

# QUEST SOFTWARE INC (QSFT)

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## 10-K

Annual report pursuant to section 13 and 15(d)  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-K**

(Mark One)

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

For the Fiscal Year Ended December 31, 2009

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 No. 000-26937

**QUEST SOFTWARE, INC.**  
(Exact Name of Registrant as Specified in its Charter)

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**33-0231678**  
(I.R.S. Employer  
Identification No.)

**5 Polaris Way**  
**Aliso Viejo, California**  
(Address of Principal Executive Offices)

**92656**  
(Zip Code)

**Registrant's Telephone Number, Including Area Code: (949) 754-8000**

**Securities Registered Pursuant to Section 12(b) of the Act:**

<u>Title of Each Class</u>	<u>Name of Exchange on Which Registered</u>
Common Stock	The Nasdaq Stock Market LLC (Nasdaq Global Select Market)

**Securities Registered Pursuant to Section 12(g) of the Act: None**

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

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

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

Indicate by check mark 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (do not check if a smaller reporting company) Smaller reporting company

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately \$0.9 billion as of June 30, 2009, based upon the closing sale price reported for that date on The Nasdaq Global Select Market.

As of February 11, 2010, 90,720,148 shares of the Registrant's common stock were outstanding.

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**Documents Incorporated by Reference**

Portions of the Registrant's Definitive Proxy Statement, to be delivered to stockholders in connection with the Registrant's 2010 Annual Meeting of Stockholders, are incorporated by reference into Part III of this Report.

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### Forward-Looking Statements

Discussions under the captions “*Business*,” “*Risk Factors*,” and “*Management’s Discussion and Analysis of Financial Condition and Results of Operations*” and other parts of this Annual Report on Form 10-K include or may include forward-looking statements within the meaning of the federal securities laws. We have based these forward-looking statements on currently available information and our current beliefs, expectations and projections about future events. All forward-looking statements contained herein are subject to numerous risks and uncertainties. Our actual results and the timing of certain events could differ materially from those projected in the forward-looking statements due to a number of factors including those discussed under the heading “*Risk Factors*” in this Report and in our other filings with the Securities and Exchange Commission (“SEC”). Should one or more of these risks or uncertainties materialize, or should the underlying estimates or assumptions prove incorrect, actual results or outcomes may vary significantly from those suggested by forward-looking information. Any forward-looking statements contained in this document are based on information available at the time of filing and we make no undertaking to update any of these forward-looking statements.

## PART I

### Item 1. *Business*

#### Overview

Quest Software, Inc. (“Quest,” “Quest Software,” the “Company,” “we,” “us” or “our”) designs, develops, markets, distributes and supports enterprise systems management software products. Our goal is to provide our customers with systems management products that improve the performance, productivity and reliability of their software applications and associated software infrastructure components such as databases, application servers, operating systems and virtual environments. Quest is an “Independent Software Vendor,” or “ISV,” a company whose products are designed to support or to interact or interoperate with other vendors’ software or hardware platforms. As such, we continually strive to innovate and evolve our product portfolio to support the dynamic nature of our markets as well as those of our customers’ IT environments. Our success has been predicated on identifying large and evolving markets, developing and acquiring new products and technologies and then leveraging our sales organization and installed base of customers to further our growth. While the Company began as a provider of software tools and solutions for the Oracle database market, which we call our Database Management market, we subsequently expanded our offerings into other adjacent markets such as Application Management, Windows Management and Virtualization Management.

We generate revenues by licensing our software products, principally on a perpetual basis. In addition to perpetual software licenses, we sell a small amount of time-based software licenses (or term licenses) wherein customers pay a single fee for the right to use the software and receive maintenance for a defined period of time. We also provide support, maintenance and implementation services for these products. As such, our reportable operating segments are Licenses and Services. The Licenses segment develops, and markets and sells licenses to use, our software products. The Services segment provides post-sale support for software products and fee-based training and consulting services related to our software products. We have a large product portfolio of high-value products that include very technically complex solutions focused on improving the management and performance of mission-critical software applications and the underlying component infrastructure. We also have volume products and software tools that enable our customers to reduce capital and operating expenditures or leverage existing investments in personnel and IT systems. Our active acquisition program is an important element of our corporate strategy and has served as a mechanism to broaden our product portfolio and enter new markets. This is evidenced by our entrance into the Application Management, Windows Management and Virtualization Management markets, through a series of acquisitions which served to propel the Company beyond its Database Management roots. Within the last five fiscal years, we have invested approximately \$487 million, in the aggregate, to acquire twenty-two companies. Our acquisition strategy is directed to broaden our product portfolio and strengthen our competitive position against both direct competitors and the continual improvements made by the platform vendors.

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Our primary portfolio of software products includes software solutions grouped into four categories: 1) Application Management, 2) Database Management, 3) Windows Management and 4) Virtualization Management. Examples of the benefits delivered by our products' include:

- improved application and database performance for large-scale complex mission-critical type systems;
- the ability to manage multi-tiered heterogeneous operating environments with integrated dashboards and metrics to leverage existing investments and support new technologies;
- comprehensive migration, management and integration capabilities to simplify, automate and secure an organization's Windows infrastructure; and
- solutions for business continuity, high availability and disaster recovery for virtualized infrastructure environments.

Application Management is a core competency and is predicated on ensuring performance and availability of mission-critical applications throughout their life cycle. We have made significant investments in the form of hiring experienced developers, product managers and others with marketing expertise to improve and broaden our suite of solutions for Application Management, and our aforementioned acquisition program. Our products are focused on the monitoring and performance management of customers' primary enterprise software applications, whether packaged or custom-developed. These applications are complex in that they traverse every layer of the IT stack including storage, databases, application servers, web servers and the actual network itself all of which adds to the complexity of managing this environment. Historically, the management of these applications was isolated among each physical layer of the technology stack. As applications themselves became modular over time and the need for our customers to improve application service levels became a market requirement, we embarked on a comprehensive research and development ("R&D") effort to build new product solutions to unify a set of existing tools and create new functionality to support the current customer demand profile. Today, customers require a solution which not only manages application service levels and helps diagnose the root causes of performance problems, but also integrates and supports the means to provide necessary corrective action. Our success within the market and current strategic focus for building increased capabilities is based upon the fact that packaged and custom-developed applications run within multi-vendor infrastructure environments. This means that customers have a myriad of platforms and investments they have deployed over the years and require tools that manage the breadth and depth of their environments. Today, the advent of virtualization has created another facet such that an IT professional who is charged with managing this infrastructure must rely on a set of tools and solutions to ensure performance levels of the application. Our flagship Foglight<sup>®</sup> solution provides functionality that enhances visibility for an administrator who may be working within an environment that encompasses both physical and virtual applications running concurrently. From a breadth perspective, our products manage custom web-based applications written in Java and .NET as well as packaged applications, such as PeopleSoft, Oracle E-Business Suite and SAP. From a depth perspective, our products cover key databases such as Oracle, DB2 and SQL Server as well as Oracle and IBM application servers and all key web servers in today's market. In 2009, we expanded our solution with the acquisition of PacketTrap Networks to encompass the network layer via the Perspective product line. By integrating network level with application aware monitoring for our customers, we are able to provide a comprehensive view of performance, capturing activity throughout the key elements of the infrastructure.

Database Management is a market where we initially built an industry-leading reputation and today continues to represent a core technical strength for the Company. Our Database Development products have gained wide acceptance in the market and continue to generate a significant amount of cash flow for the company. As databases continue to grow in size, complexity and mission criticality, the environments in which they are deployed continuously require higher levels of service and thus more advanced tools and solutions to support their operation. As such, the predominant customer environment is comprised of a heterogeneous mix of

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database platforms which are fronted by a wide array of application and web servers all of which must be orchestrated to support a business service. This complex environment requires a vendor to offer a broad tool-set to be successful in the market. Our Database Management products are marketed to database administrators (“DBA”) and developers and are designed to improve database performance and to increase the level of productivity for those database developers responsible for the efficient and accurate deployment of mission-critical databases. Historically, our products and early success were focused within the Oracle segment of the database market and we are currently recognized as a leading Oracle ISV. Several years ago, Oracle introduced products that compete directly with our Shareplex<sup>®</sup>, Quest Central<sup>®</sup> for Oracle and TOAD<sup>®</sup> products. This in turn has negatively impacted our ability to grow license revenues for certain of these products. To diversify our database business and enhance our ability to sustain revenue growth, and in direct response to the heterogeneous nature of our customers’ database profile, we embarked on a strategy to build and acquire products which addressed similar customer needs on other database platforms such as IBM’s DB2 and Microsoft’s SQL Server. More specifically, in 2001, we introduced database management tools offerings for DB2 and in the last few years, we entered the SQL Server market with our acquisition of ImcEDA Software, Inc. in 2005. ImcEDA Software expanded our offerings by delivering products for backup, recovery and security auditing solutions for SQL Server.

Our Windows Management product portfolio has been one of the key drivers of our revenue growth during the last few years. Our portfolio of products has been built by both internal development and key acquisitions such as FastLane Technologies, Inc., Aelita Software Corporation, ScriptLogic Corporation and NetPro Computing, Inc. Our Windows Management products are focused within five areas of the Microsoft infrastructure including Active Directory, Exchange, Windows Server, Sharepoint and the Windows desktop. Our strategy has been to identify opportunities within this framework and to create incremental value-add products which broaden the core functionality a customer receives “out of the box”. A portion of our product portfolio is focused on assisting customers in the migration process from one platform to the next within the Windows infrastructure but we also help customers migrate from non-Windows platforms to the associated Windows platform. For example, our migration products can assist an IT professional in moving his or her firm’s resources to the current version of Active Directory to take advantage of new features from Microsoft that were not present in an earlier version or from another directory based product to a current Active Directory platform. Another portion of our portfolio is targeted at IT professionals who manage these core elements of the Windows infrastructure such as Windows Server, Exchange, Active Directory and Sharepoint and is predicated on providing incremental management capabilities to streamline administration, increase system availability, optimize storage and enhance security. The acquisition of ScriptLogic in August of 2007 added core products to support desktop management including the centralized configuration and management of an end user’s environment, software inventory and application deployment and remote administration to allow an administrator the ability to manage his or her enterprise desktops in an efficient manner. In September 2008 we acquired NetPro Computing, Inc., an Active Directory management and administration tools vendor and subsequently integrated its operations into our Windows Management operations thereby expanding our customer footprint and broadening and enhancing our portfolio of solutions.

Our Virtualization Management product portfolio was built initially through our investment in Vizioncore during 2005 and supplemented by our acquisitions of Invirtus and Provision Networks during 2007. In December of 2007 we acquired the remaining minority interest in Vizioncore. As Virtualization Management is deployed more broadly within production servers and the datacenter, the need to manage this environment continues to emerge. Along the lines similar to that of the physical infrastructure, operational requirements and administration of these platforms have given rise to the need for Virtualization Management tools, thereby creating product categories for virtualization utilities, disaster recovery, application monitoring and virtual desktop infrastructure. The taxonomy of the Virtualization Management market is following the development of paths taken previously where platform companies create the delivery mechanism and partner with other third-party vendors such as Quest to support their platform. Today, the platform market leader is VMware, but with Microsoft and Citrix/Xensource now in the market, it is expected that “cross-platform” tools will emerge to support the requirements of the datacenter such as provisioning, monitoring, reporting, disaster recovery and the typical functions found in

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today's physical environment. We believe that the depth and breadth of our management capability across the entire IT stack uniquely positions Quest to become a preferred provider of these tools.

We invest a significant portion of our cash flow into our product development and management capabilities, and just over one-third of our employees work in product development, quality assurance or technical documentation roles. Given the need for many of our products to perform across different combinations of existing infrastructure within our customers' IT configurations, we spend a significant amount of our R&D efforts to ensure that our products work consistently within heterogeneous IT environments. For example, a particular customer that deploys an Oracle financial application on an Oracle application server with an Oracle database will generally get different performance characteristics than another customer would if it deployed the same application on an IBM application server with a DB2 database. We test, evaluate and build capabilities within our products that help our customers manage these subtle differences, which requires an extended effort to capture the potential and associated combinations and permutations of our customers' infrastructures. A large proportion of our R&D organization supports and develops existing product lines. As we increasingly seek new product opportunities within emerging markets, we have at times successfully leveraged our expertise from current products. An example of this is our entrance into the Sharepoint market with products that share technical aspects found in a few of our other products. In other instances where time to market is essential, we have supplemented our own technical efforts with technology and products from acquired companies. For example, key technology components of our vFoglight™ Virtualization Management capabilities are derived from the inter-relationship between the Vizioncore and Quest R&D teams.

In building our products, we stress technical innovation and depth, ease of deployment, ease of use and tangible, readily articulated and measurable customer benefits. We sell our products primarily via our direct field sales force and, increasingly, our telesales organization, supplemented by indirect sales through resellers and distributors. We are a global company with offices located throughout the world.

We were incorporated in California in 1987 and reincorporated in Delaware in 2009. Our principal offices are located at 5 Polaris Way, Aliso Viejo, California, 92656. We operate on a calendar fiscal year.

## **Solutions, Products and Services**

### *Solutions*

We develop innovative products that increase the performance of applications, databases and infrastructure and improve the productivity of the people who manage them, enabling customers to solve some of today's toughest IT challenges. IT organizations today rely on Quest to help achieve compliance, manage complex applications and simplify identity management.

### *Products*

We market products grouped along four main categories: 1) Application Management, 2) Database Management, 3) Windows Management and 4) Virtualization Management. Major products in these categories are described as follows.

### **Application Management**

Our Application Management products are geared to support the spectrum of professionals all the way from the Java application developer to the CIO. The primary focus of these products is to automate the tasks performed by the IT organization to manage the complexity of the application lifecycle. Our flagship product for Application Management is Foglight, while our Stat®, JClass®, PerformaSure® and JProbe® products, the latter two focused on Java applications, comprise the remainder of our offerings.

*Foglight.* Foglight provides a complete view of applications to proactively detect and diagnose the root cause of performance and availability problems in a priority that makes sense to the business. Foglight correlates

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relationships from multiple sources and maps the metrics into a dashboard providing the IT user with an understanding of how performance and availability of services are impacting the business and what an end-user view would appear to be experiencing. It accomplishes this by depicting the technology that is contributing to application performance issues and availability including the database and the physical and virtual infrastructure running behind the scenes.

*JProbe* is an enterprise-class Java profiler which provides intelligent diagnostics on memory usage, performance and test coverage, allowing developers to pinpoint and repair the root cause of application code performance and stability problems that obstruct component and integration integrity.

*PerformaSure* reconstructs the execution path of end-user request transaction. It combines transactional data with infrastructure metrics to help development and QA teams measure and analyze Java enterprise application performance. PerformaSure integrates with JProbe to support performance testing and tuning down to the line of code.

*Perspective (PacketTrap)*. Perspective provides performance management and monitoring across the network to identify bottlenecks and help solve traffic issues reducing the mean-time-to-resolution of network incidents.

*Stat<sup>®</sup> ACM*. Stat ACM (Application Change Management) helps IT managers lower their PeopleSoft and Oracle E-Business Suite total cost of ownership by providing end-to-end change management and version control. It helps keep up with change configurations and customizations so that they are updated, approved and deployed to instances throughout the application implementation lifecycle. By tracking version control and versioning capabilities as well as process management, change request tracking, requirements management and distributed development support, Stat ACM adds visibility, hides complexity and automates workflow through an easy-to-use GUI (graphical user interface) environment.

### **Database Management**

A company's database management systems represent some of the most complex and critical components within its infrastructure. As companies broaden their utilization of databases from multiple platform vendors, database administrators and developers are required to learn to use non-integrated toolsets across their environment to manage the performance and complexity of this tier. Our market leading database management products support the needs of today's database developers and DBAs by providing superior domain capabilities and cross-platform productivity tools within an integrated console to improve database quality and performance.

*Database Development*. These tools improve the productivity and capability of database developers working in the Oracle Procedural Language (PL)/SQL environment. The primary products in this product family are TOAD and SQL Navigator<sup>®</sup>. We provide a complete and integrated development environment for coding stored procedures, schemas and SQL scripts from one intuitive graphical user interface. Debugging, SQL tuning, change analysis, and general administration features improve the quality and performance of database applications before they enter production.

*The Quest Central product family for Oracle, SQL Server, DB2 and Sybase*. Administering large heterogeneous database systems in production involves many tedious, error-prone and repetitive tasks. To streamline and automate these tasks and improve the accuracy and effectiveness of database administrators, we have developed the Quest Central product family. Quest Central is a suite of tools that enables the DBA to identify the cause of performance problems without manual trial and error or decentralized tools. These products provide details on historical performance analysis and metrics to provide insight as to how performance issues occur. The Quest Central family of products provides a consistent presentation delineating the performance management of multiple databases enabling DBAs to manage more databases without adding resources. We are currently marketing and selling Quest Central DBA product families for Oracle, Microsoft SQL Server, DB2 and Sybase databases.

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*SharePlex*<sup>®</sup> SharePlex provides real-time replication of Oracle databases for customers who need to ensure a current, secondary copy of their transactional Oracle database is available if the primary database is unavailable. Many customers use SharePlex to offload management reporting, so the activity no longer compromises the performance of transaction processing. Further, SharePlex is also frequently used to eliminate end user disruption by providing continuous access to data during the migration of operating systems, hardware platforms and major application releases.

*LiteSpeed*<sup>®</sup> for SQL Server. LiteSpeed offers significant benefits to the entire organization accountable for managing Microsoft's SQL Server databases, including backups, business operations and storage management. Benefits range from time and cost savings for the IT staff on a daily basis and for IT management to support the organization's overall mission. LiteSpeed for SQL Server dramatically reduces storage costs and backup/recovery windows by compressing data in significantly less time than other backup solutions. The LiteSpeed for SQL Server backup engine compresses data up to 95 percent, in half the time required by other backup solutions. LiteSpeed speeds up restore times through its ability to recover individual database objects and encapsulate complete database restores into a single file.

### **Windows Management**

Microsoft applications and their associated infrastructure platform continue to be a global standard. Our products enable IT personnel to simplify, automate and secure their infrastructure with management, migration and integration capabilities for this environment. Our products are focused on key elements of the infrastructure including Microsoft's Active Directory, Exchange, Windows Server, Sharepoint and the Windows desktop. Our Windows Management products include:

*Quest*<sup>®</sup> *Management for Active Directory*. Microsoft Active Directory is technically complex and requires meticulous management to ensure the accuracy and security of its content across the entire enterprise. Quest Management for Active Directory is a set of products that provide diagnostics, recovery, detailed auditing, group policy management, reporting, self-service, role-based delegation and user provisioning. Our products offer a practical approach to automated user provisioning and provide a comprehensive delegation model, consolidated reporting and auditing and expert advice on problem resolution for teams managing complex Microsoft infrastructures.

*Quest*<sup>®</sup> *Management for Exchange*. E-mail growth is leading to increased traffic, storage and support issues, including compliance. Quest Management for Exchange provides a comprehensive set of tools to migrate, store, recover and intelligently manage growth and the related spending for mission-critical Exchange infrastructures. Our products enable mailbox and public folder management, distribution list management, usage analysis, and diagnostics to optimize investment and performance in Exchange environments. This allows administrators and managers to better target investments, enforce corporate policies, enhance customer service, reduce administrative costs and improve troubleshooting efficiency. Additional functionality and integration is available for customers who have chosen Microsoft Operations Manager (MOM) as their unattended monitoring solution.

*Quest*<sup>®</sup> *Migration Suite for Active Directory*. The Quest Migration Suite for Active Directory is a ZeroIMPACT<sup>™</sup> solution for planning and executing migration projects to Active Directory from Windows NT or Novell NDS. It supports thorough migration planning and Active Directory pruning and grafting – with no interruption to business workflow. Its distributed processing and robust project management features simplify migration processes.

*Quest*<sup>®</sup> *Migration Suite for Exchange*. The Quest Migration Suite for Exchange is also a ZeroIMPACT solution that helps plan and execute migration projects to Exchange 2000/2003 from Exchange 5.5 or 2000. In

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addition this product enables customers to migrate from a Domino/Notes or GroupWise environment to Exchange. It helps to ensure seamless migration processes and provides a centralized place for project management as well as analysis tools and reporting mechanisms.

*Quest® InTrust®.* Quest InTrust offers auditing and policy compliance to help systems administrators securely collect, store and report on event data to meet the needs of external regulations, internal policies and best practices.

*Quest® Authentication Services.* Quest Authentication Services, allows Unix and Linux to take advantage of the access, authentication and authorization within Active Directory. This product functionally extends Active Directory's security, compliance and authentication capabilities into the extended enterprise.

*Desktop Authority®. ScriptLogic®.* Desktop Authority centralizes control over the desktop combining into one comprehensive solution the functionality to integrate configuration, inventory, reporting, patch management, anti-spyware, device lockdown, power management and remote management into a single solution.

### **Virtualization Management**

Our Virtualization Management products are categorized as server-side, desktop and storage management solutions and help companies safeguard and optimize their virtualized environments. Our products support essential IT strategies including business continuity, high availability, disaster recovery and desktop and application lifecycle management. Our Virtualization Management products include:

*vFoglight.* vFoglight is a monitoring tool for the VMware ESX Server that provides real-time and historical monitoring and performance for virtual environments. In addition to performance monitoring, vFoglight provides a chargeback solution for the VMware ESX Server environment to apportion those costs to virtual machines based on utilization.

*vRanger™ Pro.* vRanger Pro is a backup and restore solution for virtualized environments. Administrators can schedule regular image-level backups of virtual or physical machines — while the machine is still running. Images can be stored either locally in the SAN or sent as compressed files over a WAN to remote locations to support disaster recovery strategies.

*vWorkspace.* vWorkspace is a virtual desktop management platform which simultaneously supports and fully integrates and automates application delivery, desktop deployment, and management from Microsoft Hyper-V, VMware ESX, Virtual Iron and Parallels Virtuozzo Containers.

*Quest® Storage Horizon® and vOptimizer Pro.* Storage Horizon and vOptimizer Pro are virtual storage management solutions that help IT organizations manage capacity and reclaim over-allocated virtual machine storage.

### **Services**

#### **Customer Support Services**

A high level of product maintenance and technical support is critical to the successful marketing and sale of our products and the development of long-term customer relationships. We have a reputation for providing a high level of customer support and believe this is a competitive differentiator. Initial enrollment in our customer support program for one year is bundled with a sale of a software license and entitles a customer to problem resolution services, new functional enhancements of a product, and ongoing compatibility with new releases of the database, application or other platforms supported by the product; annual renewals are offered thereafter. We also offer multi-year support. Customer support is provided domestically through our offices in Aliso Viejo and internationally through our offices in Europe, Canada and Singapore.

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### **Consulting and Training Services**

Our consulting and training services include pre- and post-sales consulting, as well as education and training. Our consulting services include a wide range of offerings such as assistance with optimization, migration, simplifying an infrastructure or increasing its responsiveness, and installation and systems integration for the rapid deployment of Quest products. We offer our consulting and training services with the initial deployment of our products as well as on an ongoing basis to address the continuing needs of our customers. Our consulting and training services staff is located throughout the Americas, Europe and APAC, enabling us to perform installations and respond to customer demands rapidly across our global customer base.

We also have relationships with resellers, professional service organizations and system integrators including Accenture, Avanade, IBM and others, which include participation in the deployment of our products to customers. These relationships help promote Quest products and provide additional technical expertise to enable us to provide the full range of consulting and training services our customers require to deploy our products.

We offer product education courses to train our business partners and customers on the implementation and use of our products. Product training is provided at our headquarters, on-line and at customer sites as well as other regional and international locations.

### **Sales, Marketing and Distribution**

We market and sell our products and services worldwide primarily through our direct sales organization, our telesales organization and, increasingly, via indirect sales channels with a group of value added resellers (VAR's) and distributors. Given the nature of our sales model and product price points, we generally transact significant sales volume at the end of a quarter with the largest amount of the yearly volume occurring during the fourth quarter. However, our government business typically operates within a timeline concurrent with the government budget whereby we see the most significant impact during the third quarter. At December 31, 2009, we had approximately 1,400 full-time sales and marketing employees, of whom approximately 800 were full-time, sales representatives. We have approximately 300 pre-sales systems engineers who work with our field sales teams to provide technical assistance and demonstrations to sales prospects. We have continued to invest in this area and have supplemented our direct sales organization with an indirect sales channel that includes companies such as Dell and IBM in addition to resellers focused on governmental business. This activity requires broad based programs to recruit, manage and expand our support operations to grow these relationships. We also employ local resellers in certain international territories not covered by our local sales offices.

We have sales offices in many major cities of the United States, Europe, Asia and Australia to facilitate close contact between current and potential customers and our field sales organization. Sales originated outside of the United States are generally denominated in the foreign currency of the country of origin. As such, we have exposure to fluctuations in foreign exchange rates, which for the year ending December 31, 2009 contributed approximately \$10.4 million to our overall reduction in total revenues, when comparing 2009 rates to 2008.

