537,040
Net income (loss)	\$ 1,152	\$ (7,622 )
Net income (loss) per share - basic	\$ 0.01	\$ (0.07 )
Net income (loss) per share - diluted	\$ 0.01	\$ (0.07 )
Shares used in per share calculation - basic	113,621	112,931
Shares used in per share calculation - diluted	119,656	112,931

## 5. Balance Sheet Accounts

### Cash and Marketable Securities

The following is a summary of cash and marketable securities (in thousands):

	December 31,	June 30,
	2018	2018
Cash	\$ 140,643	\$ 121,139
Marketable securities (consisting of available-for-sale securities)	428	1,459
Total cash and marketable securities	\$ 141,071	\$ 122,598

Marketable equity securities are recorded in “Prepaid expense and other current assets” in the accompanying condensed consolidated balance sheets as these securities are publicly-traded with readily determinable values. Marketable equity securities are classified as available-for-sale and reported at fair value with unrealized gains and losses included in “Other (expense) income, net” in the accompanying condensed consolidated statements of operations.

### Inventories

The Company values its inventory at lower of cost or net realizable value. Cost is computed using standard cost, which approximates actual cost, on a first-in, first-out basis. The Company has established inventory allowances when conditions exist that suggest that inventory may be in excess of anticipated demand or is obsolete based upon assumptions about future demand. At the point of the loss recognition, a new, lower-cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. Any written down or obsolete inventory subsequently sold has not had a material impact on gross margin for any of the periods presented.

Inventories consist of the following (in thousands):



December 31, June 30,

	2018	2018
Finished goods	\$ 44,179	\$49,393
Raw materials	14,118	14,474
Total Inventories	\$ 58,297	\$63,867

#### Property and Equipment, Net

Property and equipment consist of the following (in thousands):

December 31, June 30,

	2018	2018
Computers and equipment	\$ 70,121	\$60,677
Purchased software	22,968	21,389
Office equipment, furniture and fixtures	11,564	14,980
Leasehold improvements	51,167	50,070
Total property and equipment	155,820	147,116
Less: accumulated depreciation and amortization	(81,321 )	(68,597 )
Property and equipment, net	\$ 74,499	\$78,519

## Deferred Revenue

Deferred revenue represents amounts for (i) deferred maintenance and support revenue and (ii) other deferred revenue including professional services and training when the revenue recognition criteria have not been met.

## Guarantees and Product Warranties

The Company's standard hardware warranty period is typically 12 months from the date of shipment to end-users and 90 days for software. For certain products, the Company offers a limited lifetime hardware warranty commencing on the date of shipment from the Company and ending five (5) years following the Company's announcement of the end of sale of such product. Upon shipment of products to its customers, the Company estimates expenses for the cost to repair or replace products that may be returned under warranty and accrue a liability in cost of product revenue for this amount. The determination of the Company's warranty requirements is based on actual historical experience with the product or product family, estimates of repair and replacement costs and any product warranty problems that are identified after shipment. The Company estimates and adjusts these accruals at each balance sheet date in accordance with changes in these factors.

The following table summarizes the activity related to the Company's product warranty liability during the three and six months ended December 31, 2018 and 2017 (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2018	2017	2018	2017
Balance beginning of period	\$12,601	\$ 13,499	\$12,807	\$ 10,584
Warranties assumed due to acquisitions	—	526	—	3,682
New warranties issued	4,145	1,657	7,867	3,929
Warranty expenditures	(3,938 )	(2,672 )	(7,866 )	(5,185 )
Balance end of period	\$12,808	\$ 13,010	\$12,808	\$ 13,010

To facilitate sales of its products in the normal course of business, the Company indemnifies its resellers and end-user customers with respect to certain matters. The Company has agreed to hold the customer harmless against losses arising from a breach of intellectual property infringement or other. These agreements may limit the time within which an indemnification claim can be made and the amount of the claim. It is not possible to estimate the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements have not had a material impact on its operating results or financial position.

## Other long-term liabilities

The following is a summary of long-term liabilities (in thousands):

December 31, June 30,

	2018	2018
Acquisition related deferred payments, less current portion	\$ 11,442	\$13,251
Contingent consideration obligations, less current portion	4,095	4,898
Other contractual obligations, less current portion	29,647	31,200
Other	15,527	9,751
Total other long-term liabilities	\$ 60,711	\$59,100

### Concentrations

The Company may be subject to concentration of credit risk as a result of certain financial instruments consisting of accounts receivable and marketable securities. The Company does not invest an amount exceeding 10% of its combined cash or cash equivalents in the securities of any one obligor or maker, except for obligations of the United States government, obligations of United States government agencies and money market accounts.

## 6. Fair Value Measurements

A three-tier fair value hierarchy is utilized to prioritize the inputs used in measuring fair value. The hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels are defined as follows:

Level 1 Inputs - unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 Inputs - quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument; and

Level 3 Inputs - unobservable inputs reflecting the Company's own assumptions in measuring the asset or liability at fair value.

The following table presents the Company's fair value hierarchy for its financial assets and liabilities measured at fair value on a

recurring basis (in thousands):

December 31, 2018	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Investments:				
Marketable securities	\$428	\$ —	\$ —	\$428
Total assets measured at fair value	\$428	\$ —	\$ —	\$428
<b>Liabilities</b>				
Acquisition-related contingent consideration obligations	\$ —	\$ —	\$8,649	\$8,649
Total liabilities measured at fair value	\$ —	\$ —	\$8,649	\$8,649

June 30, 2018	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Investments:				
Marketable securities	\$1,459	\$ —	\$ —	\$1,459
Total assets measured at fair value	\$1,459	\$ —	\$ —	\$1,459
<b>Liabilities</b>				
Acquisition-related contingent consideration obligations	\$ —			