Our marketing efforts are designed to create awareness, generate leads, and assist the worldwide sales organization with converting leads into closed sales. Marketing initiatives and programs focus on how Quest products address critical issues facing today's IT buyers. We use a full complement of marketing vehicles including industry trade shows and conferences, user groups and discussion forums, educational white papers and technical briefs, electronic and print advertising, webcasts, electronic direct marketing and online advertising. Strategic and channel partners often assist us with the development, funding and execution of our marketing programs. Targeted campaigns and sales programs are developed based on objective, audience and product mix and are executed in our regions around the world to maximize revenue opportunities as quickly as possible.

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For information regarding our segment revenue and revenue by geographic area, please refer to Note 3 – Segment Reporting of our Notes to Consolidated Financial Statements.

### **Research and Development**

We believe that strong research and product development capabilities are essential to enhancing our core technologies and developing additional products. Quest products typically exhibit innovative capabilities, strong product engineering and rich user interfaces. Our commitment to ongoing product development is reflected in our investments in R&D, which were \$144.4 million, \$153.5 million and \$122.6 million for the years ended December 31, 2009, 2008 and 2007, respectively. We have actively recruited key software engineers and developers with expertise in the areas of Oracle technologies, Java, Microsoft infrastructure technologies, ERP, Virtualization and CRM systems. We have also built-up these competencies through acquisitions. In addition to the U.S., we have significant product development operations in Canada, Australia, Russia, Israel and China. Our internal R&D is supplemented by our acquisition strategy that is primarily focused on young enterprises with recently developed and in-process technologies.

### **Competition**

The market for enterprise systems management solutions is intensely competitive and characterized by rapidly changing technology and evolving standards. We expect competition to continue to increase both from existing competitors and new market entrants. We believe that our ability to compete effectively depends on many factors, including:

- the ease of use, performance, features, price and reliability of our products as compared to those of our competitors;
- the value proposition of our products in terms of return on investment and/or reduced cost of ownership;
- the timing and market acceptance of new products and enhancements to existing products developed by us and our competitors;
- the quality of our customer support; and
- the effectiveness of our sales and marketing efforts.

We compete in some instances with the platform vendors of databases, applications, infrastructure and other systems that our products are designed to support. If these vendors include similar or equivalent functionality relative to our software as standard features of their underlying product, our revenues could be adversely affected. For example, competition with Oracle over the last several years has materially reduced license revenues generated by certain of our Database Management products including SharePlex and Quest Central for Oracle and has negatively impacted the growth rate of license revenues associated with our Oracle Database Development tools. Microsoft has continually upgraded the functionality of its platform offerings, which we believe will increase competitive pressure for our products in the future.

We also compete with other vendors of database, application, windows and virtualization management tools. Public and private companies with whom we compete include:

- Oracle, BMC Software and CA in the database management product area;
- IBM/Tivoli, Hewlett Packard/Mercury, CA, Compuware and BMC Software in the application management product area;
- Symantec and NetIQ in the Windows management product area; and
- VMware and Citrix in the Virtualization management product area.

Some of our competitors and potential competitors have greater name recognition, a larger installed customer base company-wide and significantly greater financial, technical, marketing, and other resources than

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we do. Competitors may also be able to respond more quickly to new or emerging technologies and changes in customer requirements or devote greater resources to the development, promotion and sale of their products than we can.

Because there are relatively low barriers to entry in the software market, we may encounter additional competition as other established and emerging companies enter our field and introduce new products and technologies. Venture capitalists and others have funded numerous systems management companies. Accordingly, it is likely that new competitors or alliances among current and new competitors will emerge and see their offerings rapidly gain acceptance.

There can be no assurance that we will be able to compete successfully against current and future competitors. Increased competition could result in price reductions, fewer customer orders, reduced gross margins and loss of market share, any of which could materially affect our business, operating results or financial condition.

### **Seasonality**

We have experienced seasonality in our orders and revenues. We typically achieve the highest levels of orders and revenues for the year in the fourth quarter, which levels are usually higher than we achieve in the first quarter of the following year. We believe that, in general, historical seasonality results primarily from the budgeting cycles of our customers being typically higher in the third and fourth quarters and, to a lesser extent, from the structure of our sales commission program. In addition, the tendency of some of our customers to wait until the end of a fiscal quarter to finalize orders has resulted in higher order volumes towards the end of the quarter. These factors, combined with the relatively fixed nature of our expenses, leads to seasonality of net income. We expect this seasonality to continue in the future.

### **Proprietary Rights**

We rely on a combination of patents, copyrights, trademarks, service marks, trade secret laws, and contractual restrictions to establish and protect proprietary rights in our products and services. The source code for our products is protected both as a trade secret and as an unpublished copyrighted work. Despite our precautions, it may be possible for a third party to copy or otherwise obtain and use our products or technology without authorization. In addition, the laws of various countries in which our products may be sold may not protect our products and intellectual property rights to the same extent as the laws of the U.S. Our competitors may independently develop technologies that are substantially equivalent or superior to our technology.

We rely on software that we license from third parties for certain components of our products and services to enhance our products and services and meet evolving customer needs. The failure to license any necessary technology, or to maintain our existing licenses, could result in reduced demand for our products.

Because the software industry is characterized by rapid technological change, we believe that factors such as the technological and creative skills of our personnel, new product developments, frequent product enhancements, name recognition, and reliable product maintenance are more important to establishing and maintaining a technology leadership position than the various legal protections of our technology.

Although we believe that our products and services and other proprietary rights do not infringe upon the proprietary rights of third parties, third parties may assert intellectual property infringement claims against us in the future. Any such claims may result in costly, time-consuming litigation and may require us to enter into royalty or cross-license arrangements.

We have trademarks and registered trademarks in the United States and other countries, including Quest, Quest Software, the Quest Software logo, AccessManager, ActiveRoles, Aelita, Akonix, Benchmark Factory, Big

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Brother, BridgeAccess, BridgeAutoEscalate, BridgeSearch, BridgeTrak, BusinessInsight, ChangeAuditor, CI Discovery, Defender, DeployDirector, Desktop Authority, Directory Analyzer, Directory Troubleshooter, DS Analyzer, DS Expert, Foglight, GPOAdmin, Help Desk Authority, Imceda, IntelliProfile, InTrust, Invirtus, iToken, JClass, JProbe, LeccoTech, LiteSpeed, LiveReorg, LogAdmin, MessageStats, Monosphere, NBSpool, NetBase, NetControl, Npulse, NetPro, PassGo, PerformaSure, Point, Click, Done!, Quest vToolkit, Quest vWorkSpace, ReportAdmin, RestoreAdmin, ScriptLogic, SelfServiceAdmin, SharePlex, Sitraka, SmartAlarm, Spotlight, SQL Navigator, SQL Watch, SQLab, Stat, StealthCollect, Storage Horizon, Tag and Follow, Toad, T.O.A.D., Toad World, vAutomator, vConverter, vEcoShell, VESI,vFoglight, vPackager, vRanger, vSpotlight, vStream, vToad, Vintela, Virtual DBA, VizionCore, Vizioncore vAutomation Suite, Vizioncore vEssentials, Vizioncore vWorkflow, WebDefender, Webthority, Xaffire, and XRT. Other trademarks and registered trademarks are the property of their respective owners.

## **Employees**

As of December 31, 2009, we employed 3,365 full-time employees, including 1,397 in sales and marketing, 97 in consulting and training services and product fulfillment, 1,162 in research and development, 297 in customer service and support and 412 in general and administrative, including information services personnel. We believe that our future success will depend in large part upon our continuing ability to attract and retain highly skilled managerial, sales, marketing, customer support, research and development, and general and administrative personnel. Like other software companies, we face intense competition for such personnel, and we have at times experienced and continue to experience difficulty in recruiting and retaining qualified personnel. None of our employees are represented by a labor union; we have never experienced any work stoppages and we believe that our relationships with our employees are good.

## **Website Access to United States Securities and Exchange Commission Filings**

Our website is located at [www.quest.com](http://www.quest.com). Information at that website address shall not be deemed incorporated by reference into this report. We make available, free of charge on or through our website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission, or SEC. Information contained on our website is not part of this Annual Report on Form 10-K. Members of the public may read and copy any materials we file with, or furnish to, the SEC, at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. To obtain information on the operation of the Public Reference Room, please call the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site at [www.sec.gov](http://www.sec.gov) that contains the reports, proxy and information statements, and other information that we file electronically with the SEC.

## **Item 1A. Risk Factors**

An investment in our shares involves risks and uncertainties. You should carefully consider the factors described below before making an investment decision in our securities. The risks described below are the risks that we currently believe are material risks of the business and the industry in which we compete.

Our business, financial condition and results of operations could be adversely affected by any of the following risks. If we are adversely affected by such risks, then the trading price of our common stock could decline, and you could lose part or all of your investment.

## **Current economic conditions may harm our business and results of operations**

Beginning in 2008 and continuing in 2009, the U.S. and global economies slowed dramatically as a result of a variety of serious problems, including turmoil in the credit and financial markets, concerns regarding the stability and viability of major financial institutions, the state of the housing markets and volatility in worldwide

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stock markets. During 2009, we experienced reductions in revenues from countries within our Europe, Middle East and Africa (“EMEA”) sales region, where recent economic slowdowns have been especially acute. Given the significance and widespread nature of these nearly unprecedented circumstances, the U.S. and global economies could remain significantly challenged for an indeterminate period of time. These economic conditions, which are beyond our control, could cause many of our existing and potential customers to delay or reduce purchases of our products or services for some time, which in turn would harm our business by adversely affecting our revenues, results of operations, cash flows and financial condition. We cannot predict the duration of these economic conditions or the impact they will have on our customers or business.

### **Our future success may be impaired and our operating results will suffer if we cannot respond to rapid market, competitive and technological conditions in the software industry**

The market for our software products and services is characterized by:

- rapidly changing technology;
- frequent introduction of new products and services and enhancements to existing products and services by platform vendors of database, application and Windows products and by our competitors;
- increasing complexity and interdependence of software applications;
- consolidation of the software industry;
- changes in industry standards and practices; and
- changes in customer requirements and demands.

To maintain our competitive position, we must continue to enhance our existing products and develop new products and services, functionality, and technology that address the increasingly sophisticated and varied needs of our customers and prospective customers, which requires significant investment in research and development resources and capabilities, involves significant technical and business risks and requires substantial lead-time and significant investments in product development. If we fail to anticipate new technology developments, customer requirements, industry standards, or if we are unable to develop new products and services that adequately address these new developments, requirements, and standards in a timely manner, or if we are incapable of timely bringing new or enhanced products to market, our products and services may become obsolete, we may not generate suitable returns from our research and development investments, and our ability to compete may be impaired, our revenue could decline, and our operating results may suffer.

In recent years, a large portion of our revenue has been attributable to the growth of our Microsoft Systems Management and Virtualization Management products and services, and we have relied upon cash flow generation from our Database Management products to fund sales, marketing and research and development initiatives associated with our other product areas. We cannot provide any assurance that we will sustain or grow the revenues we derive from these product areas. In addition, over the last few years we have committed significant resources to development of new and enhanced application management products and have realigned our sales and services organizations to address anticipated business opportunities presented by our expanding application management product and services lines. We cannot provide any assurance that this strategy will be successful or that the release of our enhanced application management products or other new products or services will increase our revenue growth rate.

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### **Our quarterly operating results may fluctuate in future periods and, as a result, we may fail to meet expectations of investors and analysts, causing our stock price to fluctuate or decline**

Our revenues and operating results may vary significantly from quarter-to-quarter due to a number of factors. These factors include the following:

- the size and timing of customer orders (See “Variations in the size and timing of our customer orders and differing nature of our products and services could expose us to revenue fluctuations and higher operating costs”);
- the discretionary nature of our customers’ purchasing decisions and budget cycles;
- the timing of revenue recognition for sales of software products and services (See “Contractual terms or issues arising during software license negotiations may affect the timing of transactions and revenues”);
- the extent to which our customers renew their maintenance contracts with us;
- exposure to general economic conditions and reductions in corporate or public sector IT spending (See “Current economic conditions may harm our business and results of operations”);
- changes in our level of operating expenses and our ability to control costs;
- customers opting to license our products for a fixed term rather than on a perpetual basis which defers the accounting recognition of such license revenue;
- our ability to attain market acceptance of new products and services and enhancements to our existing products;
- our ability to introduce new products or enhancements to existing products and services in a timely manner;
- our ability to maintain our field and inside sales organizations with adequate numbers of sales and services personnel, and to minimize our costs of sales and marketing through efficient allocation of sales resources and methods to products having different sales characteristics and profiles;
- the introduction of new or enhanced products and services by our competitors and changes in the pricing policies of these competitors;
- the relative growth rates of competing operating system, database and application platforms and competitive conditions among vendors of these platforms;
- the unpredictability of the timing, level of sales and subsequent revenue recognition of our expanded efforts within our indirect sales channels;
- costs related to acquisitions of technologies or businesses, including acquired in-process research and development and amortization costs for intangible assets and possible impairments and uncertainties arising from the integration of products, services, employees and operations of acquired companies; and
- the timing of releases of new versions of third-party software products that our products support or with which our products compete.

In addition, the timing of our software product revenues is difficult to predict and can vary substantially from product-to-product and customer-to-customer. We budget our operating expenses on our expectations regarding future revenue levels. The timing of larger orders and customer buying patterns are difficult to forecast. Therefore, we may not learn of shortfalls in revenue or earnings or other failures to meet our expectations until late in a particular quarter. As a result, if total revenues for a particular quarter are below our expectations, we would not be able to proportionately reduce operating expenses for that quarter.

We have experienced seasonality in our orders and revenues. We typically achieve the highest levels of orders and revenues for the year in the fourth quarter, which levels are usually higher than we achieve in the first

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quarter of the following year. We believe that this seasonality results primarily from the budgeting cycles of our customers being typically higher in the third and fourth quarters and, to a lesser extent, from the structure of our sales commission program. In addition, the tendency of some of our customers to wait until the end of a fiscal quarter to finalize orders has resulted in higher order volumes towards the end of the quarter. These factors, combined with the relatively fixed nature of our expenses, leads to seasonality of earnings. We expect this seasonality to continue in the future.

Due to these factors, we believe that period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as indications of future performance. Fluctuations in our results of operations are also likely to affect the market price of our common stock, if our operating results differ from expectations of investors or securities analysts, and may not be related to or indicative of our long-term performance.

### **In periods of worsening economic conditions, our exposure to credit risk and payment delinquencies on our accounts receivable significantly increases**

Our outstanding accounts receivables are generally not secured. In addition, our standard terms and conditions permit payment within a specified number of days following the receipt of our product. While we have procedures to monitor and limit exposure to credit risk on our receivables and have not suffered any material losses, there can be no assurance such procedures will continue to effectively limit our credit risk and avoid losses. As economic conditions have deteriorated, certain of our customers have faced and may face liquidity concerns and have delayed and may delay or may be unable to satisfy their payment obligations, which would have a material adverse effect on our financial condition, operating results and cash flows.

### **Our cash and cash equivalents could be adversely affected if the financial institutions in which we hold our cash and cash equivalents fail**

Our cash and cash equivalents are highly liquid investments with original maturities of three months or less at the time of purchase. We maintain the cash and cash equivalents with major financial institutions. Deposits with these banks exceed the Federal Deposit Insurance Corporation ("FDIC") insurance limits or similar limits in foreign jurisdictions. While we monitor daily the cash balances in the operating accounts and adjust the balances as appropriate, these balances could be impacted if one or more of the financial institutions with which we deposit fails or is subject to other adverse conditions in the financial or credit markets. To date we have experienced no loss or lack of access to our invested cash or cash equivalents (other than our auction rate securities); however, we can provide no assurance that access to our invested cash and cash equivalents will not be impacted by adverse conditions in the financial and credit markets.

### **Variations in the size and timing of our customer orders and differing nature of our products and services could expose us to revenue fluctuations and higher operating costs**

Our license revenues in any quarter are substantially dependent on orders booked and delivered in that quarter. Our revenues in a given quarter could be adversely affected if we are unable to complete one or more large license transactions or if the contract terms were to prevent us from recognizing revenue during that quarter. The sales cycles for certain of our software products can last from three to nine months, or longer and often require pre-purchase evaluation periods and customer education, which can affect timing of orders. Further, we have often booked a large amount of our sales in the last month, weeks or days of each quarter and delays in the closing of sales near the end of a quarter could cause quarterly revenue to fall short of anticipated levels. Finally, while a portion of our revenues each quarter is recognized from previously deferred revenue, our quarterly performance will depend primarily upon current order volumes to generate license revenues for that quarter. These factors may cause significant periodic variation in our license revenues. In addition, we incur or commit to operating expenses based on anticipated revenue levels, and generally do not know whether revenues in any quarter will meet expectations until the end of that quarter.

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Our product portfolio is engineered for a broad variety of operating system, database and application platforms, and having a diverse set of functions and features. Some products, such as our database management products and other component products, are directed at database administrators and are generally sold at lower price points, and we strive to generate demand for these products through our telesales organization and marketing programs designed to maximize lead generation and website traffic. Sales of other, enterprise-wide products, primarily SharePlex, Foglight and Desktop Virtualization products, require substantial time and effort from our sales and support staff as well as involvement by our professional services organizations and, to an increasing degree, our systems integrator partners. Large individual sales, or even small delays in customer orders, can cause significant variation in our revenues and adversely affect our results of operations for a particular period. Historically, we have not placed significant reliance on large sales transactions in any given quarter, with a substantial volume of our revenues being driven from smaller transactions. However, if we encounter difficulty sustaining our component product volumes, and cannot generate a sufficient number of large customer orders, or if customers delay or cancel such orders in a particular quarter, our revenues and operating results may be adversely affected. For these reasons, we face increasing complexity in building and sustaining the optimum combination of field and inside sales personnel to address the various and changing sales and distribution characteristics of our products, which in turn impacts our ability to manage and minimize our sales and marketing costs.

We rely heavily on our direct sales activities for license and services revenues, including renewals of annual maintenance contracts. We have in the past restructured or made other adjustments to our sales force in response to management changes, product changes, performance issues and other internal considerations.

Accordingly, if our revenue growth rates slow or our revenues decline, or if we fail to efficiently correlate our sales and marketing resources to our various products and their differing sales and distribution strategies, our operating results could be seriously impaired because many of our expenses are relatively fixed in nature and cannot be easily or quickly changed.

### **Contractual terms or issues arising during software license negotiations may affect the timing of transactions and revenues**

Because our software products are designed to work with critical elements of the information technology systems of our customers, pre-sales evaluations of our products by potential customers and contractual negotiations are often protracted and complex, and the time necessary to negotiate mutually acceptable terms and complete software license or services transactions often result in extended sales cycles. While we generally use standardized forms of software license agreements and order documentation in our transactions, it is not uncommon for large, more sophisticated IT customers to heavily negotiate terms and conditions for sales and services involving amendments to our standard forms or the use of alternative forms of agreements, which can also delay completion of transactions and recognition of the related revenue.

Several other factors may require us to defer recognition of license revenue for a period of time after entering into a license arrangement, including instances where we are required to deliver specified additional products, product upgrades or services for which we do not have vendor-specific objective evidence of fair value, licensing our product for a fixed term rather than on a perpetual basis, or where negotiated terms of the software license agreement affect other software revenue recognition requirements.

### **Many of our products are vulnerable to direct competition from Oracle and other platform vendors**

We compete with Oracle in the market for database management solutions and the competitive pressure continues to increase. We expect that Oracle's commitment to and presence in the database management product market will increase in the future and therefore substantially increase competitive pressures. We believe that Oracle will continue to incorporate database management technology into its server software offerings and expand their development products possibly at no additional cost to its users. Competition from Oracle with certain of our Database Management products including SharePlex, Quest Central for Oracle and TOAD, our market leading Database Development product for Oracle databases, has increased over the last few years.

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In addition to the increasing competitive pressure from Oracle, Microsoft has continually upgraded the functionality of its platform offerings, which we also believe will increase competitive pressure for our Microsoft products in the future.

In some cases these types of platform vendor–provided tools are bundled with the platform and in other cases they are separately chargeable products, albeit at significantly lower price points. The inclusion of the functionality of our software as standard features of the underlying database solution or application supported by our products or sale at much lower cost could erode our revenues, particularly if the competing products and features were of comparable capability to our products. Even if the functionality provided as standard features or lower costs by these system providers is more limited than that of our software, there can be no assurance that a significant number of customers would not elect to accept more limited functionality in lieu of purchasing our products. Moreover, there is substantial risk that the mere announcements of competing products or features by large competitors such as Oracle could result in the delay or cancellation of customer orders for our products in anticipation of the introduction of such new products or features.

### **Our migration products for Microsoft’s Active Directory and Exchange are vulnerable to fluctuations in the rate at which customers migrate to these products**

Our products for the migration, administration and management of Microsoft’s Active Directory and Exchange products currently contribute approximately 20% of our Windows platform revenue. Our ability to sell licenses for our Active Directory and Exchange migration products depends in part on the rate at which customers migrate to newer versions of Microsoft’s Active Directory or to newer versions of Microsoft Exchange, and from other messaging platforms to Exchange. If these migration rates were to materially decrease, our license revenues from these migration products would likely decline.

### **Many of our products are dependent on database or application technologies of others; if these technologies lose market share or become incompatible with our products, or if these vendors introduce competitive products or acquire or form strategic relationships with our competitors, the demand for our products could suffer**

We believe that our success has depended in part, and will continue to depend in part for the foreseeable future, upon our relationships with providers of major database and enterprise software programs, including Oracle, IBM, Microsoft, VMware, Cisco and SAP. Our competitive advantage consists in substantial part on the integration between our products and products provided by these major software providers, and our extensive knowledge of their products and technologies. If these companies for any reason decide to promote technologies and standards that are not compatible with our technologies, or if they lose market share for their database or application products, our business, operating results and financial condition would be materially adversely affected. Furthermore, these major software vendors could attempt to increase their presence in the markets we serve by either introducing products that compete with our products or acquiring or forming strategic alliances with our competitors. These companies have longer operating histories, larger installed bases of customers and substantially greater financial, distribution, marketing and technical resources than we do, as well as well–established relationships with many of our present and potential customers, and may be in better position to withstand and respond to the current factors impacting this industry. As a result, we may not be able to compete effectively with these companies in the future, which could materially adversely affect our business, financial condition, operating results and cash flows.

### **If we fail to manage our operations and grow revenue or fail to continue to effectively control expenses, our future operating results could be adversely affected**

Historically, the scope of our operations, the number of our employees and the geographic area of our operations and our revenue have grown rapidly. In addition, we have acquired both domestic and international

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companies. This growth and the assimilation of acquired operations and their employees could continue to place a significant strain on our managerial, operational and financial resources. To manage our current operations and any future growth effectively, we need to continue to implement and improve additional management and financial systems and controls. We may not be able to manage the current scope of our operations or future growth effectively and still exploit market opportunities for our products and services in a timely and cost-effective way.

We cannot assure you that our operating expenses will be lower than our estimated or actual revenues in any given quarter. If we experience a shortfall in revenue in any given quarter, we likely will not be able to further reduce operating expenses quickly in response. Any significant shortfall in revenue could immediately and adversely affect our results of operations for that quarter. Also, due to the fixed nature of many of our expenses and our current revenue expectations, our income from operations and cash flows from operating and investing activities could be lower than in recent years.

### **Failure to develop and sustain additional distribution channels in the future may adversely affect our ability to grow revenues**

We intend to direct additional efforts to drive domestic and international revenue growth through sales of our products and services through indirect distribution channels, such as global hardware and software vendors, systems integrators, or value-added resellers. Our ability to increase future revenues depends on our ability to expand our indirect distribution channels. If we fail in our efforts to maintain, expand and diversify our indirect distribution channels, our business, results of operations and financial condition could be adversely affected. Increasing activity in indirect distribution channels will present a number of additional risks, including:

- we may face conflicts between the activities of our indirect channels and our direct sales and marketing activities, which may result in lost sales and customer confusion;
- our channel partners can cease marketing and distributing our products and services with limited or no notice and with little or no penalty;
- our channel partners may not be able to effectively sell our products and services;
- our channel partners may experience financial difficulties that might lead to delays, or even default, in their payment obligations;
- we may not be able to recruit additional channel partners, or replace any of our existing ones; and
- our channel partners may also offer competitive products and services, and may not give priority to marketing our products or services.

### **Intense competition in the markets for our products could adversely affect our results of operations**

The markets for our products are highly competitive. As a result, our future success will be affected by our ability to, among other things, outperform our competitors in meeting the needs of current and prospective customers and identifying and addressing new technological and market opportunities. Our competitors may develop more advanced technology, adopt more aggressive pricing policies and undertake more effective sales and marketing campaigns and may be able to leverage more extensive financial, technical or partner resources. If we are unable to maintain our competitive position, our revenues may decline and our operating results may be adversely affected.

### **Our operating results may be negatively impacted by fluctuations in foreign currency exchange rates**

Our international operations are generally conducted through our international subsidiaries, with the associated revenues and related expenses, and balance sheets, denominated in the currency of the country in which the international subsidiaries operate. As a result, our operating results may be harmed by fluctuations in

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exchange rates between the U.S. Dollar and other foreign currencies. The foreign currencies to which we currently have the most significant exposure are the Canadian Dollar, the British Pound, the Euro, the Australian Dollar and the Russian Ruble. In 2009, we implemented a foreign exchange hedging program using derivative financial instruments to hedge certain of our foreign exchange exposures. However, we do not rely on our hedging program to eliminate all foreign currency exchange rate risk.

### **Our international operations expose us to certain risks**

We maintain research and development operations in Canada, Australia, Russia, United Kingdom, China, Czech Republic, Hong Kong and Israel, and we also have significant sales activities around the globe. As a percentage of total revenues, revenues outside of the Americas were 32.8%, 37.9% and 35.8% for the years ended December 31, 2009, 2008 and 2007, respectively. As a result, we face risks from our international operations, including, among others:

- difficulties in staffing, managing and operating our foreign operations;
- difficulties in coordinating the activities of our geographically dispersed and culturally diverse operations;
- difficulties in adapting our existing foreign operations, particularly in Asia, to the control structure and requirements of a US public entity given the historical environment and cultural approach to conducting business in Asian countries;
- longer payment cycles and difficulties in collecting accounts receivable;
- seasonal reductions in business activity during the summer months in Europe, the Middle East and Africa (“EMEA”) and in other periods in other countries;
- increased financial accounting and reporting burdens and complexities;
- fluctuations in foreign currency exchange rates that are not wholly mitigated by our foreign currency hedging program;
- limitations on future growth or inability to maintain current levels of revenue from international operations if we do not invest sufficiently in our international operations;
- potentially adverse tax consequences;
- potential loss of proprietary information due to piracy, misappropriation or weaker laws regarding intellectual property protection;
- delays in localizing our products;
- political unrest or terrorism, particularly in areas in which we have facilities;
- our ability to adapt and conform to accepted local business practices and customs, including providing letters of credit or other forms of support to or for the benefit of our subsidiaries or resellers;
- compliance with a wide variety of complex foreign laws and treaties, including employment restrictions;
- compliance with licenses, tariffs and other trade barriers;
- activities by our employees, contractor or agents, especially in countries with developing economies, that are prohibited by U.S. laws and regulations such as the Foreign Corrupt Practices Act and by local laws prohibiting corrupt payments to government officials, in spite of our policies and procedures designed to ensure compliance with these laws; and
- wage inflation in foreign countries where we have historically benefited from relatively low labor costs.

Operating in international markets also requires significant management attention and financial resources and will place additional burdens on our management, administrative, operational and financial infrastructure.

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We cannot be certain that investment and additional resources required in establishing facilities in other countries will produce desired levels of revenue or profitability. In addition, we have limited experience in developing localized versions of our products and marketing and distributing them internationally.

### **Cash earned by our foreign subsidiaries is held at those subsidiaries and transferring this cash to the United States could have a negative impact on our earnings**

A substantial portion of our cash balances result from the operations of, and are held by, our foreign subsidiaries. The repatriation of cash balances from certain of our foreign subsidiaries to fund our activities within the United States could have adverse tax consequences and be limited by foreign currency exchange controls.

### **Acquisitions of companies or technologies may result in disruptions to our business and diversion of management attention**

We have in the past made and we expect to continue to make acquisitions of complementary companies, products or technologies. Acquisitions require us to assimilate the operations, products and personnel of the acquired businesses and train, retain and motivate key personnel from the acquired businesses. We may be unable to maintain uniform standards, controls, procedures and policies if we fail in these efforts. Similarly, acquisitions may subject us to liabilities and risks that are not known or identifiable at the time of the acquisition or may cause disruptions in our operations and divert management's attention from day-to-day operations, which could impair our relationships with our current employees, customers and strategic partners. We may have to use cash, incur debt or issue equity securities to pay for any future acquisitions. Use of cash or debt may affect our liquidity and use of cash would reduce our cash reserves and reduce our financial flexibility. The issuance of equity securities for any acquisition could be substantially dilutive to our stockholders. In addition, our profitability may suffer because of acquisition-related costs or amortization costs for intangible assets with indefinite useful lives. In consummating acquisitions, we are also subject to risks of entering geographic and business markets in which we have no or limited prior experience. If we are unable to fully integrate acquired businesses, products or technologies with our existing operations, we may not receive the intended benefits of an acquisition.

### **If our goodwill or amortizable intangible assets become impaired we may be required to record a significant charge to earnings**

Under generally accepted accounting principles, we review our goodwill and amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization, future cash flows, and slower growth rates in our industry. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, resulting in an impact on our results of operations.

### **Accounting for equity investments in companies may affect our operating results**

We have made equity investments in other software companies and a private equity fund. We regularly consider opportunities to make equity investments in other companies focused on software development or marketing activities, and expect from time to time to complete additional investments. These investments are risky because the market for the products and technologies being developed by these companies are typically in the early stages and may never materialize. Estimating the fair value of our equity investments is inherently subjective and may contribute to volatility in our reported results of operations. We have recognized accounting charges due to the impairment of the value of our investments in the past and may need to do so again in the

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future if we cannot substantiate the fair value of our strategic equity investments. If we are required to consolidate the operating results of these companies, use the equity method of accounting, or write down the value of our cost method investments, our operating results may be adversely affected.

### **Our investment portfolio may become impaired by deterioration of the capital markets**

We invest our cash balances in high-quality issuers and, limit the amount of credit exposure to any one issuer other than the United States government and its agencies. Our cash equivalent and investment portfolio as of December 31, 2009 consists of money market funds, auction rate municipal securities and term deposits. Our municipal auction rate securities are investment grade quality and are in compliance with our investment policy as of the end of 2009. Our investments are subject to general credit, liquidity and market and interest rate risks. As a result, we may experience reductions in value or loss of liquidity of our investments. In addition, should any investment cease paying or reduce the amount of interest paid to us, our interest income would suffer. These market risks associated with our investment portfolio could have a material adverse effect on our business, results of operations, liquidity, and financial condition. See Note 4 – Cash and Cash Equivalents and Investments of our Notes to Consolidated Financial Statements for additional information about our cash equivalents and investment portfolio.

### **Changes in, or interpretations of, tax rules and regulations may adversely affect our effective tax rates**

We are a U.S. based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. Unanticipated changes in our tax rates could affect our future results of operations. Our future effective tax rates could be unfavorably affected by changes in, or interpretation of, tax rules and regulations in the jurisdictions in which we do business, by unanticipated decreases in the amount of revenue or earnings in countries with low statutory tax rates, by lapses of the availability of the U.S. research and development tax credit, or by changes in the valuation of our deferred tax assets and liabilities.

In addition, we are subject to the continual examination of our income tax returns by the IRS and other domestic and foreign tax authorities. These examinations are expected to focus on our intercompany transfer pricing practices as well as other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from the examinations. We believe such estimates to be reasonable; however, there can be no assurance that the final determination of any of these examinations will not have an adverse effect on our financial position, operating results and cash flows.

### **We face risks associated with governmental contracting**

We derive a portion of our revenues from contracts with the United States government and its agencies and from contracts with state and local governments or agencies. Most of our government contracting is conducted indirectly through third party resellers and only an immaterial portion of our government contracting revenues arise from contracts in which we bear the risk of renegotiation of profits or contractual termination at the government's election. However, demand and payment for our products and services are impacted by public sector budgetary cycles and funding availability, with funding reductions or delays adversely impacting public sector demand for our products and services. Public sector customers may also change the way they procure new contracts and may adopt new rules or regulations governing contract procurement, including required competitive bidding or use of "open source" products, where available. These factors may limit the growth of or reduce the amount of revenues we derive from the public sector, which could negatively affect our results of operations.

### **We may not generate increased business from our current customers, which could slow our revenue growth in the future**

Most of our customers initially make a purchase of our products for a single department or location. Many of these customers may choose not to expand their use of our products. If we fail to generate expanded business

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from our current customers, our business, operating results and financial condition could be materially adversely affected. In addition, as we deploy new modules and features for our existing products or introduce new products, our current customers may choose not to purchase this new functionality or these new products.

### **Maintenance revenue could decline**

Our services revenues arising from maintenance services have increased over the last three years as a result of a growing base of installed products. Declines in our license bookings, adverse changes in our foreign currency exchange rates, increased discounting in maintenance renewal bookings and/or a reduction in the extent to which our customers renew maintenance contracts would lead to declines in our maintenance revenue growth rates. As maintenance revenue makes up a substantial portion of our total revenue, any decline in our maintenance revenue could have an adverse impact on our business and financial results.

### **Failure to develop or leverage strategic relationships could harm our business by denying us selling opportunities and other benefits**

Our development, marketing, and distribution strategies rely increasingly on our ability to form strategic relationships with software and other technology companies. These business relationships often consist of cooperative marketing programs, joint customer seminars, lead referrals, and cooperation in product development. Many of these relationships are not contractual and depend on the continued voluntary cooperation of each party with us. Divergence in strategy or change in focus by, or competitive product offerings by, any of these companies may interfere with our ability to develop, market, sell, or support our products, which in turn could harm our business. Further, if these companies enter into strategic alliances with other companies or are acquired, they could reduce their support of our products. Our existing relationships may be jeopardized if we enter into alliances with competitors of our strategic partners. In addition, one or more of these companies may use the information they gain from their relationship with us to develop or market competing products.

### **Failure to adequately protect our intellectual property rights could harm our competitive position**

Our success and ability to compete are dependent on our ability to develop and maintain the proprietary aspects of our technology. We generally rely on a combination of trademark, trade secret, patent, copyright law and contractual restrictions to establish and protect our proprietary rights in our products and services.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets, and to determine the validity and scope of the proprietary rights of others. Any such resulting litigation, whether successful or unsuccessful, could result in substantial costs and diversion of management and financial resources, which could harm our business.

Our means of protecting our proprietary rights may prove to be inadequate and competitors may independently develop similar or superior technology. Policing unauthorized use of our products is difficult, and we cannot be certain that the steps we have taken will prevent misappropriation of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. We also believe that, because of the rapid rate of technological change in the software industry, trade secret and copyright protection are less significant than factors such as the knowledge, ability and experience of our employees, frequent product enhancements and the timeliness and quality of customer support services.

### **Third parties may claim that our software products or services infringe on their intellectual property rights, exposing us to litigation that, regardless of merit, may be costly to defend**

Our success and ability to compete are also dependent upon our ability to operate without infringing upon the proprietary rights of others. Third parties may claim that our current or future products infringe their

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intellectual property rights. Any such claim, with or without merit, could have a significant effect on our business and financial results. Any future third party claim could be time consuming, divert management's attention from our business operations and result in substantial litigation costs, including any monetary damages and customer indemnification obligations, which may result from such claims. In addition, parties making these claims may be able to obtain injunctive or other equitable relief affecting our ability to license the products that incorporate the challenged intellectual property. As a result of such claims, we may be required to obtain licenses from third parties, develop alternative technology or redesign our products. We cannot be sure that such licenses would be available on terms acceptable to us, if at all. If a successful claim is made against us and we are unable to develop or license alternative technology, our business and financial results and position could be materially adversely affected.

### **Our business may be adversely affected if our software contains errors or security flaws**

The software products we offer are inherently complex. Despite testing and quality control, we cannot be certain that errors or security flaws will not be found in current versions, new versions or enhancements of our products after commencement of commercial shipments. Significant technical challenges also arise with our products because our customers purchase and deploy our products across a variety of computer platforms and integrate them with a number of third-party software applications and databases. If new or existing customers have difficulty deploying our products or require significant amounts of customer support, our operating margins could be harmed. Moreover, we could face possible claims and higher development costs if our software contains undetected errors or security flaws or if we fail to meet our customers' expectations. As a result of the foregoing, we could experience:

- loss of or delay in revenues and loss of market share;
- loss of customers;
- damage to our reputation;
- failure to achieve market acceptance;
- diversion of development resources;
- increased service and warranty costs;
- legal actions by customers against us which could, whether or not successful, increase costs and distract our management; and
- increased insurance costs.

The detection and correction of any security flaws can be time consuming and costly. In addition, a product liability claim, whether or not successful, could harm our business by increasing our costs and distracting our management.

### **We incorporate software licensed from third parties into some of our products and any significant interruption in the availability of these third-party software products or defects in these products could reduce the demand for, or prevent the shipping of, our products**

Certain of our software products contain components developed and maintained by third-party software vendors. We expect that we may have to incorporate software from third-party vendors in our future products. We may not be able to replace the functionality provided by the third-party software currently offered with our products if that software becomes obsolete, defective or incompatible with future versions of our products or is not adequately maintained or updated. Any significant interruption in the availability of these third-party software products or defects in these products could harm our sales unless and until we can secure an alternative source. Although we believe there are adequate alternate sources for the technology licensed to us, such alternate sources may not provide us with the same functionality as that currently provided to us.

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### **Natural disasters or power outages could disrupt our business**

A substantial portion of our operations is located in California, and we are subject to risks of damage and business disruptions resulting from earthquakes, floods, wildfires and similar events, as well as from power outages. We have in the past experienced limited and temporary power outages in our California facilities due to power shortages, and we expect in the future to experience additional power losses. While the impact to our business and operating results has not been material, we cannot assure you that natural disasters or power outages will not adversely affect our business in the future. Since we do not have sufficient redundancy in our networking infrastructure, a natural disaster or other unanticipated problem could have an adverse effect on our business, including both our internal operations and our ability to communicate with our customers or sell and deliver our products.

### **Failure to attract and retain personnel may negatively impact our business**

Our success and ability to compete depends largely on the continued contributions of our key management, sales, engineering, marketing, support, professional services and finance personnel. We experience turnover throughout our organization and many key positions are held by people who are new to the Company or to their roles. If these people are unable to quickly become familiar with the issues they face in their roles or are not well suited to their new roles, then this could result in the Company having problems in executing its strategy or in reporting its financial results. We are highly dependent upon the talents, relationships and contributions of a few executives and have no guarantee of their retention. We have been targeted by recruitment agencies seeking to hire our key management, finance, engineering, sales and marketing and professional services personnel.

We historically have used stock options as a significant component of our employee compensation program to align employees' interests with the interests of our stockholders, encourage employee retention and provide competitive compensation packages. We have recently started using restricted stock units (RSUs) to compensate and retain key employees and to align the interests of our employees and stockholders. For example, beginning in 2008 we designed an employee reward program for key employees, which provides us with the ability to make awards under the program in the form of RSUs. If we are unable to hire or retain qualified personnel, or if newly hired personnel fail to develop the necessary skills or fail to reach expected levels of productivity, our ability to develop and market our products will be weakened.

### **Our revolving line of credit agreement and our loan agreement contain financial and non-financial covenants, and default of any covenant could adversely affect us**

Our revolving line of credit agreement with Wells Fargo Foothill, LLC, as well as our loan agreement with Mutual of Omaha Bank which is secured by our real property at our headquarters in Aliso Viejo, California, impose operating restrictions on us in the form of financial and non-financial covenants. These restrictions limit the manner in which we can conduct our business and may restrict us from engaging in favorable business opportunities. If we were to fail to comply with these covenants and not obtain a waiver from our lenders, we would be in default under these agreements, in which case our lenders could, among other things, terminate the facilities, demand immediate repayment of any outstanding amounts, and foreclose on our collateral.

### **Settlement of civil litigation relating to our historical stock option granting practices is pending final court approval**

In October 2006, a purported shareholder class action was filed in the United States District Court for the Central District of California against the Company and certain of our current or former officers and directors (the "Options Class Action") alleging that the Company improperly backdated stock options, resulting in false or misleading disclosures concerning, among other things, our financial condition and that the individual defendants sold our stock while in possession of material nonpublic information. The Company, the class representative and certain of our current and former officers and directors have agreed to settle all claims in the Options Class

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Action. A final hearing for approval of the settlement is scheduled before the U.S. District Court on March 15, 2010. If the settlement is approved following the final hearing, the court will enter a judgment dismissing the Options Class Action with prejudice as to all defendants, including the Company. If the settlement is not approved for any reason, the case will resume, which may be time consuming and expensive, and cause distraction from the operation of our business. The adverse resolution of this Options Class Action could have a material adverse effect on our business, financial condition and results of operations and we could be required to pay significant legal fees and damages in connection with this Options Class Action.

### **Unforeseen difficulties with the re-implementation and operation of our Oracle computerized accounting system, or with the upgrading or implementation of our other computerized accounting and finance systems, could adversely affect our operating results, our ability to manage our business effectively, and the effectiveness of our internal controls over financial reporting**

We are currently in the process of re-implementing our Oracle accounting system, and we are also updating and implementing various other computerized accounting and finance systems. Designing and implementing these systems is a major undertaking, both financially and from a management and personnel perspective. Costs and risks inherent in the conversion to our upgraded and new systems may include disruption to our normal procedures, potential delays, expenditure overruns beyond the projects' budgets, and problems achieving accuracy in the conversion of electronic data. Failure to properly or adequately address these issues could result in increased costs and the diversion of management's attention and resources, negatively impacting our operating results and ability to effectively manage our business. Once upgraded and new systems are implemented, they may not operate as we expect them to. Any significant failure or malfunction may result in disruptions of our operations.

This project will require changes to certain aspects of our existing system of internal controls over financial reporting. If we encounter unanticipated delays in upgrading our systems and implementing new systems, we may be unable to complete our testing of internal controls within the required time periods, which could create a material weakness or significant deficiency in our overall internal controls. Due to the number of controls examined, the complexity of our processes, and the subjectivity involved in determining the effectiveness of controls, we cannot be certain that, in the future, all of our controls will continue to be considered effective by management or, if considered effective by our management, that our auditors will agree with such assessment. Consequently, we could be subject to regulatory sanctions or lose investor confidence in the accuracy or completeness of our financial reports.

### **Our stock price could become more volatile and your investment could lose value**

All of the factors discussed in this section could affect our stock price. The timing of announcements in the public market regarding new products, product enhancements or technological advances by our competitors or us, and any announcements by us of acquisitions, major transactions, or management changes could also affect our stock price. Changes in the amounts and frequency of our share repurchases could adversely affect our stock price as well. Our stock price is subject to speculation in the press and the analyst community, changes in recommendations or earnings estimates by financial analysts, changes in investors' or analysts' valuation measures for our stock, our credit ratings and market trends unrelated to our performance. In addition, if the market for technology stocks, or the stock market in general, experiences uneven investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, operating results or financial condition. A significant drop in our stock price could expose us to the risk of securities class actions lawsuits, which could result in substantial costs and divert management's attention and resources, which could adversely affect our business.

### **Item 1B. *Unresolved Staff Comments***

None.

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### **Item 2. Properties**

Our corporate and administrative headquarters and certain research and development, sales and marketing and support personnel are located at two buildings that comprise our 170,000 square foot facility that we own in Aliso Viejo, California. We also lease properties throughout the United States and foreign countries to house additional research and development, sales and marketing, general and administrative and support personnel. Our largest leased facilities include:

<u>Location</u>	<u>Area Leased (sq. ft.)</u>	<u>Lease Expiration</u>
Dublin, Ohio	51,307	August 2013
St. Petersburg, Russia	46,985	May 2010
Toronto, Canada	33,768	December 2014
Maidenhead, United Kingdom	29,090	October 2010
Ottawa, Canada	27,263	May 2013
Halifax, Canada	26,640	August 2013
Boca Raton, FL	25,380	January 2010
Melbourne, Australia	21,480	March 2010
Cologne, Germany	21,087	July 2010

We believe that our properties are in good condition, adequately maintained and suitable for the conduct of our business. Certain of our lease agreements provide options to extend the lease for additional specified periods. For additional information regarding our obligations under leases, see Note 16 – Commitments and Contingencies of our Notes to Consolidated Financial Statements.

### **Item 3. Legal Proceedings**

The information set forth under Note 16 – Commitments and Contingencies of our Notes to Consolidated Financial Statements, included in Part IV, Item 15 of this Report, is incorporated herein by reference. For an additional discussion of certain risks associated with legal proceedings, see the section entitled “Risk Factors” in Item 1A of this Report.

### **Item 4. Submission of Matters to a Vote of Security Holders**

No matters were submitted to a vote of security holders during the quarter ended December 31, 2009.

## **PART II**

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

#### **Market Information**

Our common stock is listed on The Nasdaq Global Select Market (formerly the NASDAQ National Market) under the symbol “*QSFT*.” The following table sets forth the high and low sale prices on The Nasdaq Global Select Market for our common stock for the periods indicated.

	<u>High</u>	<u>Low</u>
2008:		
First Quarter	\$ 18.37	\$ 12.14
Second Quarter	17.12	12.50
Third Quarter	15.57	12.36
Fourth Quarter	14.00	10.31
2009:		
First Quarter	\$ 13.39	\$ 10.41
Second Quarter	14.78	12.34
Third Quarter	17.69	13.68
Fourth Quarter	18.82	16.17

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### Holders

On February 11, 2010, the closing sale price of our common stock on The Nasdaq Global Select Market was \$16.12 per share. As of February 11, 2010, there were 128 holders of record of our common stock (not including beneficial holders of shares held in “street name”).

### Dividends

We have never declared or paid any cash dividends on our common stock and do not expect to do so in the foreseeable future. We currently intend to retain all available funds for use in the operation and expansion of our business. Any future determination to pay dividends will be at the discretion of our board of directors and will depend on our results of operations, financial condition, contractual and legal restrictions and other factors the board deems relevant.

### Issuer Purchases of Equity Shares

The table below summarizes information about our purchases of equity securities registered pursuant to Section 12 of the Exchange Act during the quarterly period ended December 31, 2009.

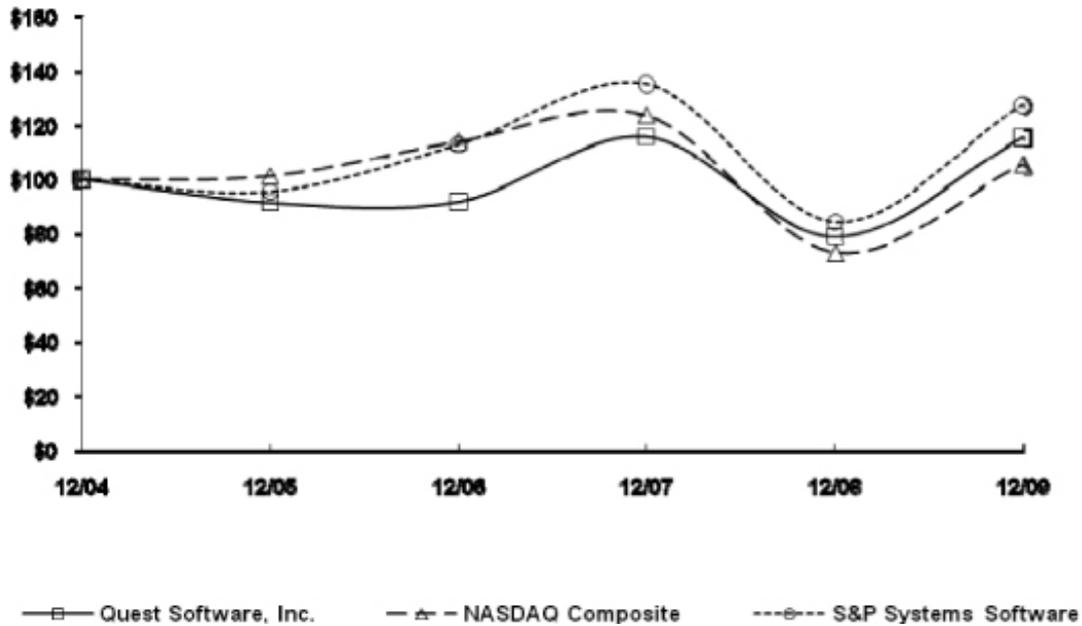
<u>Period.</u>	<u>Total Number of Shares of Common Stock Purchased (1)</u>	<u>Price Paid per Share of Common Stock (2)</u>	<u>Total Number of Shares of Common Stock Purchased as Part of Publicly Announced Plans or Programs (1)</u>	<u>Maximum Approximate Dollar Value of Shares of Common Stock that May Yet Be Purchased Under the Plans or Programs (in millions)</u>
Oct. 1, 2009 through Oct. 31, 2009	—	\$ —	—	\$ 100.0
Nov. 1, 2009 through Nov. 30, 2009	89,454	\$ 16.65	89,454	\$ 98.5
Dec. 1, 2009 through Dec. 31, 2009	565,615	\$ 17.17	565,615	\$ 88.8
Total	655,069	\$ 17.10	655,069	\$ 88.8

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- (1) In August 2009, the Board of Directors authorized a plan to repurchase up to \$100 million of our common stock. Any stock repurchases may be made through open market and privately negotiated transactions, at times and in such amounts as management deems appropriate, including pursuant to one or more Rule 10b5-1 trading plans. Rule 10b5-1 permits Quest to establish, while not in possession of material nonpublic information, prearranged plans to buy stock at a specific price in the future, regardless of any subsequent possession of material nonpublic information. The timing and actual number of shares repurchased will depend on a variety of factors including market conditions, corporate and regulatory requirements, and capital availability. The stock repurchase program does not have an expiration date and may be limited or terminated at any time without prior notice.
- (2) The price paid per share of common stock does not include the related transaction costs.

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Performance Graph

The following graph shows a comparison of cumulative total shareholder return, calculated on a dividend reinvested basis, for Quest Software, the NASDAQ Composite Index (the "NASDAQ Index"), and the S&P Systems Software Index (the "Industry Index"). The graph assumes \$100 was invested in each of the Common Stock of Quest Software, the NASDAQ Index and the Industry Index on December 31, 2004. Note that historic stock price performance is not necessarily indicative of future stock price performance.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\***  
Among Quest Software, Inc., The NASDAQ Composite Index  
And The S&P Systems Software Index



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### Item 6. Selected Financial Data

	2009 (1)	2008 (2)	Year ended December 31,		2005 (5)
			2007 (3)	2006 (4)	
	(in thousands, except per share amounts)				
<b>Consolidated Income Statement Data:</b>					
Revenues:					
Licenses	\$ 279,238	\$ 334,083	\$ 308,652	\$ 290,247	\$256,131
Services	415,998	401,294	322,329	271,342	215,873
Total revenues	695,236	735,377	630,981	561,589	472,004
Cost of revenues:					
Licenses	7,581	8,586	6,111	5,570	5,005
Services	58,528	62,060	55,173	49,773	38,381
Amortization of purchased technology	19,393	20,231	14,459	15,932	11,476
Total cost of revenues	85,502	90,877	75,743	71,275	54,862
Gross profit	609,734	644,500	555,238	490,314	417,142
Operating expenses:					
Sales and marketing	272,944	312,493	275,037	247,500	203,851
Research and development	144,370	153,464	122,592	110,612	89,078
General and administrative	76,748	84,954	81,758	65,821	48,435
Amortization of other purchased intangible assets	13,159	11,302	7,345	6,758	7,179
In-process research and development	—	955	220	960	7,840
Litigation loss provision, net (6)	19,025	—	—	—	—
Total operating expenses	526,246	563,168	486,952	431,651	356,383
Gain on sale of corporate aircraft	—	—	—	3,987	—
Income from operations	83,488	81,332	68,286	62,650	60,759
Other income (expense), net	2,549	1,030	22,422	13,005	(1,046)
Income before income tax provision	86,037	82,362	90,708	75,655	59,713
Income tax provision	15,678	14,319	27,589	16,670	27,257
Net income	\$ 70,359	\$ 68,043	\$ 63,119	\$ 58,985	\$ 32,456
Basic net income per share	\$ 0.77	\$ 0.65	\$ 0.62	\$ 0.58	\$ 0.33
Diluted net income per share	\$ 0.75	\$ 0.64	\$ 0.60	\$ 0.57	\$ 0.32
Weighted average shares outstanding:					
Basic	91,926	104,192	101,819	101,380	97,621
Diluted	94,066	106,261	105,284	104,103	101,030
<b>Consolidated Balance Sheet Data:</b>					
Cash, cash equivalents and short-term and long-term investments (7)	\$ 386,256	\$ 260,362	\$ 365,715	\$ 390,160	\$242,961
Total assets	1,465,138	1,345,659	1,319,130	1,161,537	989,947
Current and long-term portion of deferred revenue	372,138	338,712	285,660	235,559	174,803
Short-term obligations	114,049	88,804	96,302	104,936	89,982
Long-term obligations (8)	86,159	44,391	39,842	2,129	1,730
Total stockholders' equity	892,792	873,752	897,326	818,913	723,432

(1) In 2009, we completed one acquisition for total purchase consideration of \$15.0 million (see Note 2 – Acquisitions of our Notes to Consolidated Financial Statements).

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- (2) In 2008, we completed five acquisitions for total purchase consideration of \$144.3 million (see Note 2 – Acquisitions of our Notes to Consolidated Financial Statements).
- (3) In 2007, we completed nine acquisitions for total purchase consideration of \$157.1 million (see Note 2 – Acquisitions of our Notes to Consolidated Financial Statements).
- (4) In 2006, we completed two acquisitions for total purchase consideration of \$17.6 million.
- (5) In 2005, we completed five acquisitions for total purchase consideration of \$159.4 million.
- (6) Litigation loss provision recorded with our settlement of the shareholder class action relating to alleged stock option backdating. See Note 16 – Commitments and Contingencies of our Notes to Consolidated Financial Statements for details.
- (7) As of December 31, 2009, includes \$0.8 million of restricted cash primarily designated for our acquisition of PacketTrap Networks, Inc. As of December 31, 2008, includes \$2.4 million of restricted cash designated for the satisfying of certain indemnification obligations related to escrow agreements with acquired companies where Quest is the holder of the escrow money. As of December 31, 2007, includes \$48.9 million of restricted cash designated for the acquisition of PassGo Technologies Limited which closed on January 2, 2008.
- (8) Includes \$44.4 million, \$40.8 million and \$37.1 million as of December 31, 2009, 2008 and 2007, respectively, in long-term taxes payable recorded in compliance with provisions set forth in FASB’s standard on *Accounting for Uncertainty in Income Taxes—An Interpretation of FASB’s standard on Accounting for Income Taxes*, which we adopted on January 1, 2007.

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

The following discussion of our financial condition and results of operations (“MD&A”) should be read in conjunction with the consolidated financial statements and notes to those statements included elsewhere in this Report. Certain statements in this Report, including statements regarding our business strategies, operations, financial condition and prospects are forward-looking statements. Use of the words “believe,” “expect,” “anticipate,” “will,” “contemplate,” “would,” “project,” “plan,” “may,” “could,” “intend,” “likely,” “might,” “estimate,” “continue” and similar expressions that contemplate future events may identify forward-looking statements.

Numerous important factors, risks and uncertainties affect our operations and could cause actual results to differ materially from those expressed or implied by these or any other forward-looking statements made by us or on our behalf. Readers are urged to carefully review and consider the various disclosures made in this Report, including those described under “Risk Factors,” and in other filings with the SEC that attempt to advise interested parties of certain risks and factors that may affect our business. Readers are cautioned not to place undue reliance on these forward-looking statements, which are based on current expectations and reflect management’s opinions only as of the date thereof. We do not assume any obligation to revise or update forward-looking statements. Finally, our historic results should not be viewed as indicative of future performance.

### **Overview**

#### ***Our Company and Business Model***

Quest Software, Inc., together with our subsidiaries ScriptLogic and Vizioncore, delivers innovative products that help IT organizations get enhanced performance from their computing environment. Our product areas are Application Management, Database Management, Windows Management and Virtualization Management. The focus of our products is based upon generating higher levels of performance, manageability and productivity throughout our customers’ IT infrastructure and with products and services that enable them to manage the investments they have made within their IT environment.

Our initial core competency as a database management company was built upon deep expertise within the Oracle database platform where we assembled a portfolio of products to manage and speed the development on

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the platform. As customers required heterogeneous database management tools, we broadened our product portfolio to deliver complementary solutions and expanded our offerings to address other database platforms, including DB2 and SQL Server. Today, most of our database management revenue is derived from products focused on the Oracle platform. In the last several years however, Oracle has increased the functionality of their database products creating a stronger competitive offering which has impaired our license growth for certain products. This has negatively impacted our database management license growth. Our database development product group led by TOAD continues to be the most significant revenue contributor of our Oracle database products. As we were impacted from Oracle's encroachment within the management market we sought to diversify our portfolio and fostered development on Microsoft's SQL Server database platform. Today, our SQL Server management products support backup and recovery, capacity management and performance management for one of Microsoft's strategic platforms. Application deployments typically front large databases, thus the database logically interacts with other elements of the application infrastructure. This logical linkage and reliance on the database led Quest into its next product focal point known as Application Management.

Beginning with our acquisition of Foglight Software in January 2000 and then Sitraka in October 2002, and continuing with our current offerings for application management, we have made significant investments and evolved the development of products for this market. Foglight remains our flagship product and largest revenue component of our application management offerings. As our customers face the need to manage more complex applications with service oriented architectures, our products for identifying application outages and performance have become important tools. Improving and adding to our Foglight offering has been a major focal point for us over the past few years. In 2009, we acquired PacketTrap Networks to increase the functionality around our product capabilities in this area by incorporating network layer performance monitoring into our solution.

After establishing a market presence in both the database and application management markets, we sought to broaden our portfolio further into the Windows management tools market in early 2000 with our acquisition of Fastlane Technologies. In 2004, we acquired Aelita Software. Our acquisition of Aelita, combined with internally developed products, solidified our position as one of Microsoft's leading ISV's. In August of 2007 we acquired ScriptLogic, extending our product footprint to address desktop management, a new market for us. Further, in September 2008 we acquired NetPro Computing, Inc. ("NetPro"), expanding our Active Directory product portfolio. In 2009, and with the cloud computing paradigm gaining market acceptance, we launched our first set of Software as a Service ("SaaS") Windows management solutions, which is hosted on Microsoft's Azure platform. We market and support management tools for six key Microsoft platforms – Windows Server, Active Directory, Exchange, SQL Server, Azure and the Microsoft desktop. Our products address both migration and management of the Windows platform. Our migration business comprises a set of products which support migration from other competitive platforms to the comparable Microsoft platform, as well as migrations from earlier to the most current version of Microsoft platforms. In addition, we offer products which complement the core platform tools which are natively used by customers to manage these platforms once they are in a production environment.

As our Windows products emerged and continued to grow in market popularity, the composition of our overall revenue profile changed from being primarily derived from Oracle database platform tools to a more balanced profile with our Windows products. Our Windows products represent the largest portion of our total revenues.

As the market for virtualization began to develop we made an investment in Vizioncore during 2005 which served as the cornerstone for our next strategic product line expansion. During 2007, we further expanded this product portfolio with subsequent acquisitions of Invirtus and Provision Networks. In December 2007 we acquired the remaining minority interest in Vizioncore. As customers increase the use of today's Virtualization platforms the market is moving past the early-adopter phase into mainstream production usage in support of server consolidation, disaster recovery and other usage scenarios across the datacenter. The taxonomy of the Virtualization Management market is following the development of paths taken previously where platform companies create the delivery mechanism and partner with other third-party vendors such as Quest to support

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their platform. Today, the platform market leader is VMware, but with Microsoft and Citrix/ XenSource entering the market, it is expected that “cross-platform” tools will emerge to support the requirements of the datacenter such as provisioning, monitoring, reporting, disaster recovery and the typical functions found in today’s physical environment. We believe that the depth and breadth of our management capability across the entire IT stack uniquely positions Quest to manage this environment.

Strategic acquisitions and investments have been a key part of our corporate strategy. Over the past three years, we spent approximately \$312 million on fifteen acquisitions and invested \$12.3 million in three early stage private companies. This strategic deployment of capital covered many of our existing market segments including Application Management, Windows Management and Virtualization Management. We intend to continue to identify and acquire companies in adjacent or contiguous markets, as we have done in the past. We have also used acquisitions and investments to build upon or extend our core competencies with incremental technology to increase our existing product functionality or complete a key portion of a deliverable on the product roadmap.

We derive revenues from three primary sources: (1) software licenses, (2) post-contract technical support services (“maintenance”) and (3) consulting and training services. Our software licensing model is primarily based on perpetual license fees. In addition to perpetual software licenses, we sell a small amount of time-based software licenses (or term licenses) wherein customers pay a single fee for the right to use the software and receive maintenance for a defined period of time. Our license fees are typically calculated either on a per-server basis or a per-seat/user basis.

Maintenance contracts entitle a customer to telephone or internet support and unspecified maintenance releases, updates and enhancements. First-year maintenance contracts are typically sold with the related perpetual software license and renewed on an annual basis thereafter at the customer’s option. Generally, annual maintenance renewal fees are priced as a percentage of the net initial customer purchase price (which includes both the fee for a perpetual license and first year maintenance). Revenue is allocated to first year maintenance based on vendor-specific objective evidence (“VSOE”) of fair value and amortized over the term of the maintenance contract, typically 12 months, although at times we sell maintenance with terms of greater than 12 months.

We also provide consulting and training services which relate to the installation and configuration of our products but do not include significant customization to or development of the underlying software code. Revenue allocated to consulting and training services is analyzed based on VSOE of fair value and recognized as the services are performed. Such revenues represented 9.1%, 10.2% and 11.4% of total services revenues for the twelve months ended December 31, 2009, 2008 and 2007, respectively.

### ***Summary of Consolidated Financial Results***

As discussed in more detail throughout our MD&A, for the twelve months ended December 31, 2009 compared to the twelve months ended December 31, 2008, we delivered the following financial performance:

- Total revenues decreased by \$40.1 million, or 5.5%, to \$695.2 million;
- Total expenses decreased by \$42.3 million, or 6.5%, to \$611.7 million;
- Income from operations increased by \$2.2 million, or 2.7%, to \$83.5 million;
- Other income, net increased by \$1.5 million, from \$1.0 million in 2008 to \$2.5 million in 2009;
- Diluted earnings per share increased by \$0.11, or 16.8%, to \$0.75;
- Weighted average basic and diluted shares outstanding decreased from 104.2 million and 106.3 million in 2008 to 91.9 million and 94.1 million in 2009.
- Cash and cash equivalents increased by \$77.0 million, or 35.7%, to \$292.9 million.

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Our 2009 revenues were affected by a weak macro-economic environment. This was particularly visible within our EMEA sales regions where revenues were down approximately 17% when compared to the 2008 period, while revenues in our Americas and Asia Pacific sales regions were flat year-over-year.

In 2009, we experienced a decline in revenues in all product areas except Virtualization Management, with the most notable decline coming from our Database Management product area. Our 2009 total revenues were also negatively impacted by the strengthening U.S. Dollar. This resulted in lower U.S. Dollar equivalent sales for several currencies including the Euro and British Pound. Since certain of our international sales are denominated in these non-U.S. Dollar currencies, the impact from foreign currency comprised approximately 26%, or \$10.4 million, of the overall decrease in total revenues.

Although total revenues declined, our management of discretionary and headcount related expenses, combined with the net benefit from foreign currency exchange rates, resulted in an increase in our operating margin.

A portion of the 2009 total expenses was due to a \$19.0 million litigation loss provision recorded in connection with our settlement of the shareholder class action relating to alleged stock option backdating. See Note 16 – Commitments and Contingencies of our Notes to Consolidated Financial Statements for additional information. During 2009, we experienced a significant decrease in personnel related costs, which include compensation, benefits and payroll related taxes compared to the same period in 2008. Our full-time employee headcount at the end of 2009 was 3,365, as compared to 3,477 at the end of 2008. Our full-time employee headcount in locations outside of the United States was 1,554 at the end of 2009 compared to 1,646 at the end of 2008. We continue to realize benefit from certain cost management initiatives we have undertaken since mid-2008 which include reduced headcount and travel costs, as well as other measures. Our 2009 total expenses were also impacted by the strengthening U.S. Dollar relative to certain non-U.S. Dollar currencies in 2009, which resulted in a lesser U.S. Dollar equivalent for several currencies as noted above. Since certain of our international expenses are denominated in these non-U.S. Dollar currencies, our total expenses in 2009 were reduced by approximately \$26.0 million compared against the same period in 2008 as a result of the impact of foreign currency exchange rates when comparing 2009 rates to 2008.

### *Foreign Currency*

While we are a U.S. Dollar functional company on a world-wide basis, we transact business and operate using multiple foreign currencies. As such, the value of our revenues, expenses, certain account balances and cash flows are exposed to fluctuations in foreign currencies against the value of the U.S. Dollar. For example, when the U.S. Dollar strengthens against several non-U.S. Dollar currencies as has recently occurred, our foreign revenues and thus our total revenues can be negatively impacted. A stronger U.S. Dollar translates into lower expenses in those entities where we have operations and our personnel and occupancy expenses are denominated in non-U.S. Dollars, resulting in lower total expenses. Conversely, a weaker U.S. Dollar would have the opposite effects on total revenues and expenses. In certain geographic regions and within specific currencies, partial offsets between revenues and expenses or balance sheet positions may reduce this exposure. In other instances, we can manage our operations to reduce foreign currency exposure or utilize derivative instruments to manage this exposure. See Note 14 – Derivative Instruments for additional details.

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### Results of Operations

Except as otherwise indicated, the following are percentage of total revenues:

	Year Ended December 31,		
	2009	2008	2007
Revenues:			
Licenses	40.2%	45.4%	48.9%
Services	59.8	54.6	51.1
Total revenues	100.0	100.0	100.0
Cost of revenues:			
Licenses	1.1	1.2	1.0
Services	8.4	8.4	8.7
Amortization of purchased technology	2.8	2.8	2.3
Total cost of revenues	12.3	12.4	12.0
Gross profit	87.7	87.6	88.0
Operating expenses:			
Sales and marketing	39.3	42.5	43.6
Research and development	20.8	20.9	19.4
General and administrative	11.0	11.6	13.0
Amortization of other purchased intangible assets	1.9	1.5	1.2
In-process research and development	—	0.1	—
Litigation loss provision, net	2.7	—	—
Total operating expenses	75.7	76.6	77.2
Income from operations	12.0	11.0	10.8
Other income, net	0.4	0.1	3.6
Income before income tax provision	12.4	11.1	14.4
Income tax provision	2.3	1.9	4.4
Net income	10.1%	9.2%	10.0%

### Comparison of Fiscal Years Ended December 31, 2009 and 2008

#### Revenues

Total revenues and year-over-year changes are as follows (in thousands, except for percentages):

	2009	2008	Increase/(Decrease)	
			Dollars	Percentage
Revenues:				
Licenses				
Americas	\$177,120	\$192,781	\$(15,661)	(8.1)%
Rest of World	102,118	141,302	(39,184)	(27.7)%
Total license revenues	279,238	334,083	(54,845)	(16.4)%
Services				
Americas	281,378	265,230	16,148	6.1%
Rest of World	134,620	136,064	(1,444)	(1.1)%
Total service revenues	415,998	401,294	14,704	3.7%
Total revenues	\$695,236	\$735,377	\$(40,141)	(5.5)%

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**Licenses Revenues** — The decrease in license revenues was due primarily to decreased sales of our Database Management products across all geographic regions and Windows Management products in our Europe, the Middle East and Africa (“EMEA”) region. In 2009 we sold significantly more term-based licenses, which resulted in \$22.9 million of deferred license revenue at the end of 2009 compared to \$6.9 million in 2008, representing an approximate \$16 million increase in deferred license revenue that would have otherwise been recognized as license revenue in 2009 had those same sales been perpetual based. Our 2009 license revenues were also negatively impacted by the strengthening U.S. Dollar relative to certain non-U.S. Dollar currencies in 2009. This resulted in a lesser U.S. Dollar equivalent for several currencies including the Euro and British Pound. Since certain of our international sales are denominated in these non-U.S. Dollar currencies, the impact from foreign currency comprised approximately 16% of the overall decrease in license revenues.

**Services Revenues** — Services revenues are derived from post-contract technical support services (“maintenance”) and consulting and training services. The largest component of our services revenues is maintenance revenue. Maintenance revenues are generated from support and maintenance services relating to current year sales of new software products and from the renewal of existing maintenance agreements for software licenses sold in prior periods. The main driver of our growth in services revenues was maintenance renewals on our Windows Management products in the Americas. Also contributing to the growth in services revenues were maintenance renewals on our Virtualization Management products across all geographic regions. Maintenance revenues from our Database Management products decreased particularly in the EMEA region. Revenue from consulting and training services as a percentage of total service revenues was approximately 9.1% and 10.2% of total service revenues in the twelve months ended December 31, 2009 and 2008, respectively.

Maintenance revenues continue to contribute a larger percentage of our total revenues for two primary reasons: growth of our installed base of customers via new license sales, and acquisitions and their related maintenance contracts. As our maintenance customer base grows, maintenance renewals have a larger influence on the maintenance revenue growth rate and the amount of new software license revenues has a diminishing effect. Therefore, the growth rate of total revenues does not necessarily correlate directly to the growth rate of new software license revenues in a given period. The primary determinant of changes in our maintenance revenue profile is the extent to which our customers renew their annual maintenance agreements, taking into account the number of products and licenses for which each customer renews, and the timing of the renewals by each such customer. If our maintenance renewals were to decline materially, our maintenance revenues, total revenues and cash flows would likely decline materially as well.

Over the past twelve months we have experienced declining growth in our maintenance revenues and expect this trend to continue through at least 2010. The three main reasons for this decline are: reduced sales of new software licenses during 2009; fewer acquisitions which resulted in less revenue contribution from acquired deferred maintenance revenues; and impact from foreign currency.

## Cost of Revenues

Total cost of revenues and year-over-year changes are as follows (in thousands, except for percentages):

	<u>2009</u>	<u>2008</u>	<u>Dollars</u>	<u>Decrease</u> <u>Percentage</u>
Cost of Revenues:				
Licenses	\$ 7,581	\$ 8,586	\$(1,005)	(11.7)%
Services	58,528	62,060	(3,532)	(5.7)%
Amortization of purchased technology	19,393	20,231	(838)	(4.1)%
Total cost of revenues	\$85,502	\$90,877	\$(5,375)	(5.9)%

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*Cost of Licenses* — Cost of licenses primarily consists of third-party software royalties, product packaging, delivery, and personnel costs. Cost of licenses as a percentage of license revenues was 2.7% and 2.6% for the twelve months ended December 31, 2009 and 2008. The decrease in cost of licenses was due primarily to a \$0.6 million reduction in hardware and inventory purchases that are sold with certain of our software products and a \$0.3 million reduction in delivery costs.

*Cost of Services* — Cost of services primarily consists of personnel, outside consultants, facilities and systems costs used in providing maintenance, consulting and training services. Cost of services does not include development costs related to bug fixes and upgrades which are classified in research and development and which are not separately determinable. Personnel related costs and travel decreased by \$2.0 million and \$1.0 million, respectively. An additional \$0.8 million of the overall decrease in cost of services was due to lower consulting and other professional fees. The impact from foreign currency comprised approximately 80% of the overall decrease in cost of services. Cost of services as a percentage of service revenues was 14.1% and 15.5% in the twelve months ended December 31, 2009 and 2008, respectively.

*Amortization of Purchased Technology* — Amortization of purchased technology includes amortization of the fair value of purchased technology associated with acquisitions. We expect amortization of purchased technology within the cost of revenues arising from acquisitions completed prior to December 31, 2009 to be not less than \$15.1 million in the year ending December 31, 2010.

### Operating Expenses

Year-over-year changes in the principal components of our operating expenses are as follows (in thousands, except for percentages):

	2009	2008	Increase/(Decrease)	
			Dollars	Percentage
Operating Expenses:				
Sales and marketing	\$272,944	\$312,493	\$(39,549)	(12.7)%
Research and development	144,370	153,464	(9,094)	(5.9)%
General and administrative	76,748	84,954	(8,206)	(9.7)%
Amortization of other purchased intangible assets	13,159	11,302	1,857	16.4%
In-process research and development	—	955	(955)	(100)%
Litigation loss provision, net	19,025	—	19,025	— %
Total operating expenses	\$526,246	\$563,168	\$(36,922)	(6.6)%

*Sales and Marketing* — Sales and marketing expenses consist primarily of compensation and benefit costs for sales and marketing personnel, sales commissions, and costs of trade shows, travel and entertainment and various discretionary marketing programs. The decrease in sales and marketing expense during the twelve months ended December 31, 2009 over the comparable period in 2008 was due primarily to a \$26.9 million decrease in personnel related costs and a \$4.9 million decrease in travel costs. The decrease in personnel related costs was due primarily to reductions in commissions, base salary and related payroll taxes, share-based compensation and bonuses. We also had a \$3.6 million decrease in conferences and trade show costs and a \$1.4 million decrease in advertising costs. The impact from foreign currency comprised approximately 32% of the overall decrease in sales and marketing expense.

*Research and Development* — Research and development expenses consist primarily of compensation and benefit costs for software developers who develop new products, bug fixes and upgrades to existing products and at times provide engineering support for maintenance services, software product managers, quality assurance and technical documentation personnel, and payments made to outside software development consultants in

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connection with our ongoing efforts to enhance our core technologies and develop additional products. The decrease in research and development expense during the twelve months ended December 31, 2009 as compared to the same period in 2008 was due primarily to a \$5.1 million decrease in personnel related costs and a \$1.8 million decrease in travel costs. Also, expenditures related to certain post-acquisition contingent payment obligations that were tied to technology milestones decreased by approximately \$2.7 million. Research and development expenses were also impacted by the increased value of the U.S. Dollar as a significant portion of our developers are located outside of the U.S. The impact from foreign currency comprised approximately 90% of the overall decrease in research and development expenses.

*General and Administrative* — General and administrative expenses consist primarily of compensation and benefit costs for our executive, finance, legal, human resources, administrative and information services personnel, and professional fees for audit, tax and legal services. The decrease in general and administrative expense during the twelve months ended December 31, 2009 over the comparable period in 2008 was due primarily to a decrease of \$5.5 million in personnel related costs and a \$0.5 million decrease in travel costs. Lower corporate insurance, recruiting and legal costs contributed \$3.1 million to the overall decrease in general and administrative costs. The impact from foreign currency comprised approximately 22% of the overall decrease in general and administrative expenses.

*Amortization of Other Purchased Intangible Assets* — Amortization of other purchased intangible assets includes the amortization of customer lists, trademarks, non-compete agreements and maintenance contracts associated with acquisitions. The increase in amortization of other purchased intangible assets during the twelve months ended December 31, 2009 over the comparable period in 2008 was due primarily to a full twelve months of amortization of intangibles acquired during the last half of 2008, resulting in an increase of \$3.7 million. The increase from 2008 acquired intangibles was partially offset by certain other purchased intangible assets that were fully amortized prior to the twelve months ended December 31, 2009. We expect amortization of other purchased intangible assets within operating expenses arising from acquisitions completed prior to December 31, 2009 to be not less than \$12.1 million in the year ending December 31, 2010.

*In-Process Research and Development* — In-process research and development expenses relate to in-process technology acquired in May 2008. These costs were charged to operations as the technologies had not reached technological feasibility and did not have alternative future uses at the date of acquisition.

*Litigation Loss Provision, Net* — Litigation loss provision, net of \$19.0 million relates to a \$29.4 million settlement of the shareholder class action for alleged stock option backdating filed in October 2006 in the U.S. District Court for the Central District of California against Quest and certain of our current or former officers and directors, which amount was offset by approximately \$10 million in insurance proceeds paid by our insurance providers in the fourth quarter of 2009. See Note 16 – Commitments and Contingencies of our Notes to Consolidated Financial Statements for additional information.

### Other Income, Net

Other income, net consists of the following (in thousands):

	<u>Year Ended December 31</u>	
	<u>2009</u>	<u>2008</u>
Interest income	\$ 1,863	\$ 10,972
Interest expense	(2,827)	(128)
Foreign currency gain (loss), net <sup>(1)</sup>	3,640	(7,532)
Forward foreign currency contracts loss, net <sup>(2)</sup>	(893)	—
Unrealized gains (losses) on ARS <sup>(3)</sup>	5,172	(8,515)
Unrealized (losses) gains on Put Options <sup>(3)</sup>	(4,543)	7,873
Impairment losses on cost method investments	—	(2,001)
Other income	137	361
<b>Total other income, net</b>	<b>\$ 2,549</b>	<b>\$ 1,030</b>

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Other income, net primarily includes interest income generated by our investment portfolio, gains and losses from foreign exchange fluctuations and gains or losses on other financial assets as well as a variety of other non-operating expenses. Other income, net was \$2.5 million in the twelve months ended December 31, 2009 compared to \$1.0 million in the same period of 2008. Interest expense was \$2.8 million and \$0.1 million in the twelve months ended December 31, 2009 and 2008, respectively. The increase in interest expense is due to debt agreements entered into in 2009. See Note 8 – Loans Payable of our Notes to Consolidated Financial Statements for additional information regarding our debt agreements. Interest income was \$1.9 million and \$11.0 million in the twelve months ended December 31, 2009 and 2008, respectively. The decrease in interest income was due primarily to lower average investment yields and average cash and investment balances. We had a foreign currency gain of \$3.6 million and a loss of \$7.5 million for the twelve months ended December 31, 2009 and 2008, respectively. Our foreign currency gains or losses are predominantly attributable to translation gains or losses relative to the U.S. Dollar on the re-measurement of net monetary assets, including accounts receivable and cash, which were primarily denominated in the Euro, and to a lesser extent, the British Pound and Canadian Dollar.

### Income Tax Provision

During the twelve months ended December 31, 2009, the provision for income taxes increased to \$15.7 million from \$14.3 million in the comparable period of 2008, representing an increase of \$1.4 million. The effective income tax rate increased to 18.2% in 2009, compared to 17.4% in 2008. The increase in the effective tax rate is primarily related to a combination of factors including the mix of income between high and low tax jurisdictions, a net benefit due to the closure of a California Franchise Tax Audit during the year ended December 31, 2009, and the closure of an Internal Revenue Service examination which provided a benefit during the year ended December 31, 2008.

### Comparison of Fiscal Years Ended December 31, 2008 and 2007

#### Revenues

Total revenues and year-over-year changes are as follows (in thousands, except for percentages):

	<u>2008</u>	<u>2007</u>	<u>Dollars</u>	<u>Increase</u> <u>Percentage</u>
Revenues:				
Licenses				
Americas	\$192,781	\$186,076	\$ 6,705	3.6%
Rest of World	141,302	122,576	18,726	15.3%
Total license revenues	334,083	308,652	25,431	8.2%
Services				
Americas	265,230	215,198	50,032	23.2%
Rest of World	136,064	107,131	28,933	27.0%
Total service revenues	401,294	322,329	78,965	24.5%
Total revenues	\$735,377	\$630,981	\$104,396	16.5%

*Licenses Revenues* — License revenues from sales of our Windows and Virtualization Management products were the most significant drivers of license revenues growth during 2008 while Database Management license revenues decreased. Approximately half of the increase in our Windows Management license revenues came from the contributions of ScriptLogic and NetPro. Total license revenues in the twelve months ended December 31, 2007 benefited from the change in our revenue recognition practices for large reseller transactions. The modified practice was applied to transactions consummated on or after January 1, 2007 due to change in

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circumstances involving improved cash collection histories with these resellers. If this change had been implemented prior to January 1, 2007 we would have reported \$295.7 million in license revenues in 2007, which would imply a 13% growth rate in total license revenues in the 2008 period.

*Services Revenues* — The main driver of services revenues growth in both the Americas and the Rest of World during the year ended December 31, 2008 was maintenance revenues from our Windows Management products. Approximately 34% of the overall increase in services revenues during the period came from the contributions of ScriptLogic, PassGo and NetPro. Consulting and training services as a percentage of total service revenues represented 10.2 % and 11.4% in the years ended December 31, 2008 and 2007, respectively.

### Cost of Revenues

Total cost of revenues and year-over-year changes are as follows (in thousands, except for percentages):

	2008	2007	Increase	
			Dollars	Percentage
Cost of Revenues:				
Licenses	\$ 8,586	\$ 6,111	\$ 2,475	40.5%
Services	62,060	55,173	6,887	12.5%
Amortization of purchased technology	20,231	14,459	5,772	39.9%
Total cost of revenues	\$90,877	\$75,743	\$15,134	20.0%

*Cost of Licenses* — Cost of licenses as a percentage of license revenues was 2.6% and 2.0% for the twelve months ended December 31, 2008 and 2007, respectively. The increase in cost of licenses, both in terms of absolute dollars and as a percentage of licenses revenues, was primarily the result of a \$2.0 million, or 80.1%, increase in royalty expense related to sales of licenses to royalty-bearing products and a \$0.8 million, or 74.7%, increase in hardware purchases that are sold with certain of our software products.

*Cost of Services* — Personnel related costs increased during 2008 by approximately \$5.5 million, or 16.7%, primarily due to growth in our technical support headcount. Average headcount related to our technical support group increased approximately 19%, with the impact from our acquisition of ScriptLogic contributing approximately one-third of the increase. An additional \$0.9 million of the overall increase in cost of services was due to higher consulting and other professional fees. Cost of services as a percentage of services revenues was 15.5% and 17.1% in the twelve months ended December 31, 2008 and 2007, respectively. The margin improvement was primarily due to increased customer maintenance and support revenues with a lower associated increase in headcount.

*Amortization of Purchased Technology* — The increase in amortization of purchased technology from 2007 to 2008 was primarily due to technology acquired in 2008, offset slightly by certain technologies that were fully amortized prior to and during 2008.

### Operating Expenses

Year-over-year changes in the principal components of our operating expenses are as follows (in thousands, except for percentages):

	2008	2007	Increase	
			Dollars	Percentage
Operating Expenses:				
Sales and marketing	\$312,493	\$275,037	\$37,456	13.6%
Research and development	153,464	122,592	30,872	25.2%
General and administrative	84,954	81,758	3,196	3.9%
Amortization of other purchased intangible assets	11,302	7,345	3,957	53.9%
In-process research and development	955	220	735	334.1%
Total operating expenses	\$563,168	\$486,952	\$76,216	15.7%

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*Sales and Marketing* — The increase in sales and marketing expense during the year ended December 31, 2008 over the comparable period in 2007 was primarily due to higher personnel costs, including increased commission expense as well as severance payments associated with our headcount reductions in the second and fourth quarters of 2008. Personnel related costs increased approximately \$28.1 million, or 14.1%, primarily due to a 16% increase in average headcount within our sales and presales groups, including the headcount added with our acquisitions of ScriptLogic and NetPro, severance payments of \$4.1 million of which the majority was related to our headcount reductions, a \$2.4 million foreign currency impact and an increase of \$5.0 million in commission expense on higher license revenues. On a year-over-year basis, an increase of \$1.6 million, or 38.2%, in advertising costs, \$2.2 million, or 61.4%, in trade show costs, and \$1.0 million, or 80.2%, in employee rewards programs also contributed to the overall increase.

*Research and Development* — The increase in research and development expense during the year ended December 31, 2008 as compared to the same period in 2007 was primarily due to higher personnel related costs, which increased \$20.3 million, or 20.9%, as a result of an 8% increase in average headcount (some of which was due to reassignment of certain product management from marketing to research and development), a \$2.1 million foreign currency impact and the impact from our acquisitions of ScriptLogic and NetPro. An additional \$3.7 million of the overall increase is attributable to certain post-acquisition contingent payment obligations tied to technology development milestones. Research and development expenses were also impacted by the devaluation of the U.S. Dollar as a significant portion of our developers are located outside of the U.S.

*General and Administrative* — General and administrative expenses were held relatively consistent year-over-year, with only a 3.9% increase. The slight increase in general and administrative expense during the year ended December 31, 2008 over the comparable period in 2007 was primarily due to higher personnel related costs, which increased \$8.5 million, or 19.1%, on a 16% increase in average headcount hired to support the company's growth including the headcount added from our acquisition of ScriptLogic. The increase in personnel related costs included a \$1.4 million increase in share-based compensation related to our July 2008 non-employee director grants, with no non-employee director grants made in 2007, and \$1.1 million of increased share-based compensation expense related to the first year of granting restricted stock units to our executive officers. Also contributing to the increase in general and administrative expenses was bad debt, which increased by \$1.1 million period-over-period. The increase in personnel related costs and bad debt was offset partially by a \$7.3 million, or 67.1%, decrease in restatement related costs.

*Amortization of Other Purchased Intangible Assets* — The increase in amortization of other purchased intangible assets from 2007 to 2008 was primarily due to other purchased intangible assets from acquisitions made in 2008, offset slightly by certain other purchased intangible assets that were fully amortized prior to and during 2008.

*In-Process Research and Development* — In-process research and development expenses related to in-process technology acquired in May 2008 and November 2007. These costs were charged to operations as the technologies had not reached technological feasibility and did not have alternative future uses at the date of acquisition.

### ***Other Income, Net***

Other income, net decreased to \$1.0 million in 2008 from \$22.4 million in 2007. The largest impact to other income, net during 2008 was a foreign currency loss of \$7.5 million compared to a gain of \$4.4 million in 2007. Our foreign currency gains or losses are predominantly attributable to translation gains or losses relative to the U.S. Dollar on the re-measurement of net monetary assets, including accounts receivable and cash, which were primarily denominated in the Euro, and to a lesser extent, the British Pound and Canadian Dollar. Interest income was \$11.0 million and \$18.1 million in the year ended December 31, 2008 and 2007, respectively. The decrease in interest income was due primarily to lower average investment yields and lower average cash and investment balances. We also recorded a \$2.0 million loss in the year ended December 31, 2008 for two cost method

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investments and \$0.6 million in losses on our investments in auction rate securities, net of a gain from a put agreement with the investment firm that sold us these securities (see Liquidity and Capital Resources for additional details). These investments were determined to have fair values less than carrying value and deemed other-than-temporarily impaired.

### **Income Tax Provision**

During the twelve months ended December 31, 2008, the provision for income taxes decreased to \$14.3 million from \$27.6 million in the comparable period of 2007, representing a decrease of \$13.3 million. The effective income tax rate decreased to 17.4% in 2008, compared to 30.4% in 2007. The decrease in the effective tax rate is primarily due to the closure of an Internal Revenue Service examination of income tax returns through December 31, 2004, and a combination of other factors including the mix of income between high and low tax jurisdictions, and the impact of net operating losses and associated valuation allowances in certain foreign jurisdictions. The closure of the Internal Revenue Service's examination of income tax returns through December 31, 2004 resulted in a tax benefit of \$5.1 million with a corresponding reversal of income tax expense and related interest.

### **Inflation**

Economic inflation has not had a significant effect on our results of operations or financial position for the years ended December 31, 2009, 2008 and 2007.

### **Liquidity and Capital Resources**

Cash and cash equivalents and short-term and long-term investments were approximately \$385.5 million and \$257.9 million as of December 31, 2009 and 2008, respectively. Of these amounts, \$214.1 million and \$160.4 million as of December 31, 2009 and 2008, respectively, are domiciled in locations outside of the U.S.

At December 31, 2009, we held within short-term investments \$47.6 million (with a fair value of \$44.2 million) of investment grade municipal notes with an auction reset feature ("auction rate securities" or "ARS"). These securities are collateralized by higher education funded student loans which are supported by the federal government as part of the Federal Family Education Loan Program (FFELP). The ARS were pledged as collateral for the amount drawn on our UBS line of credit. In July 2009, we drew down \$34.4 million, or 70%, of the par value against the value of our ARS. We do not have reason to believe that any of the underlying issuers of our ARS are presently at risk or that the underlying credit quality of the assets backing our auction rate security investments has been impacted by the reduced liquidity of these investments. Based on our current ability to access cash and other short-term investments, our expected operating cash flows, and other sources of cash that we expect to be available, we do not anticipate the current lack of liquidity of these investments to have a material impact on our business strategy, financial condition, results of operations or cash flows. Additionally, in October 2008, we entered into a put agreement with the investment firm that sold us our ARS. Under the terms of the agreement, we have the ability to put all of our ARS to the investment firm at any time during the period beginning June 30, 2010 and ending June 30, 2012 at par value. The investment firm also has the right to repurchase these ARS at par value on or before June 30, 2010. For more information concerning our ARS see Note 4 – Cash and Cash Equivalents and Investments of our Notes to Consolidated Financial Statements.

Summarized annual cash flow information is as follows (in thousands):

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Cash provided by operating activities	\$153,286	\$ 151,851	\$ 137,436
Cash used in investing activities	(70,084)	(76,047)	(187,295)
Cash used in financing activities	(3,706)	(101,927)	(122)
Effect of exchange rate changes	(2,451)	6,450	(615)
Net increase (decrease) in cash and cash equivalents	\$ 77,045	\$ (19,673)	\$ (50,596)

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### *Operating Activities*

Cash provided by operating activities is primarily comprised of net income, adjusted for non-cash activities such as depreciation and amortization and compensation expense associated with share-based payments. These non-cash adjustments represent charges reflected in net income, therefore, to the extent that non-cash items increase or decrease our future operating results, there will be no corresponding impact on our cash flows. After excluding the effects of these non-cash charges, the primary changes in cash flows relating to operating activities resulted from changes in operating assets and liabilities. The analyses of the changes in our operating assets and liabilities are as follows:

- Accounts receivable increased to \$157.5 million at December 31, 2009 from \$153.9 million at December 31, 2008. Day's sales outstanding, or DSO, were 75 days and 70 days as of December 31, 2009 and December 31, 2008, respectively, and our daily sales remained relatively flat at \$2.1 million for the quarter ended December 31, 2009 compared to \$2.2 million for the quarter ended December 31, 2008. Collection of accounts receivable and related DSO could fluctuate in future periods due to the timing and amount of our revenues and their linearity and the effectiveness of our collection efforts.
- Deferred revenue increased to \$372.1 million at December 31, 2009 from \$338.7 million at December 31, 2008, resulting in an increase in operating liabilities and reflecting a cash inflow of \$33.4 million for the twelve months ended December 31, 2009. The increase in deferred revenue was due primarily to growth in sales of time-based software licenses, which accounts for approximately \$16.0 million of the overall increase in deferred revenue, and to growth of our software post-contract technical support services customer base.
- Other accrued expenses decreased to \$31.9 million at December 31, 2009 from \$39.9 million at December 31, 2008, resulting in a decrease in operating liabilities and reflecting a cash outflow of \$8.3 million for the twelve months ended December 31, 2009. The decrease in other accrued expenses was due primarily to payments of certain acquisition related liabilities.

One of the primary cash outflows within operating assets and liabilities during the twelve months ended December 31, 2009 was the net payment of \$19.0 million for our settlement of the shareholder class action relating to alleged stock option backdating. See Note 16 – Commitments and Contingencies of our Notes to Consolidated Financial Statements for details. In addition, we paid \$15.1 million for taxes, a decrease of \$7.4 million over the comparable 2008 period.

### *Investing Activities*

Cash used in investing activities in the twelve months ended December 31, 2009 included \$45.0 million for purchases of investment securities net of sales and maturities, \$12.3 million paid for acquisitions, \$11.3 million in capital expenditures and \$3.0 million for a cost method investment in an early stage private company. We will continue to purchase property and equipment needed in the normal course of our business. We also plan to use cash generated from operations and/or proceeds from our investment securities to fund other strategic investment and acquisition opportunities that we continue to evaluate. We plan to use excess cash generated from operations to invest in short and long-term investments consistent with past investment practices.

We will also continue to use cash for capital improvements to our existing back office accounting and finance systems with a goal of automating more of our back office accounting and finance functions. In 2009 we implemented a plan to improve our accounting and finance systems with an expectation that these improvements will support the back office functions for the foreseeable future. We began making improvements in 2009 with a re-implementation of our Oracle accounting system. The re-implementation project is a multiple phase project with a projected go-live date during 2010. The overall cost associated with this project is expected to be \$7.0 million to \$10.0 million, the majority of which will be capitalized and depreciated over approximately 7 years. We have also spent significant time, effort and money updating and implementing various other accounting and finance systems throughout 2009 and have additional projects planned for 2010.

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### *Financing Activities*

Cash used in financing activities in the twelve months ended December 31, 2009 included \$112.4 million paid for repurchases of our common stock and \$4.5 million for repayment of loans outstanding and fees related to our undrawn line of credit. We received net proceeds of \$68.4 million from our loans payable and \$43.3 million from the issuance of our common stock due to exercises of stock options.

On February 17, 2009, we entered into a two year revolving line of credit agreement with Wells Fargo Foothill, LLC as the arranger, administrative agent and lender. We intend to use the proceeds from the credit agreement for working capital and other general corporate purposes. The credit agreement allows for cash borrowings and letters of credit under a secured revolving credit facility of up to a maximum of \$100 million. Interest will accrue at a floating rate based on, at the Company's election, (i) LIBOR (subject to reserve requirements and a minimum LIBOR of 2.75%) or (ii) the greatest of (a) 4.0%, (b) the Federal Funds Rate plus 0.5% or (c) Wells Fargo's prime rate, in each case, plus an applicable margin. The credit agreement includes limitations on the Company's ability to, among other things, incur debt, grant liens, make acquisitions and other investments, make certain restricted payments such as dividend payments, and dispose of assets. The credit agreement is secured by substantially all of the Company's assets, subject to certain exceptions including the company headquarters facility. As of December 31, 2009, we have a zero balance outstanding under this line of credit. In the twelve months ended December 31, 2009 \$2.0 million was paid for the total fees associated with this line of credit and will be amortized over the life of the credit agreement as interest expense.

In March 2009, our Board of Directors authorized a stock repurchase of up to \$100 million of our common stock. This stock repurchase authorization was terminated in connection with the commencement of the June 2009 tender offer as discussed below. During the twelve months ended December 31, 2009, we repurchased 341,639 shares under this stock repurchase authorization at a weighted-average price per share of \$11.37, for a total cost of \$3.9 million.

In June 2009, we commenced a modified "Dutch Auction" tender offer to purchase up to 10,715,000 shares of our common stock. In July 2009 we accepted for purchase 6,850,871 shares in the tender offer, at a price of \$14.00 per share, for a total cost of \$95.9 million excluding approximately \$1.3 million in fees and expenses related to the tender offer.

In August 2009, the Board of Directors authorized a plan to repurchase up to \$100 million of our common stock. Any stock repurchases may be made through open market and privately negotiated transactions, at times and in such amounts as management deems appropriate, including pursuant to one or more Rule 10b5-1 trading plans. Rule 10b5-1 permits Quest to establish, while not in possession of material nonpublic information, prearranged plans to buy stock at a specific price in the future, regardless of any subsequent possession of material nonpublic information. The timing and actual number of shares repurchased will depend on a variety of factors including market conditions, corporate and regulatory requirements, and capital availability. The stock repurchase program does not have an expiration date and may be limited or terminated at any time without prior notice. During the twelve months ended December 31, 2009, we repurchased 655,069 shares under this stock repurchase authorization at a weighted-average price per share of \$17.10, for a total cost of \$11.2 million.

On July 6, 2009, we drew down \$34.4 million, or 70%, of the par value against the value of our ARS. As this credit line was structured as a "net no cost" loan, any interest charges will be offset by interest earned on the underlying ARS. See Note 4 – Cash and Cash Equivalents and Investments for additional details regarding these investments.

On August 3, 2009, we entered into a loan agreement with Mutual of Omaha Bank whereby we borrowed an aggregate principal amount of \$34 million. The loan is secured by our real property at our headquarters in Aliso Viejo, California. We intend to use the proceeds from the loan for working capital and other general corporate purposes. The loan matures in five years, during which time we will make equal monthly principal and interest

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payments at a 7.03% interest rate on a fixed rate, 25-year amortization schedule. Events of default include, among other things, payment defaults, breaches of covenants and bankruptcy events. In the case of a continuing event of default, the lender may, among other things, accelerate the payment of any unpaid principal and interest amounts, increase the then-current interest rate by 5% and foreclose on the real estate collateral.

As we continue to evaluate potential acquisitions, potential future stock repurchases or other general corporate expenditures which may be in excess of current cash available within certain operating entities, sourcing cash to fund these activities requires financial flexibility afforded by financing instruments. As such, we plan to continue to evaluate potential debt financings when and if reasonable financing terms become available to us.

Based on our current operating plan, we believe that our existing cash, cash equivalents, investment balances, cash flows from operations and available debt financing will be sufficient to finance our operational cash needs through at least the next 12 to 24 months. Our ability to generate cash from operations is subject to substantial risks described under the caption "Risk Factors". One of these risks is that our future business does not stay at a level that is similar to, or better than, our recent past. In that event, we may be unable to generate or sustain positive cash flow from operating activities. We would then be required to use existing cash, cash equivalents, investment balances and debt financing to support our working capital and other cash requirements. Also, acquisitions are an important part of our business model. As such, significant amounts of cash could and will likely be used in the future for additional acquisitions or strategic investments. If additional funds are required to support our working capital requirements, acquisitions or other purposes, we may seek to raise funds through public or private equity or, as discussed above, debt financing or from other sources. We can provide no assurance that additional financing will be available at all or, if available, that we would be able to obtain additional financing on terms favorable to us.

### Contractual Obligations and Off-Balance Sheet Arrangements

As of December 31, 2009, our contractual obligations or commercial commitments include our facility lease commitments and operating leases for office facilities and certain items of equipment. We do not have any other off-balance sheet arrangements that could reduce our liquidity.

The following table summarizes our obligations as of December 31, 2009 and the effect we expect such obligations to have on our liquidity and cash flows in future periods (in thousands):

<u>Contractual Obligations</u>	<u>Total</u>	<u>Payments due by period</u>			
		<u>Less Than 1 Year</u>	<u>1-3 Years</u>	<u>3-5 Years</u>	<u>More Than 5 Years</u>
Operating lease obligations	\$ 45,354	\$ 16,667	\$ 19,128	\$ 8,269	\$ 1,290
Capital lease obligations	435	276	159	—	—
Purchase obligations	2,930	2,682	248	—	—
Loans payable	65,894	32,602	1,159	32,133	—
Contingent consideration <sup>(2)</sup>	4,000	2,000	2,000	—	—
Acquisition related obligations	1,333	1,333	—	—	—
<b>Total contractual cash obligations</b>	<b>\$119,946</b>	<b>\$ 55,560</b>	<b>\$ 22,694</b>	<b>\$ 40,402</b>	<b>\$ 1,290</b>

(1) Our purchase obligations relate primarily to marketing contracts, public relations contracts and committed sales events.

(2) We enter into earn-out agreements with the shareholders of certain companies we acquire. The earn-out contingency are typically based on the acquired company's products' total revenue or sales growth over a specified period after the acquisition date.

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In addition to the cash commitments above, \$51.3 million of unrecognized tax benefits, inclusive of penalties and interest, have been recorded as liabilities in accordance with FIN 48, and we are uncertain as to if or when such amounts may be settled and is not included in the above table.

### **Recently Issued Accounting Pronouncements**

See Note 1 – Summary of Significant Accounting Policies of our Notes to Consolidated Financial Statements for information regarding recently issued accounting pronouncements.

### **Critical Accounting Policies and Estimates**

Our consolidated financial statements are based on the selection and application of generally accepted accounting principles, which require us to make estimates and assumptions about future events that affect the amounts reported in our financial statements and the accompanying notes. Future events and their effects cannot be determined with certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates and any such differences may be material to our financial statements. We believe that the policies set forth below may involve a higher degree of judgment and complexity in their application than our other accounting policies and represent the critical accounting policies and estimates used in the preparation of our financial statements. If different assumptions or conditions were to prevail, the results could be materially different from our reported results. Historically, our assumptions, judgments and estimates relative to our critical accounting policies and estimates have not differed materially from actual results. Our significant accounting policies are presented within Note 1 – Summary of Significant Accounting Policies of our Notes to Consolidated Financial Statements. Management has discussed the development and selection of these critical accounting policies and estimates with the Audit Committee of our Board of Directors and the Audit Committee has reviewed the related disclosures.

#### ***Revenue Recognition***

Our revenue recognition policy is one of our critical accounting policies because revenue is a key component of our results of operations and is based on complex rules that require us to make significant judgments and estimates. In applying our revenue recognition policy we must determine which portions of our revenue are recognized currently (generally perpetual software licenses) and which portions must be deferred (generally maintenance, consulting and training services). In addition, we analyze various factors including our pricing policies, the credit-worthiness of our customers, accounts receivable aging data and contractual terms and conditions in helping us make judgments about revenue recognition. Changes in judgments with respect to any of these factors could materially impact the timing and amount of revenue and costs recognized.

We recognize revenue pursuant to the requirements of FASB's guidance on *Software Revenue Recognition*. In accordance with FASB's guidance, we cannot recognize any revenue before all of the following criteria are met: (1) there is persuasive evidence of an arrangement; (2) we deliver the products; (3) fees are fixed or determinable and license agreement terms are free of contingencies or uncertainties that may alter the agreement such that it may not be complete and final; and (4) collection is probable.

We initially capture value for our products by selling a perpetual software license to end customers. The fee for the first year of maintenance is included in, or bundled with, the perpetual software license at the time of initial sale. As such, the combination at initial sale of a perpetual software license and one year of maintenance represents a "multiple-element" arrangement for revenue recognition purposes.

When all four of our revenue recognition criteria are met, the multiple-element aspect of our arrangements means the only revenue recognized upfront, at the time of initial sale, is the residual revenue allocated to the perpetual software license. The revenue associated with the fair value of the undelivered maintenance and/or consulting and training services included in the initial sale is deferred and is subsequently recorded to revenue ratably over the support term and as such services are performed, respectively. The fair value of the undelivered elements is determined based on VSOE of fair value.

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Revenue for our standalone sales of annual maintenance renewals in years two, three and beyond is recognized ratably over the support term. Sales of maintenance for multiple annual periods are treated similarly.

Revenue from our consulting and training services is generally recognized as the services are performed in accordance with the underlying service contracts.

Our maintenance VSOE of fair value is determined by reference to the prices our customers pay for this support when it is sold separately; that is, when we enter into an arms-length, annual renewal transaction with customers where the only offering sold is maintenance. These standalone maintenance renewal transactions are typically one year in duration and are priced as a targeted percentage of the initial, discounted purchase price which includes both the upfront license fee and the first year of maintenance. We bill maintenance renewal transactions in advance of the services provided. We also offer customers the right to purchase maintenance for multiple annual periods at discounted prices beyond the first year as they will be paying cash upfront, well in advance of the multi-year services performed.

Our consulting and training services VSOE of fair value is determined by reference to our established pricing and discounting practices for these services when sold separately. Our consulting and training services are typically sold as time-and-materials based contracts that range from five to fifteen days in duration. We sell consulting and training services both standalone and as part of multiple-element arrangements.

Our VSOE of fair value is impacted by estimates and judgments that, if significantly different, could materially impact the timing and amount of revenue recognized in current and future periods. These estimates and judgments include, among other items:

- the ability to identify and validate VSOE of fair value for undelivered elements via the use of sampling techniques;
- the impact on sampling results of customer negotiating pressure on renewal rates;
- the impact on sampling results of maintenance renewals on deals originally sold via indirect channels;
- the fair value of that undelivered element for sampled transactions; and
- the economic impact of combining multiple renewal rate negotiations relative to varying products with varying purchase dates, into a single, new coterminous maintenance.

Historically, we have been able to establish VSOE of fair value for maintenance, consulting and training services but we may modify our pricing and discounting practices in the future. This could result in changes to our VSOE of fair value for these undelivered elements. If this were to occur, our future revenue recognition for multiple-element arrangements would differ significantly from our historical results. If we were unable to support at all through VSOE the fair value of our maintenance, consulting or training services, the entire amount of revenue from our initial, upfront sale of both a perpetual software license bundled with one year of maintenance and any consulting and training services would be deferred and recognized ratably over the life of the contract.

If we cannot objectively determine the fair value of any undelivered element (hardware, software, specific upgrade rights, etc.) in a bundled software and services arrangement, we defer revenue until all elements are delivered and services are performed, or until fair value can be objectively determined for any remaining undelivered elements.

In addition to perpetual software licenses, we sell a small amount of time-based software licenses (or term licenses) each year wherein customers pay a single fee for the right to use the software and receive maintenance for a defined period of time. Approximately 3.5% of 2009 license revenue was generated by these time-based software licenses. All license and support revenues on these term licenses are deferred and recognized ratably over the license term.

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We license our products primarily through our direct sales force, our telesales force and, increasingly, indirect channels including value added resellers and distributors. For our direct sales, we utilize written contracts as the means to establish the terms and conditions upon which our products and services are sold to our end customers. For our indirect sales transactions, we accept orders from our resellers and distributors when they have existing orders from an end customer. Indirect sales through resellers are a growing proportion of our transaction volume. These transactions are generally handled via processes and policies that are similar to an end customer sale. We utilize written contracts coupled with purchase orders as the means to establish the terms and conditions of these indirect sales transactions.

We recognize revenue from reseller and distributor transactions upon invoicing the order provided all other revenue recognition criteria have been met. For those resellers and distributors that have established a history of consistent, timely cash collection with us, we accept orders and simultaneously recognize revenue since the resellers and distributors have existing orders from an end user customer. For those resellers that have not established a history of consistent, timely cash collection with us, we accept orders and defer revenue until cash collection occurs. The probability of collection criteria per GAAP is applied to each individual reseller or distributor rather than to all channel partners sales in aggregate.

Substantially all of our software license arrangements do not include acceptance provisions. Since such acceptance provisions are not contained in our software license arrangements as standard provisions and the incidence of returns in accordance with such acceptance provisions cannot be reasonably estimated, if a contract does include such a provision we recognize revenue upon the earlier of receipt of written customer acceptance or expiration of the acceptance period.

We evaluate arrangements with governmental entities containing “fiscal funding” or “termination for convenience” provisions, when such provisions are required by law, to determine the probability of possible cancellation. We consider multiple factors, including the history with the customer in similar transactions, and the planning, budgeting and approval processes undertaken by the governmental entity. If we determine upon execution of these arrangements that cancellation is not likely, we then recognize revenue once all of the criteria described above have been met. If such a determination cannot be made, revenue is recognized upon the earlier of cash receipt or approval of the applicable funding provision by the governmental entity.

We assess whether fees are fixed or determinable at the time of sale and recognize revenue if all other requirements have been met. Our standard payment terms require payment within 30 days but may vary based on the country in which the agreement is executed. We generally deem payments that are due within 6 months to be fixed and determinable based on collections history and thereby satisfy the required revenue recognition criteria.

For additional information regarding our revenue recognition accounting policies see Note 1 – Summary of Significant Accounting Policies of our Notes to Consolidated Financial Statements.

### ***Asset Valuation***

Asset valuation includes assessing the recorded value of certain assets, including accounts receivable, goodwill and other intangible assets. We use a variety of factors to assess valuation, depending upon the asset.

- Accounts Receivable – We maintain an allowance for sales returns and cancellations as well as an allowance for bad debt. Regarding our allowance for sales returns and cancellations, our standard form license and maintenance and/or service agreements do not typically or expressly provide for product returns or cancellations as a matter of right unless we have breached the product warranty and are unable to cure the

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breach. Our product warranties are typical industry warranties that a product will perform in accordance with established written specifications. However, we maintain the sales returns and cancellations allowance to cover the circumstances where the company accepts returns or cancellations on a discretionary basis even though not contractually obligated to do so. This allowance also covers estimated losses for our customer's unwillingness to make required payments. The allowance for bad debt is for estimated losses resulting from our customer's inability to make required payments related to enforceable contracts. To support both these allowances, we are required to make significant estimates of future software license returns, of cancellations for both maintenance and consulting and training services, and of write-offs of customer accounts as bad debts – all related to current period revenues. The amount of our reserves is based on these estimates, the contractual terms and conditions of our contracts, our accounts receivable aging and our historical collection experience with a customer base. If significant product performance issues were to arise resulting in our accepting sales returns, additional allowances may be required which would result in a reduction of revenue in the period such determination was made. While such return, cancellation and bad debt write-off amounts have historically been within our planned expectations and the allowances established, we cannot guarantee that our sales returns and allowances will be adequate to cover future performance issues of our customer base and allowances may be required which would result in additional general and administrative expense and less revenue in the period such determination was made.

- Goodwill – We test goodwill for impairment at the reporting unit level on an annual basis in the fourth quarter or more frequently if we believe indicators of impairment exist. Goodwill impairment is deemed to exist if the net book value of a reporting unit exceeds its estimated fair value. We performed our annual impairment review in the fourth quarter of 2009 and determined that the carrying value of each reporting unit was less than the estimated fair value of the reporting units. In calculating the fair value of the reporting units (licenses and services), the Market Approach and Income Approach were the methodologies deemed the most reliable and were the primary methods used for our impairment analysis. We will continue to perform annual impairment reviews during the fourth quarter of each year or earlier if indicators of potential impairment exist. Future impairment reviews could result in significant charges against earnings to write down the value of goodwill.
- Amortizing Intangible Assets – These assets are recorded at their estimated fair value and include technology, in-process research and development, customer lists, maintenance contracts, trade names, trademarks and non-compete agreements acquired and are being amortized using the straight-line method over estimated useful lives ranging from two to seven years.

We make estimates of fair value based upon assumptions believed to be reasonable. These estimates are based on historical experience and information obtained from the management of the acquired companies and are inherently uncertain. Critical estimates in valuing certain of the intangible assets include but are not limited to: future expected cash flows from license sales, maintenance agreements, consulting contracts, customer contracts and acquired developed technologies and patents; expected costs to develop the in-process research and development into commercially viable products and estimated cash flows from the projects when completed; the acquired company's brand and market position, as well as assumptions about the period of time the acquired brand will continue to be used in the combined company's product portfolio; acquired company key personnel's willingness and ability to compete; and discount rates. Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates or actual results.

The net carrying amount of amortizing intangible assets was considered recoverable at December 31, 2009. In accordance with FASB's standard on *Accounting for the Impairment or Disposal of Long-Lived Assets*, these intangible assets are reviewed for events or changes in circumstances, which indicate that their carrying value may not be recoverable. We periodically review the carrying value of these assets to determine whether or not impairment to such value has occurred. In the event that in the future it is determined that the other intangible assets value has been impaired, an adjustment will be made in that corresponding period resulting in a charge against earnings for the write-down.

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- Investments in Non-Consolidated Companies – All of our investments in non-consolidated companies are currently accounted for under the cost method, as we do not have a readily determined market value and given that we do not have the ability to exercise significant influence over these companies' operations. Significant influence is generally deemed to exist when we have an ownership interest in the voting stock of the investee of between 20% and 50%, although other factors, such as representation on the investee's Board of Directors, voting rights and the impact of commercial arrangements, are also typically considered in determining the appropriate accounting treatment. We periodically monitor our investments for impairment and will record reductions in carrying values if and when necessary. The evaluation process is based on information that we request from these privately-held companies. This information is not subject to the same disclosure regulations as U.S. public companies and, as such, the basis for these evaluations is subject to the timing and the accuracy of the data received from these companies. As part of this evaluation process, our review includes but is not limited to a review of each company's cash position, recent financing activities, financing needs, earnings and revenue outlook, operational performance, management or ownership changes, and impacts from competitive pressures. If we determine that the carrying value of our investment in a company is at an amount above fair value, an adjustment will be made in that corresponding period resulting in a charge against earnings for the write-down.

### *Accounting for Income Taxes*

As part of the process of preparing our financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process requires a significant amount of judgment, estimation and uncertainty and our estimate of income taxes can be highly sensitive to shifts of taxable income reported between such tax jurisdictions. Additionally, our U.S. and foreign tax returns are subject to routine compliance reviews by the various tax authorities. Although we believe we have appropriate support for the positions taken on our tax returns, our income tax expense includes amounts intended to satisfy income tax assessments that could result from the examination of our tax returns. Determining the income tax expense for such contingencies requires a significant amount of judgment and estimation.

We recognize liabilities for uncertain tax positions based on a two-step process. Both steps presume that the tax position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. The first step is to evaluate the tax position for recognition by determining if, based on the weight of available evidence, it is more likely than not that the position will be sustained on examination. The second step requires us to estimate and measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement with a taxing authority. It is inherently difficult and subjective to estimate such amounts, as this may require us to determine the probability of various possible outcomes. We reevaluate these uncertain tax positions on a periodic basis. This evaluation is based on factors including, but not limited to, current year tax positions, expiration of statutes of limitations, litigation, legislative activity, or other changes in facts and circumstances. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision in that period. The amounts ultimately paid upon resolution of such uncertain tax positions could be materially different from the amounts previously included in our income tax expense and therefore could have a material impact on our consolidated results of operations. The tax liabilities for uncertain tax positions are recorded as a separate component in our long-term income taxes payable/receivable balance.

We recognize deferred income tax assets and liabilities based upon the differences between the financial statement carrying amounts and the tax bases of assets and liabilities. Such deferred income taxes primarily relate to the timing of the recognition of certain revenue items and the timing of the deductibility of certain reserves and accruals for income tax purposes. We regularly review the deferred tax assets for recoverability and establish a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. If we are unable to generate sufficient future taxable income, or if there is a material change in the actual effective tax rates or time periods within which the underlying timing differences become taxable or deductible, we could be required to establish an additional valuation allowance against the deferred tax assets,

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which could result in a substantial increase in our effective tax rate and have a materially adverse impact on our operating results. U.S. income taxes were not provided for on undistributed earnings from certain non-U.S. subsidiaries because those earnings are considered permanently reinvested. Should that judgment change, U.S. income taxes would have to be recognized on those undistributed earnings no longer considered to be permanently invested.

### *Accounting for Share-based Compensation*

We account for share-based compensation in accordance with the fair value recognition provisions per generally accepted accounting principles (“GAAP”). Under GAAP, share-based compensation expense is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. We use the Black-Scholes option-pricing model to determine the fair value of stock options. The Black-Scholes option-pricing model incorporates various subjective assumptions including expected volatility, expected term and the risk-free interest rates. We estimate the expected volatility based upon historical volatilities of our common stock. We determine the expected term of our share-based awards based on historical exercise patterns across two different groups of employees. In addition, judgment is also required in estimating the forfeiture rate on share-based awards. We calculate the expected forfeiture rate based on average historical trends. These input factors are subjective and are determined using management’s judgment. If a difference arises between the assumptions used in determining share-based compensation cost and the actual factors which become known over time, we may change the input factors used in determining future share-based compensation costs. Any such changes could materially impact our results of operations in the period in which the changes are made and in periods thereafter.

### *Determining Functional Currencies for the Purpose of Consolidation*

In preparing our consolidated financial statements, we are required to re-measure the financial statements of the foreign subsidiaries from their local currency into United States dollars. This process results in foreign currency re-measurement gains and losses included in “other income, net” in the consolidated income statements.

Under the relevant accounting guidance, the treatment of these re-measurement gains or losses is dependent upon our determination of the functional currency of each subsidiary. The functional currency is determined based on the judgment of management and involves consideration of all relevant economic facts and circumstances affecting the subsidiary. The currency in which the subsidiary transacts a majority of its transactions (including transfer pricing arrangements, billings, financing, payroll and other expenditures) is one consideration of determining the functional currency; however, any dependency upon the parent and the nature of the subsidiary’s operations are also considered.

Other income, net includes any gain or loss associated with the re-measurement of a subsidiary’s financial statements when the functional currency of a subsidiary is the United States dollar. However, if the functional currency is deemed to be the local currency, any gain or loss associated with the translation of these financial statements into the United States dollar would be included within accumulated other comprehensive income on our consolidated balance sheets. If we determine that there has been a change in the functional currency of a subsidiary to the local currency, any translation gains or losses arising after the date of change would be included within stockholders’ equity as a component of accumulated other comprehensive income.

Based on our assessment of the factors discussed above, we consider the United States dollar to be the functional currency for each of our international subsidiaries. As a result of this determination, assets and liabilities in these subsidiaries are re-measured at current exchange rates, except for property and equipment and deferred revenue, which are re-measured at historical exchange rates. Revenues and expenses are re-measured at weighted average exchange rates in effect during the year except for revenue and costs related to the above mentioned balance sheet items which are re-measured at historical exchange rates. Accordingly, we had a net foreign currency re-measurement gain of \$3.6 million for the year ended December 31, 2009 and a net foreign

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currency re-measurement loss of \$7.5 million for the year ended December 31, 2008, recorded to other income, net in the respective periods. Had we determined that the functional currency of our subsidiaries was the local currency, these translation gains and losses would have been included in our statement of stockholders' equity as a component of comprehensive income for each of the years presented, and would not have the impacts on our net income that are currently reflected in our consolidated financial statements.

The magnitude of these gains or losses is dependent upon fluctuations within the exchange rates of the foreign currencies in which we transact business against the United States dollar and the significance of the assets, liabilities, revenues and expenses denominated in foreign currencies and the effect of any foreign currency hedging activities that we have entered into (See Note 14 – Derivative Instruments for details). The company operates in a number of currencies worldwide, most notably in the Euro, the United Kingdom Pound Sterling, Canadian Dollar, Australian Dollar and Russian Ruble. Any future re-measurement gains or losses could differ significantly from those we have experienced in recent years. In addition, if we determine that a change in the functional currency of one of our subsidiaries has occurred at any point in time, we would be required to include any translation gains or losses from the date of change in accumulated other comprehensive income on our consolidated balance sheets.

### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

#### **Foreign Exchange Risk**

We are a U.S. Dollar functional company and transact business in a number of different foreign countries around the world. In most instances, revenues are collected and operating expenses are paid in the local currency of the country in which we are transacting. Accordingly, we are exposed to both transaction and translation risk relating to changes in foreign exchange rates.

Our exposure to foreign exchange risk originates both from our foreign operations net profits and losses denominated in currencies other than the U.S. Dollar, as well as our net balances of monetary assets and liabilities in our foreign subsidiaries. These exposures have the potential to produce either gains or losses depending on the directional movement of the foreign currencies versus the U.S. Dollar and our operational profile in foreign subsidiaries. Our cumulative currency gains or losses in any given period may be lessened by the economic benefits of diversification and the correlative relationships of different currencies, but there can be no assurance that this pattern will continue to be true in future periods. During the twelve months ended December 31, 2009, we had a negative effect, or reduction, of \$10.4 million on total revenues and a positive effect in the form of a reduction to total expenses by \$26.0 million related to foreign currency fluctuation when comparing 2009 rates to 2008. In addition, for the twelve months ended December 31, 2009, within other income, net we had foreign currency gains of \$3.6 million compared to foreign currency losses of \$7.5 million in the comparable period in 2008.

The foreign currencies to which we currently have the most significant exposure are the Euro, the Canadian Dollar, the British Pound, the Australian Dollar and the Russian Ruble. Prior to January 1, 2009, we did not use derivative financial instruments to hedge our foreign exchange exposures, nor did we use such instruments for speculative trading purposes. However, in 2009, we implemented a limited foreign exchange hedging program. We now enter into hedges in the form of forward foreign currency contracts to reduce the range of outcomes foreign currency rate changes can have on non-functional currency denominated forecasted transactions and balance sheet positions, which include certain monetary assets and liabilities denominated in foreign currencies. The forward foreign currency contracts are carried at fair value and denominated in various currencies as listed in the tables below. The duration of forward contracts ranges from less than one month to nine months. A description of our accounting for forward foreign currency contracts is included in Note 1 – Summary of Significant Accounting Policies and Note 14 – Derivative Instruments of our Notes to Consolidated Financial Statements.

The magnitude of success of our hedging activities depends upon the accuracy of our estimates of various balances and transactions denominated in non-functional currencies. To the extent our estimates are correct,

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gains and losses on our forward foreign currency contracts will be offset by corresponding losses and gains on the underlying transactions. In order to monitor the financial impact of our foreign currency hedges, we subject our hedges to a stress test. This test is intended to quantify the impact to our financial statements of an abnormal change in the foreign currency rates in which we do business. When subjected to a 10% adverse change, we estimated that the fair value of our contracts would decline by \$5.5 million. When subjected to a 20% adverse change, we estimated that the fair value of our contracts would decline by \$11.0 million.

We do not use forward foreign currency contracts for speculative or trading purposes. We enter into forward foreign currency contracts with reputable financial institutional counterparties whose financial health we monitor. To date, we have not experienced nonperformance by any of these counterparties and anticipate performance by all counterparties.

The following table summarizes the notional amounts and fair values of our outstanding forward foreign currency contracts at December 31, 2009. All contracts have maturities of nine months or less. Fair values represent estimated settlement amounts for contracts outstanding at December 31, 2009 (notional amounts and fair values in U.S. Dollars in thousands):

Forward Foreign Currency Contracts		
Currency	Notional Amount	Fair Value
Australian Dollar	\$ 2,545	\$ 65
Canadian Dollar	11,554	125
Danish Krone	1,214	61
Euro	21,991	514
British Pound	9,965	263
Israeli Shekel	1,947	(14)
Russian Ruble	5,586	106
Total	\$54,802	\$ 1,120

## Interest Rate Risk

Our exposure to market interest-rate risk relates primarily to our investment portfolio. We traditionally do not use derivative financial instruments to hedge the market risks of our investments. We place our investments with high-quality issuers and money market funds and articulate allocation limits in our investment policy to any one issuer other than the United States government. Our investment portfolio as of December 31, 2009 consisted of money market funds, auction rate securities ("ARS"), U.S. Treasuries, commercial paper and certificates of deposit. Investments purchased with an original maturity of three months or less are considered to be cash equivalents. We classify our ARS as trading and all other investments as available-for-sale. Trading securities are carried at fair value, with changes in fair value reported in earnings. Available-for-sale securities are carried at fair value, with unrealized gains and losses, net of tax, reported in a separate component of stockholders' equity.

At December 31, 2009, we held within short-term investments \$47.6 million (with a fair value of \$44.2 million) of ARS. The Dutch auction process that resets the applicable interest rate at predetermined calendar intervals is intended to provide liquidity to the holder of the ARS by matching buyers and sellers within a market context enabling the holder to gain immediate liquidity by selling such interests at par or rolling over their investment. The auctions for these securities began failing in February of 2008. When auctions fail, our securities earn interest based on formulaic multiples of municipal bond indices such as the JJ Kenny Index or the S&P High Grade Index. The resulting interest rate has been highly sensitive to changes in the short term structure of interest rates and asset backed securities.

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Information about our investment portfolio is presented in the table below, which states the amortized book value and related weighted-average interest rates by year of maturity (in thousands):

	Amortized Book Value	Weighted Average Rate
Investments maturing by December 31, 2010 (1)	\$ 318,926	0.22%
2011	1,500	1.00%
2012	916	8.14%
2013	—	—
2014	—	—
Thereafter	—	—
Total portfolio	\$ 321,342	9.36%

(1) Includes \$225 million in cash equivalents and \$47.6 million in our ARS, which become exercisable under Put Options in 2010.

See Note 4 – Cash and Cash Equivalents and Investments of our Notes to Consolidated Financial Statements for additional information regarding our investment portfolio.

### Item 8. Financial Statements and Supplementary Data

The financial statements required by this item are included in Part IV, Item 15 of this Form 10-K and are presented beginning on page F-1.

The following tables set forth selected unaudited consolidated quarterly financial data for the eight quarters ended December 31, 2009:

	Dec. 31, 2009 (1)	Sept. 30, 2009 (1)	June 30, 2009	Quarters Ended				March 31, 2008	December 31, 2008
				March 31, 2009	Dec. 31, 2008	Sept. 30, 2008	June 30, 2008		
				(in thousands, except per share data)					
Revenues	\$ 194,531	\$ 170,849	\$ 164,257	\$ 165,597	\$ 201,599	\$ 187,565	\$ 173,433	\$ 172,780	
Gross profit	172,560	149,062	143,259	144,852	178,022	165,451	150,656	150,371	
Income before income tax provision	44,680	711	26,100	14,544	36,286	21,261	7,424	17,391	
Net income	\$ 37,022	\$ 2,949	\$ 20,459	\$ 9,929	\$ 29,171	\$ 17,317	\$ 8,266	\$ 13,289	
Basic net income per share	\$ 0.41	\$ 0.03	\$ 0.22	\$ 0.11	\$ 0.28	\$ 0.16	\$ 0.08	\$ 0.13	
Diluted net income per share	\$ 0.40	\$ 0.03	\$ 0.21	\$ 0.10	\$ 0.28	\$ 0.16	\$ 0.08	\$ 0.13	

(1) The net income for the quarter ended September 30, 2009 included a \$29.4 million litigation loss provision recorded in connection with our settlement of the shareholder class action relating to alleged stock option backdating. The net income for the quarter ended December 31, 2009 included a \$10.0 million credit to litigation loss provision representing insurance proceeds paid by our insurance providers in the fourth quarter of 2009.

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### **Item 9. *Changes In and Disagreements with Accountants on Accounting and Financial Disclosure***

None.

### **Item 9A. *Controls and Procedures***

#### **Evaluation of Disclosure Controls and Procedures**

The Company maintains disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in reports filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported within the specified time periods and accumulated and communicated to management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2009 as required by paragraph (b) of Rule 13a-15 or Rule 15d-15 of the Exchange Act. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of that date, the Company's disclosure controls and procedures as defined in Rules 13a-15(e) or 15d-15(e) under the Exchange Act were effective, at the reasonable assurance level.

#### **Management's Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2009.

Management performed an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2009, utilizing the criteria described in the "Internal Control — Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. The objective of this assessment was to determine whether the Company's internal control over financial reporting was effective as of December 31, 2009. Based on this evaluation and those criteria, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, concluded that, as of December 31, 2009, our internal control over financial reporting was effective.

The effectiveness of the Company's internal control over financial reporting has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report which is included herein.

#### **Changes in Internal Control over Financial Reporting**

There have not been any changes in internal control over financial reporting that occurred in the fourth quarter of 2009 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
Quest Software, Inc.:

We have audited the internal control over financial reporting of Quest Software, Inc. and subsidiaries (the "Company") as of December 31, 2009, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2009, of the Company and our report dated February 19, 2010 expressed an unqualified opinion on those financial statements and financial statement schedule and included an explanatory paragraph regarding the Company's changes in its method of accounting in 2007 for income taxes as a result of adopting new accounting guidance on the accounting for uncertainty in income taxes.

/s/ DELOITTE & TOUCHE LLP

Costa Mesa, California  
February 19, 2010

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### **Item 9B. *Other Information***

Not applicable.

## **PART III**

### **Item 10. *Directors, Executive Officers and Corporate Governance***

Information required by this item will be included in the sections captioned “*Directors,*” “*Executive Officers,*” “*Code of Ethics,*” “*Corporate Governance,*” “*Board of Directors and Committees*” and “*Section 16(a) Beneficial Ownership Reporting Compliance*” of our definitive proxy statement, to be delivered to stockholders in connection with our 2010 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

### **Item 11. *Executive Compensation***

Information regarding compensation of certain named executive officers will be included in the section captioned “*Executive Compensation and Related Information*” appearing in our definitive proxy statement, to be delivered to stockholders in connection with our 2010 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

### **Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Information required by this item will be included in the section captioned “*Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*” appearing in our definitive proxy statement, to be delivered to stockholders in connection with our 2010 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

### **Item 13. *Certain Relationships and Related Transactions, and Director Independence***

Information required by this item will be included in the section captioned “*Certain Relationships and Related Transactions,*” and “*Corporate Governance*” appearing in our definitive proxy statement, to be delivered to stockholders in connection with our 2010 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

### **Item 14. *Principal Accounting Fees and Services***

Information required by this item will be included in the section captioned “*Fees Paid to the Independent Registered Public Accounting Firm*” in our definitive proxy statement, to be delivered to stockholders in connection with our 2010 Annual Meeting of Stockholders. Such information is incorporated herein by reference.

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**Table of Contents****PART IV****Item 15. Exhibits, Financial Statement Schedules**

The following documents are filed as part of this Form 10-K.

(1) Financial Statements

	<b>Page</b>
<a href="#">Report of Independent Registered Public Accounting Firm</a>	F-3
<a href="#">Consolidated Balance Sheets as of December 31, 2009 and 2008</a>	F-4
<a href="#">Consolidated Income Statements for the Years Ended December 31, 2009, 2008 and 2007</a>	F-5
<a href="#">Consolidated Statements of Stockholders' Equity and Comprehensive Income for the Years Ended December 31, 2009, 2008 and 2007</a>	F-6
<a href="#">Consolidated Statements of Cash Flows for the Years Ended December 31, 2009, 2008 and 2007</a>	F-7
<a href="#">Notes to Consolidated Financial Statements</a>	F-8

(2) Financial Statement Schedule

The following financial statement schedule should be read in conjunction with the consolidated financial statements of Quest Software, Inc. filed as part of this Report:

- Schedule II — Valuation and Qualifying Accounts

Schedules other than that listed above have been omitted since they are either not required or not applicable or because the information required is included in the consolidated financial statements included elsewhere herein or the notes thereto.

(3) Exhibits

<b>Exhibit Number</b>	<b>Exhibit Title</b>
3.1*	Certificate of Incorporation of Quest Software, Inc. (incorporated by reference to our Current Report on Form 8-K filed on April 30, 2009)
3.2*	Bylaws of Quest Software, Inc. (incorporated by reference to our Current Report on Form 8-K filed on April 30, 2009)
4.1*	Form of Registrant's Specimen Common Stock Certificate (incorporated by reference to our Registration Statement on Form S-1 and all amendments thereto filed on June 11, 1999 (File No. 333-80543))
10.1*	Form of Directors' and Officers' Indemnification Agreement (incorporated by reference to our Registration Statement on Form S-1 and all amendments thereto filed on June 11, 1999 (File No. 333-80543))
10.2*++	Quest Software, Inc. 1999 Stock Incentive Plan, as amended (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.3*++	Form of Stock Option Agreement used under the Quest Software, Inc. 1999 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended September 30, 2004)

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<u>Exhibit Number</u>	<u>Exhibit Title</u>
10.4*++	Form of Restricted Stock Unit Award Agreement used under the Quest Software, Inc. 1999 Stock Incentive Plan, as amended (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.5*++	Quest Software, Inc. 2001 Stock Incentive Plan, as amended (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.6*++	Form of Stock Option Agreement used under the Quest Software, Inc. 2001 Stock Incentive Plan (incorporated by reference to our Registration Statement on Form S-8 (File No. 333-82784) filed on February 14, 2002)
10.7*++	Quest Software, Inc. 2008 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.8*++	Form of Stock Option Agreement used under the Quest Software, Inc. 2008 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.9*++	Form of Restricted Stock Unit Award Agreement used under the Quest Software, Inc. 2008 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.10*++	Quest Software, Inc. Executive Incentive Plan (incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2007)
10.11*	Credit Agreement dated as of February 17, 2009 between Quest Software, Inc. and Wells Fargo Foothill, LLC (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2009)
10.12*	Security Agreement dated as of February 17, 2009 among Quest Software, Inc., Aelita Software Corporation, ScriptLogic Corporation, Vizioncore, Inc., NetPro Computing, Inc. and those additional entities that hereafter become parties hereto, and Wells Fargo Foothill, LLC (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2009)
10.13*++	Voting Agreement dated June 1, 2009 by and between Quest Software, Inc. and Vincent C. Smith (incorporated by reference to our Current Report on Form 8-K filed on June 1, 2009)
10.14*	Loan and Security Agreement, dated as of August 3, 2009, between Quest Software, Inc. as Borrower and Mutual of Omaha Bank as Lender (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)
10.15*	Secured Promissory Note, dated as of August 3, 2009, from Quest Software, Inc. as Maker to Mutual of Omaha Bank as Payee (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)
10.16*	Deed of Trust, Security Agreement, Assignment of Rents and Leases, and Fixture Filing, dated as of August 3, 2009, by and among Quest Software, Inc. as Trustor, Mutual of Omaha Bank as Beneficiary, and Fidelity National Title Company as Trustee (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)
10.17*	Environmental Certification and Indemnity Agreement, dated as of August 3, 2009, by Quest Software, Inc. as Obligor in favor of Mutual of Omaha Bank as Lender (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)
14.1	Code of Conduct and Ethics

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<u>Exhibit Number</u>	<u>Exhibit Title</u>
21.1	Subsidiaries of the Registrant
23.1	Consent of Deloitte & Touche LLP
31.1	Certification of the Principal Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification of the Principal Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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\* Incorporated by reference

++ Indicates a management contract or compensatory arrangement.



**CONSOLIDATED FINANCIAL STATEMENTS AND  
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM  
QUEST SOFTWARE, INC. AND SUBSIDIARIES  
December 31, 2009, 2008 and 2007**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
Quest Software, Inc.:

We have audited the accompanying consolidated balance sheets of Quest Software, Inc. and subsidiaries (the “Company”) as of December 31, 2009 and 2008, and the related consolidated statements of income, stockholders’ equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2009. Our audits also included the financial statement schedule listed in the Index at Item 15. These consolidated financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on the consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 10 to the consolidated financial statements, the Company changed its method of accounting in 2007 for income taxes as a result of adopting new accounting guidance on the accounting for uncertainty in income taxes.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of December 31, 2009, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 19, 2010, expressed an unqualified opinion on the Company’s internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Costa Mesa, California  
February 19, 2010

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**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands)

	December 31	
	2009	2008
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 292,940	\$ 215,895
Restricted cash	796	2,425
Short-term investments	90,109	632
Accounts receivable, net of allowances of \$5,605 and \$8,384 at December 31, 2009 and 2008, respectively	157,534	153,892
Prepaid expenses and other current assets	32,178	17,362
Deferred income taxes	11,832	18,460
Total current assets	585,389	408,666
Property and equipment, net	70,051	77,394
Long-term investments	2,411	41,410
Intangible assets, net	76,072	104,567
Goodwill	670,481	655,777
Deferred income taxes	34,127	28,026
Other assets	26,607	29,819
Total assets	\$ 1,465,138	\$ 1,345,659
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 3,714	\$ 3,798
Accrued compensation	45,831	45,079
Other accrued expenses	31,902	39,927
Loans payable	32,602	—
Deferred revenue	285,907	272,626
Total current liabilities	399,956	361,430
Long-term liabilities:		
Deferred revenue	86,231	66,086
Income taxes payable	44,433	40,846
Loans payable	33,292	—
Other long-term liabilities	8,434	3,545
Total long-term liabilities	172,390	110,477
Total liabilities	572,346	471,907
Commitments and contingencies (Notes 2 and 16)		
Stockholders' equity:		
Preferred stock, \$0.001 par value, 10,000 shares authorized; no shares issued or outstanding	—	—
Common stock, \$0.001 par value, 200,000 shares authorized; 90,202 and 94,298 shares issued and outstanding at December 31, 2009 and 2008, respectively	90	94
Additional paid-in-capital	689,385	740,887
Retained earnings	203,130	132,771
Accumulated other comprehensive income	187	—
Total stockholders' equity	892,792	873,752
Total liabilities and stockholders' equity	\$ 1,465,138	\$ 1,345,659

The accompanying notes are an integral part of these consolidated financial statements.

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**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**CONSOLIDATED INCOME STATEMENTS**  
(In thousands, except per share data)

	<u>Year Ended December 31</u>		
	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Revenues:</b>			
Licenses	\$ 279,238	\$ 334,083	\$ 308,652
Services	415,998	401,294	322,329
Total revenues	695,236	735,377	630,981
<b>Cost of revenues:</b>			
Licenses	7,581	8,586	6,111
Services	58,528	62,060	55,173
Amortization of purchased technology	19,393	20,231	14,459
Total cost of revenues	85,502	90,877	75,743
Gross profit	609,734	644,500	555,238
<b>Operating expenses:</b>			
Sales and marketing	272,944	312,493	275,037
Research and development	144,370	153,464	122,592
General and administrative	76,748	84,954	81,758
Amortization of other purchased intangible assets	13,159	11,302	7,345
In-process research and development	—	955	220
Litigation loss provision, net	19,025	—	—
Total operating expenses	526,246	563,168	486,952
Income from operations	83,488	81,332	68,286
Other income, net	2,549	1,030	22,422
Income before income tax provision	86,037	82,362	90,708
Income tax provision	15,678	14,319	27,589
Net income	\$ 70,359	\$ 68,043	\$ 63,119
<b>Net income per share:</b>			
Basic	\$ 0.77	\$ 0.65	\$ 0.62
Diluted	\$ 0.75	\$ 0.64	\$ 0.60
<b>Weighted-average shares:</b>			
Basic	91,926	104,192	101,819
Diluted	94,066	106,261	105,284

The accompanying notes are an integral part of these consolidated financial statements.

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**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
**AND COMPREHENSIVE INCOME**  
(In thousands)

	<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Stockholders' Equity</u>	<u>Total Comprehensive Income</u>
	<u>Shares</u>	<u>Amount</u>					
<b>BALANCE, January 1, 2007</b>	101,819	\$ 102	\$ 815,335	\$ 4,293	\$ (817)	\$ 818,913	
Cumulative effect to prior year retained earnings related to the adoption of FIN 48	—	—	—	(2,684)	—	(2,684)	
Proceeds received from certain executive officers as part of our restatement remedial actions	—	—	158	—	—	158	
Compensation expense associated with share-based payments	—	—	17,455	—	—	17,455	
Unrealized gain on available-for-sale securities, net of tax	—	—	—	—	365	365	\$ 365
Net income	—	—	—	63,119	—	63,119	63,119
Comprehensive income	—	—	—	—	—	—	\$ 63,484
<b>BALANCE, December 31, 2007</b>	101,819	102	832,948	64,728	(452)	897,326	
Common stock issued under share-based compensation plans	3,926	4	39,960	—	—	39,964	
Repurchase of common stock	(11,440)	(11)	(142,989)	—	—	(143,000)	
Fees related to the repurchase of common stock	—	—	(2,250)	—	—	(2,250)	
Net tax deficiency related to share-based compensation	—	—	(2,500)	—	—	(2,500)	
Cancellation and retirement of shares related to settlement of the Imceda escrow	(7)	(1)	(87)	—	—	(88)	
Cash settlement of equity based awards	—	—	(743)	—	—	(743)	
Proceeds received from certain executive officers as part of our restatement remedial actions	—	—	200	—	—	200	
Compensation expense associated with share-based payments	—	—	16,348	—	—	16,348	
Losses reclassified to net income	—	—	—	—	452	452	\$ 452
Net income	—	—	—	68,043	—	68,043	68,043
Comprehensive income	—	—	—	—	—	—	\$ 68,495
<b>BALANCE, December 31, 2008</b>	94,298	94	740,887	132,771	—	873,752	
Common stock issued under share-based compensation plans	3,752	4	43,260	—	—	43,264	
Net tax benefit related to share-based compensation	—	—	4,867	—	—	4,867	
Repurchase of common stock	(7,848)	(8)	(111,009)	—	—	(111,017)	
Fees related to the repurchase of common stock	—	—	(1,431)	—	—	(1,431)	
Cash settlement of equity based awards	—	—	(1,268)	—	—	(1,268)	
Compensation expense associated with share-based payments	—	—	14,079	—	—	14,079	
Unrealized loss on available-for-sale securities, net of tax	—	—	—	—	(9)	(9)	\$ (9)
Unrealized gain on foreign currency hedges, net of tax	—	—	—	—	196	196	196
Net income	—	—	—	70,359	—	70,359	70,359
Comprehensive income	—	—	—	—	—	—	\$ 70,546
<b>BALANCE, December 31, 2009</b>	90,202	\$ 90	\$ 689,385	\$ 203,130	\$ 187	\$ 892,792	

The accompanying notes are an integral part of these consolidated financial statements.

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**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

	Year Ended December 31		
	2009	2008	2007
<b>Cash flows from operating activities:</b>			
Net income	\$ 70,359	\$ 68,043	\$ 63,119
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	47,973	48,255	37,362
Compensation expense associated with share-based payments	15,178	17,106	17,455
Deferred income taxes	2,376	(236)	(18,201)
Unrealized (gain) loss on long-term investments, net of gains/losses from put options	(636)	642	—
Impairment losses on cost method investments	—	2,001	—
Excess tax benefit related to share-based compensation	(1,825)	(3,415)	—
Provision for bad debts	72	1,358	302
In-process research and development	—	955	220
Other non-cash adjustments, net	254	578	308
Changes in operating assets and liabilities, net of effects of acquisitions:			
Accounts receivable	320	(6,915)	(10,496)
Prepaid expenses and other current assets	(1,156)	1,809	(3,670)
Other assets	(674)	986	(575)
Accounts payable	(491)	(1,694)	(2,815)
Accrued compensation	(3,208)	(3,871)	8,679
Other accrued expenses	(8,339)	(5,359)	1,394
Income taxes payable	(3,149)	(5,465)	8,590
Deferred revenue	33,426	37,113	38,140
Other liabilities	2,806	(40)	(2,376)
<b>Net cash provided by operating activities</b>	<b>153,286</b>	<b>151,851</b>	<b>137,436</b>
<b>Cash flows from investing activities:</b>			
Purchases of property and equipment	(11,286)	(12,244)	(13,050)
Cash paid for acquisitions, net of cash acquired	(12,253)	(137,207)	(146,842)
Change in restricted cash	1,494	46,496	(48,924)
Purchases of cost method investments	(3,000)	(3,160)	(6,109)
Purchases of investment securities	(47,853)	(52,003)	(30,766)
Sales and maturities of investment securities	2,814	82,071	58,396
<b>Net cash used in investing activities</b>	<b>(70,084)</b>	<b>(76,047)</b>	<b>(187,295)</b>
<b>Cash flows from financing activities:</b>			
Proceeds from loans payable	68,428	—	—
Repayment of loans payable	(2,534)	—	—
Repurchase of common stock	(112,447)	(145,250)	—
Repayment of capital lease obligations	(263)	(256)	(280)
Cash paid for line of credit fees	(1,979)	—	—
Proceeds from the exercise of stock options	43,264	39,964	—
Excess tax benefit related to share-based compensation	1,825	3,415	—
Proceeds received from certain executive officers as part of our restatement remedial actions	—	200	158
<b>Net cash used in financing activities</b>	<b>(3,706)</b>	<b>(101,927)</b>	<b>(122)</b>
Effect of exchange rate changes on cash and cash equivalents	(2,451)	6,450	(615)
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>77,045</b>	<b>(19,673)</b>	<b>(50,596)</b>
Cash and cash equivalents, beginning of period	215,895	235,568	286,164
<b>Cash and cash equivalents, end of period</b>	<b>\$ 292,940</b>	<b>\$ 215,895</b>	<b>\$ 235,568</b>
<b>Supplemental disclosures of consolidated cash flow information:</b>			
Cash paid for interest	\$ 3,746	\$ 289	\$ 289
Cash paid for income taxes	\$ 15,077	\$ 22,452	\$ 35,861
<b>Supplemental schedule of non-cash investing and financing activities:</b>			
Unrealized (loss)/gain on available-for-sale securities, net of tax	\$ (9)	\$ —	\$ 365
Unrealized gain on forward foreign currency contracts	\$ 196	\$ —	\$ —
Contingent consideration related to PacketTrap acquisition	\$ 4,000	\$ —	\$ —
Unpaid purchases of property and equipment	\$ 1,081	\$ 852	\$ 697

The accompanying notes are an integral part of these consolidated financial statements.

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Financial Statement Presentation**

Quest Software, Inc. was incorporated in California in 1987 and reincorporated in Delaware in 2009. We are a leading developer and vendor of application, database, Windows and virtualization management software products. We also provide consulting, training, and support services to our customers. We have wholly-owned research and development subsidiaries and sales subsidiaries for marketing, distribution, and support of our products and services in the United States and abroad. References to “Quest,” “Quest Software,” the “Company,” “we,” “us,” or “our” refer to Quest Software, Inc. and its consolidated subsidiaries.

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and include our accounts and those of our majority owned subsidiaries. Intercompany transactions are eliminated and the portion of the net income or net loss of subsidiaries applicable to minority interests adjusts other income, net.

Certain reclassifications have been made to prior year amounts to conform to the current year presentation within the stockholders’ equity section of our December 31, 2008 consolidated balance sheet as a result of changing our state of incorporation from California to Delaware during 2009 and assigning a par value to our common stock.

***Cumulative Effect of Prior Period Consolidated Balance Sheet Adjustment***

Included in the “net tax benefit related to share based compensation” is a correction of \$6.9 million related to deferred taxes on stock options that had been incorrectly derecognized in 2006. The correction does not impact earnings and management has concluded that this correction is immaterial. Since the \$6.9 million should not have been recorded as reductions to deferred tax assets and additional paid-in capital during 2006, both the deferred tax asset and additional paid-in capital are being re-established in the current period ending December 31, 2009. The relative impact to prior periods would have been an increase in the deferred tax asset and additional paid-in capital of \$7.1 million as of December 31, 2008 and 2007.

**Use of Estimates**

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**New Accounting Pronouncements**

***Fair Value Measurements***

The Financial Accounting Standards Board (“FASB”) issued new accounting guidance on fair value measurements. The new guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. On January 1, 2008, we adopted the new guidance for financial assets and financial liabilities measured at fair value on a recurring basis (see Note 15 – Fair Value Measurements for further details). On January 1, 2009, we adopted the new guidance for non-financial assets and non-financial liabilities measured at fair value on a nonrecurring basis. In April 2009, FASB issued additional guidance for estimating fair value when the volume and level of activity for the asset or liability have

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

significantly decreased and was effective for us in the second quarter of fiscal 2009. This includes guidance on identifying circumstances that indicate a transaction is not orderly. In August 2009, FASB issued clarifying guidance that in circumstances in which a quoted price in an active market for an identical liability is not available, a reporting entity is required to measure fair value of such liability using one or more of the techniques prescribed by the update. The adoption of fair value measurements guidance did not have a material impact on our consolidated financial position or results of operations.

***Business Combinations***

The FASB issued new accounting guidance on business combinations. This guidance requires an acquiring entity to recognize the assets acquired and the liabilities assumed at the acquisition date measured at their fair values as of that date, with limited exceptions. In addition, it requires that: acquisition costs be generally expensed as incurred; non-controlling interests (formerly known as “minority interests”) be valued at fair value at the acquisition date; acquired contingent liabilities be recorded at fair value at the acquisition date and subsequently measured at either the higher of such amount or the amount determined under existing guidance for non-acquired contingencies; in-process research and development (“IPR&D”) be recorded at fair value as an indefinite-lived intangible asset at the acquisition date; restructuring costs associated with a business combination be generally expensed subsequent to the acquisition date; and changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense. There are also a substantial number of new disclosure requirements. We adopted this guidance effective January 1, 2009. In April 2009, FASB issued new guidance that amends and clarifies the initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. We only had one acquisition during 2009 and we capitalized acquired IPR&D, recognized the liability for the contingent consideration and expensed acquisition costs as a result of the adoption of this standard. We expect this guidance will have an impact on accounting for future business combinations but the impact will be dependent upon the nature, terms and size of future acquisitions.

***Other Accounting Pronouncements***

In December 2007, FASB issued new accounting guidance which establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, the guidance requires the recognition of a non-controlling interest (minority interest) as equity in the consolidated financial statements and separate from the parent’s equity. The amount of net income attributable to the non-controlling interest will be included in consolidated net income on the face of the income statement. The guidance clarifies that changes in a parent’s ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this guidance requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the non-controlling equity investment on the deconsolidation date. The guidance also includes expanded disclosure requirements regarding the interests of the parent and its non-controlling interest. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. We adopted this guidance effective January 1, 2009. There was no material impact from adoption of this guidance on our consolidated financial position or results of operations.

In March 2008, FASB issued an amendment to its accounting guidance for accounting for derivative instruments and hedging activities. The amendment applies to all derivative instruments and related hedged items accounted for under the previous guidance. This amendment requires entities to provide greater transparency about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for, and how derivative instruments and related hedged items affect an entity’s financial position,

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

results of operations and cash flows. This amendment is effective for fiscal years and interim periods beginning after November 15, 2008. We adopted this amendment effective January 1, 2009. Since the amendment only required additional disclosure, the adoption of this amendment did not impact our consolidated financial position or results of operations.

In April 2008, FASB issued an amendment to its accounting guidance for goodwill and other intangible assets. The guidance amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under the previous guidance, and requires expanded disclosures regarding intangible assets existing as of each reporting period. The intent of this amendment is to improve the consistency between the useful life of a recognized intangible asset under the business combinations guidance and the period of expected cash flows used to measure the fair value of the intangible asset under the business combinations guidance and other generally accepted accounting principles (“GAAP”). This amendment is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. We adopted this amendment effective January 1, 2009. There was no impact from adoption of this guidance on our consolidated financial position or results of operations.

In June 2008, FASB issued a new accounting guidance on determining whether instruments granted in share-based payment transactions are participating securities. The guidance requires that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of basic earnings per share. This guidance is effective for us on January 1, 2009 and also requires retroactive restatement of earnings per share for all prior periods presented in the financial statements and footnotes. Our unvested share-based payment awards do not contain non-forfeitable rights to dividends or dividend equivalents; as such adoption of this guidance did not have an impact on our basic or diluted earnings per share.

In November 2008, FASB ratified accounting guidance regarding equity method investment accounting. This guidance clarifies the accounting for certain transactions and impairment considerations involving equity method investments. This guidance is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. We adopted the guidance effective January 1, 2009. There was no impact from adoption of this guidance on our consolidated financial position or results of operations as we do not currently have any investments that are accounted for under the equity method.

In November 2008, FASB ratified accounting guidance for defensive intangible assets. This guidance clarifies the accounting for certain separately identifiable intangible assets which an acquirer does not intend to actively use but intends to hold to prevent its competitors from obtaining access to them. This guidance requires an acquirer in a business combination to account for a defensive intangible asset as a separate unit of accounting which should be amortized to expense over the period the asset diminishes in value. This guidance is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. We adopted the guidance effective January 1, 2009. There was no material impact from this adoption on our consolidated financial position or results of operations.

In April 2009, FASB issued an amendment to its accounting guidance on disclosures about fair value of financial instruments, to require disclosures about the fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. Interim financial reporting requirements were amended to require those disclosures in summarized financial information at interim reporting periods. This amendment is effective for interim periods ending after June 15, 2009. This amendment did not have a material impact on our consolidated financial position or results of operations.

In April 2009, FASB issued an amendment on its accounting guidance on other-than-temporary impairment for debt securities to make the guidance more operational and to improve the presentation and disclosure of

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

other-than-temporary impairments on debt and equity securities in the financial statements. This amendment does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. This amendment is effective for interim and annual reporting periods ending after June 15, 2009. This amendment did not have a material impact on our consolidated financial position or results of operations.

In May 2009, FASB issued new accounting guidance for subsequent events, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. This guidance was effective for us in the second quarter of fiscal 2009. Management has assessed subsequent events through the date of filing our Annual Report on Form 10-K. The adoption of this guidance did not have a material impact on our consolidated financial position or results of operations.

In June 2009, FASB issued its Accounting Standards Codification (“Codification”) as the source of authoritative accounting principles recognized by FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with generally accepted accounting principles (“GAAP”). The Codification eliminates the GAAP hierarchy and establishes one level of authoritative GAAP. All other literature is considered non-authoritative. This Codification is effective for financial statements issued for interim and annual periods ending after September 15, 2009. We adopted the Codification in the third quarter of fiscal 2009. There will be no change to our consolidated financial statements due to the implementation of the Codification other than changes in reference to various authoritative accounting pronouncements in our Notes to Consolidated Financial Statements.

In October 2009, FASB issued an amendment to its accounting guidance on revenue arrangements with multiple deliverables. This new accounting guidance addresses the unit of accounting for arrangements involving multiple deliverables and how consideration should be allocated to separate units of accounting, when applicable. This guidance will be effective for fiscal years beginning on or after June 15, 2010. Early adoption is permitted. This guidance will not have a material impact on our consolidated financial position or results of operations.

In October 2009, FASB issued an amendment to its accounting guidance on certain revenue arrangements that include software elements. The new accounting guidance excludes from software revenue recognition all tangible products containing both software and non-software components that function together to deliver the product’s essential functionality. This guidance will be effective for fiscal years beginning on or after June 15, 2010. Early adoption is permitted. This guidance must be adopted in the same period that the company adopts the amended accounting for arrangements with multiple deliverables described in the preceding paragraph. This guidance will not have a material impact on our consolidated financial position or results of operations.

In December 2009, FASB issued a new guidance regarding improvements to financial reporting by enterprises involved with variable interest entities. The new guidance provides an amendment to its consolidation guidance for variable interest entities and the definition of a variable interest entity and requires enhanced disclosures to provide more information about an enterprise’s involvement in a variable interest entity. This amendment also requires ongoing assessments of whether an enterprise is the primary beneficiary of a variable interest entity and is effective for us January 1, 2010. There was no impact from adoption of this guidance on our consolidated financial position or results of operations.

In January 2010, FASB issued an amendment to its accounting for distributions to shareholders with components of stock and cash. This new guidance clarifies that the stock portion of a distribution to shareholders that allows them to elect to receive cash or shares with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance. This guidance is effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. There was no impact from adoption of this guidance since we have never declared dividends on our common stock.

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

In January 2010, FASB issued an amendment to its accounting and reporting for decreases in ownership of a subsidiary. This amendment clarifies the scope of the decrease in ownership provisions in the consolidation – overall subtopic and related guidance. This amendment is effective beginning in the period that an entity adopts FASB’s guidance on *Noncontrolling Interests in Consolidated Financial Statements*, which was effective January 1, 2009 for us. There was no impact from the adoption of this guidance on our consolidated financial position or results of operations.

In January 2010, FASB issued an amendment regarding improving disclosures about fair value measurements. This new guidance requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. We do not expect adoption of this guidance to have an impact on our consolidated financial position or results of operations.

**Cash Equivalents and Investments**

We consider highly liquid investments with original maturities of three months or less at the date of purchase to be cash equivalents. Cash equivalents consist primarily of AAA-rated money market funds in all periods presented. Investments consist of available-for-sale or trading securities as defined in *Accounting for Certain Investments in Debt and Equity Securities*. These investments are recorded at fair value and are classified as investments in the accompanying consolidated balance sheets as of December 31, 2009. The changes in fair values on trading securities are recorded as a component of other income, net. The changes in fair values, net of applicable taxes, on available-for-sale investment securities are recorded as unrealized gains (losses) as a component of accumulated other comprehensive income in stockholders’ equity. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in other income, net. The cost basis for realized gains and losses on available-for-sale securities is determined on a specific identification basis. Investments are made based on our investment policy which restricts the types of investments that can be made. We have classified available-for-sale and trading securities as short-term or long-term based primarily on the maturity date of the related securities.

**Concentration of Credit Risk**

Financial instruments that potentially subject us to credit risk include cash and cash equivalents, investments and accounts receivable. We believe that credit risks related to our investment portfolio are moderated by limitations we place on our exposure to any one issuer and credit risks on accounts receivable are moderated by the diversity of our products, customers and geographic sales areas. We monitor extensions of credit and have not experienced significant credit losses in the past. We maintain an allowance both for bad debts and for sales returns and cancellations and such losses and returns have historically been within management’s expectations. No single customer accounted for 10% or more of our total revenues or accounts receivable for the years ended December 31, 2009, 2008 or 2007.

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Allowances for Doubtful Accounts and Returns**

We record allowances for doubtful accounts based upon a specific review of significant outstanding invoices and/or our historical write-off experience. We also record a provision for estimated sales returns and allowances on product and service related sales in accordance with GAAP. These estimates are based on historical sales returns and other known factors.

**Other Assets**

The following table summarizes our other assets by asset type at the dates indicated (in thousands):

<u>Asset Type</u>	December 31	
	2009	2008
Cost method investments	\$14,427	\$11,493
Put options <sup>(1)</sup>	—	7,873
Income taxes receivable	4,885	4,475
Lease security deposits	2,622	2,502
Non-current restricted cash <sup>(2)</sup>	1,197	932
Other	3,476	2,544
<b>Total Other Assets</b>	<b>\$26,607</b>	<b>\$29,819</b>

(1) The Put Options relate to settlement agreements entered into with the investment firm that sold us our auction rate securities (see Note 4 – Cash and Cash Equivalents and Investments). This was re-classified to other current assets during 2009 as the put options have a first exercise date of June 30, 2010.

(2) Relates primarily to cash restricted as a condition to certain non-US facility leases.

Cost method investments are investments made in non-consolidated companies accounted for under the cost method as we do not have a readily determined market value and given that we do not have the ability to exercise significant influence over these companies' operations. These investments were made in early stage private companies and a private equity fund for business and strategic purposes. We may make additional investments of this nature in the future. We periodically monitor our investments for impairment and will record reductions in carrying values if and when necessary. The evaluation process is based on information that we request from these privately-held companies. This information is not subject to the same disclosure regulations as U.S. public companies and, as such, the basis for these evaluations is subject to the timing and the accuracy of the data received from these companies. As part of this evaluation process, our review includes but is not limited to a review of each company's cash position, recent financing activities, financing needs, earnings and revenue outlook, operational performance, management or ownership changes, and impacts from competitive pressures. If we were to subsequently determine that the carrying value of our investment in a company is at an amount above fair value, an adjustment will be made in that corresponding period resulting in a charge against earnings for the write-down.

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**[Table of Contents](#)****QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)****Property and Equipment**

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are provided using the straight-line method over the following estimated useful lives:

	<b>Years</b>
Building	30
Furniture and fixtures	7
Machinery and equipment	7
Computer equipment	3
Computer software	3–7

Leasehold improvements are amortized over the shorter of the estimated useful lives of the improvements or the term of the related lease. Repair and maintenance costs associated with property, equipment and leasehold improvements are expensed as incurred. Software licenses are recorded at cost and are amortized over the shorter of the estimated useful lives of the related products or the term of the license, generally three years.

We capitalize external direct costs of materials and services used in developing or obtaining internal-use computer software and amortize these costs using the straight-line method over the estimated useful life of the software, which range from 3 to 7 years. Costs of significant upgrades and enhancements that result in additional functionality are also capitalized, whereas costs incurred for maintenance and minor upgrades and enhancements are expensed as incurred.

**Business Acquisitions**

For business acquisitions, we recognize separately from goodwill the identifiable assets acquired, the liabilities assumed, and any noncontrolling interests in an acquiree, which are measured at the acquisition date fair value. Goodwill arising from acquisitions (see Note 2 – Acquisitions and Note 6 – Goodwill and Intangible Assets, Net) is measured as the excess of consideration transferred over the net amounts of the identifiable assets acquired and the liabilities assumed at the acquisition date.

We use significant estimates and assumptions, including fair value estimates, as of the business combination date and refine those estimates that are provisional, as necessary, during the measurement period. The measurement period is the period after the acquisition date, not to exceed one year, in which we may gather new information about facts and circumstances that existed as of the acquisition date to adjust the provisional amounts recognized. Measurement period adjustments are applied retrospectively. All other adjustments are recorded to the income statement.

Costs to effect an acquisition are recorded in general and administrative expenses on the consolidated income statements as the expenses are incurred.

Intangible assets are recorded at the estimated fair value of developed technology, in-process research and development, customer lists, maintenance contracts, trademarks, trade names and non-compete agreements acquired and amortized using the straight-line method over estimated useful lives. The estimated useful lives of the intangible assets being amortized range from two to seven years. The estimated fair value of trade names associated with ScriptLogic Corporation acquired in August 2007 and PacketTrap Networks, Inc. acquired in December 2009 were assigned indefinite useful lives and are not being amortized. Accumulated amortization of intangible assets was \$174.8 million and \$142.2 million at December 31, 2009 and 2008, respectively. The net carrying amount of intangible assets was considered recoverable at December 31, 2009. We test goodwill for

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impairment at the reporting unit level on an annual basis in the fourth quarter or more frequently if we believe indicators of impairment exist. The carrying amount of goodwill was considered recoverable at December 31, 2009, based on the results of our goodwill impairment evaluation performed in the fourth quarter of 2009.

**Long-Lived Assets**

We account for the impairment and disposition of long-lived assets in accordance with *Accounting for the Impairment or Disposal of Long-Lived Assets*. In accordance with this guidance, long-lived assets to be held and used are reviewed for events or changes in circumstances, which indicate that their carrying value may not be recoverable. We periodically review the carrying value of long-lived assets to determine whether or not impairment to such value has occurred.

**Derivative Instruments**

*Foreign Exchange Risk Management Policy*

In February 2009, our Board of Directors approved our Foreign Exchange Risk Management Policy. The policy identifies target exposures such as balance sheet, cash flow and income statement risks, program objectives, approved financial instruments and counterparties, accounting and tax treatment, as well as oversight, reporting and controls. The functional currency of all our subsidiaries is the U.S. Dollar. Our exposure to foreign exchange risk is composed of the combination of our foreign operations net profits and losses denominated in currencies other than the U.S. Dollar, as well as our net balances of monetary assets and liabilities within our foreign subsidiaries. These exposures have the potential to produce either gains or losses depending on the directional movement of the foreign currencies versus the U.S. Dollar and our operational profile in foreign subsidiaries. Certain balance sheet items are re-measured each period and the changes in value are recorded within other income, net.

FASB's authoritative guidance on *Derivative Instruments and Hedging Activities* requires that we recognize all derivative instruments on the balance sheet at fair value. If certain conditions are met, hedge accounting may be applied and the derivative instrument may be specifically designated as: (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or unrecognized firm commitment, referred to as a *fair value hedge*, or (b) a hedge of the exposure to the variability of cash flows of a recognized asset, liability or forecasted transaction, referred to as a *cash flow hedge*, or (c) a hedge of the foreign currency exposure of an unrecognized firm commitment, a recognized asset or liability, a forecasted transaction or a net investment in a foreign operation, referred to as a *foreign currency hedge*.

In the case of a qualifying cash flow hedge, changes in the value of the derivative instruments that are highly effective are recognized in Accumulated other comprehensive income ("AOCI") on the consolidated balance sheets, until the hedged item is recognized in the consolidated income statement. The ineffective portion of a derivative's change in fair value is recognized through the consolidated income statement. Upon the occasional termination of a cash flow hedge, the remaining cost of that hedge is amortized over the remaining life of the hedged item in proportion to the change in the hedged forecasted transaction. We have derivatives in place to hedge the exposure to the variability in future cash flows for forecasted research and development cash expenses. We formally document all qualifying hedge relationships, as well as our risk management objective and strategy for undertaking each hedge transaction. Derivatives that are non-designated hedges are adjusted to fair value through the consolidated income statement. Quest does not use derivative instruments for speculative purposes. See Note 14 – Derivative Instruments for a full description of our derivative activities.

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**Fair Value of Financial Instruments**

The carrying amounts of our financial instruments including cash and cash equivalents, investments in available-for-sale and trading securities, accounts receivable, derivatives, accounts payable, accrued liabilities and loans payable approximate their respective fair values because of the relatively short period of time between origination of the instruments and their expected realization or liquidation, or because they are carried at fair value.

We adopted FASB's standard for financial assets and financial liabilities measured at fair value on a recurring basis on January 1, 2008. The standard defines fair value measurements, establishes a framework for measuring fair value and outlines a fair value hierarchy based on the inputs to valuation techniques used to measure fair value. The standard categorizes the inputs to valuation techniques into a three-level hierarchy based on the extent to which the measurement relies on observable market inputs in measuring fair value. Assets and liabilities are classified within this hierarchy in their entirety based on the lowest level of any input that is significant to the fair value measurement. Financial instruments carried at fair value under a Level 1 include inputs based on unadjusted quoted prices in active markets for those identical financial instruments. The financial instruments recorded under Level 2 are valued primarily utilizing inputs or prices that are observable in the marketplace, can be derived from observable market data or corroborated by observable levels at which transactions are executed. Because financial instruments classified as Level 3 are generally based on unobservable inputs, the process to determine fair value is generally more subjective and involves management judgment and assumptions. These assumptions may have a significant effect on our estimates of fair value, and the use of different assumptions as well as changes in market conditions could have a material effect on our results of operations or financial condition.

We adopted FASB's standard for nonfinancial assets and nonfinancial liabilities measured at fair value on a nonrecurring basis on January 1, 2009. We performed impairment testing for goodwill at the reporting unit level on an annual basis, or more frequently if we believe indicators of impairment exist.

See Note 15 – Fair Value Measurements in our Notes to Consolidated Financial Statements for further information, including the classification within the three-level hierarchy of all of our assets and liabilities carried in our consolidated balance sheet at fair value as of December 31, 2009.

**Revenue Recognition**

We derive revenues from three primary sources: (1) software licenses, (2) annual maintenance and support services and (3) consulting and training services. We recognize revenue in accordance with FASB's guidance on software revenue recognition.

Before revenue can be recognized all of the following criteria must be satisfied:

- (1) Persuasive evidence of an arrangement exists – including a written contract signed by both the end customer and Quest.
- (2) Delivery has occurred – when all product and/or service that is essential to the functionality is delivered to the end customer.
- (3) The fee is fixed or determinable – when we have a signed contract that states the agreed upon fee for our product and/or service and specifies the related terms and conditions that govern that arrangement, and is free of material contingencies or significant uncertainty.
- (4) Collection is probable – assessed based on the probability of collection on a customer-by-customer basis based on payment history and our evaluation of the customer's financial position.

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We license our products primarily through our direct sales force, our telesales force and, increasingly, indirect channels including value added resellers and distributors. For our direct sales, we utilize written contracts as the means to establish the terms and conditions upon which our products and services are sold to our end customers. For our indirect sales transactions, we accept orders from our resellers and distributors when they have existing orders from an end customer. Indirect sales through resellers are a growing proportion of our transaction volume. These transactions are generally handled via processes and policies that are similar to an end customer sale. We utilize written contracts coupled with purchase orders as the means to establish the terms and conditions of these indirect sales transactions.

We recognize revenue from reseller and distributor transactions upon invoicing the order provided all other revenue recognition criteria have been met. For those resellers and distributors that have established a history of consistent, timely cash collection with us, we accept orders and simultaneously recognize revenue since the resellers and distributors have existing orders from an end user customer. For those resellers that have not established a history of consistent, timely cash collection with us, we accept orders and defer revenue until cash collection occurs. The probability of collection criteria per GAAP is applied to each individual reseller or distributor rather than to all channel partners sales in aggregate.

Most of our software products are “off the shelf” products that do not require customization. We initially capture value for our products by selling a perpetual software license to end customers. The fee for the first year of maintenance is included in, or bundled with, the perpetual software license at the time of initial sale. As such, the combination at initial sale of a perpetual software license and one year of maintenance services represents a “multiple–element” arrangement for revenue recognition purposes.

We account for the perpetual software license component of these multiple–element arrangements using the residual method, which requires recognition of the perpetual software license revenue once all software products have been delivered to the end customer and the only undelivered element is maintenance, consulting and training services, if applicable. The value of the undelivered elements is determined based on vendor specific objective evidence (“VSOE”) of fair value and is deferred. The residual value, after allocation of the fee to the undelivered elements based on VSOE of fair value, is then allocated to the perpetual software license for the software products being sold.

Our maintenance VSOE of fair value is determined by reference to the prices our customers pay for this support when it is sold separately; that is, when we enter into an arms–length, annual renewal transaction with customers where the only offering sold is maintenance. These standalone maintenance renewal transactions are typically for one year in duration and are priced as a targeted percentage of the initial, discounted purchase price. We bill these renewal transactions in advance of the services provided. We also offer customers the right to purchase maintenance for multiple annual periods beyond the first year. Revenue for our standalone sale of annual maintenance renewals in years two, three and beyond is recognized ratably over the support term. Sales of maintenance for multiple annual periods are treated similarly.

Our consulting and training services VSOE of fair value is determined by reference to our established pricing and discounting practices for these services when sold separately. Our consulting and training services are typically sold as time–and–materials based contracts that range from five to fifteen days in duration. Revenue from consulting and training services is generally recognized as the services are performed in accordance with the underlying service contracts.

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If we cannot objectively determine the fair value of any undelivered element (hardware, software, specific upgrade rights, etc.) in a bundled software and services arrangement, we defer revenue until all elements are delivered and services are performed, or until fair value can be objectively determined based on VSOE of fair value for any remaining undelivered elements.

In addition to perpetual software licenses, we sell a small amount of time-based software licenses (or term licenses) each year wherein customers pay a single fee for the right to use the software and receive maintenance for a defined period of time. Approximately 3.5% of 2009 license revenue was generated by these time-based software licenses. All license and maintenance revenues on these term licenses are deferred and recognized ratably over the license term.

There are numerous factors that can affect our assessment of whether the revenue recognition criteria are satisfied. For example:

- An arrangement with governing terms and conditions that extend payment terms beyond our customary and historical practices may indicate that collection is not probable. We assess whether fees are fixed or determinable at the time of sale and recognize revenue if all other requirements have been met. Our standard payment terms are 30 days but may vary based on the country in which the agreement is executed. We generally deem payments that are due within 6 months to be fixed and determinable based on collections history and thereby satisfy the required revenue recognition criterion.
- An arrangement with a contractual clause indicating the transaction is contingent on the end customer's "satisfaction with and acceptance of" the product may yield a conclusion that the fee is not yet fixed or determinable. Substantially all of our software license arrangements do not include acceptance provisions. Since such acceptance provisions are not contained in our software license arrangements as standard provisions and the incidence of returns in accordance with such acceptance provisions cannot be reasonably estimated, if a contract does include such a provision we recognize revenue upon the earlier of receipt of written customer acceptance or expiration of the acceptance period.
- We evaluate arrangements with governmental entities containing "fiscal funding" or "termination for convenience" provisions, when such provisions are required by law, to determine the probability of possible cancellation. We consider multiple factors, including the history with the customer in similar transactions, and the planning, budgeting and approval processes undertaken by the governmental entity. If we determine upon execution of these arrangements that the likelihood of cancellation is not likely, we then recognize revenue once all of the criteria described above have been met. If such a determination cannot be made, revenue is recognized upon the earlier of cash receipt or approval of the applicable funding provision by the governmental entity.

Our product return policy is reflected in our standard form license, maintenance and/or service agreements for end customers as well as for resellers and distributors. These agreements do not typically or expressly provide for product returns and cancellations as a matter of right. Quest maintains an allowance for sales returns and cancellations to cover the circumstances where the company accepts returns or cancellations on a discretionary basis even though not contractually obligated to do so. This allowance is intended only as an estimate of customer payment obligations associated with enforceable contracts for the delivery of products or services, which based on our history, we do not expect to collect.

We analyze various factors including our historical experience, the credit-worthiness of our customers, accounts receivable aging data, contractual terms and conditions and our current analysis of the collectability of accounts receivable in helping us make judgments about the level of allowances to hold for sales returns and cancellations. Changes in judgments on any of these factors could materially impact the timing and amount of revenue and costs recognized.

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We recognize channel rebates in accordance with GAAP. The rebates provided to those who distribute our products are recorded as an offset to revenue as they are considered adjustments of the selling price of our products during the period of the corresponding order.

**Uncollected Deferred Revenue**

Because of our revenue recognition policies, there are circumstances for which we are unable to recognize revenue relating to sales transactions that have been billed, but the related account receivable has not been collected. While the receivable represents an enforceable obligation, for balance sheet presentation purposes we have offset the deferred revenue with the related account receivable and no amounts appear in our consolidated balance sheets for such transactions. The aggregate amount of unrecognized accounts receivable and deferred revenue was \$39.8 million and \$39.9 million at December 31, 2009 and 2008, respectively.

**Software Development Costs**

Costs incurred in the research and development of new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. After technological feasibility is established, any additional costs are capitalized in accordance with FASB's guidance on *Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed* until the product is available for general release. Because our current process for developing software is essentially completed concurrently with the establishment of technological feasibility, no software development costs have been capitalized as of December 31, 2009 and 2008.

**Advertising Expenses**

We expense all advertising costs as incurred, and such costs were \$4.5 million, \$5.9 million and \$4.3 million for the years ended December 31, 2009, 2008 and 2007, respectively.

**Foreign Currency Translation**

In accordance with FASB's guidance on *Foreign Currency Translation*, the United States Dollar is considered to be the functional currency for our foreign subsidiaries, as such subsidiaries act primarily as an extension of our parent company's operations. The determination of functional currency is primarily based on the subsidiaries' relative financial and operational dependence on the parent company. Assets and liabilities in these subsidiaries are re-measured at current exchange rates, except for property and equipment, deferred revenue, depreciation and investments, which are translated at historical exchange rates. Revenues and expenses are re-measured at weighted average exchange rates in effect during the year except for costs related to the above mentioned balance sheet items which are translated at historical rates. Foreign currency gains and losses are included in "other income, net" in the consolidated income statements. There was a net foreign currency gain (loss) of \$3.6 million, \$(7.5) million and \$4.4 million for the year ended December 31, 2009, 2008 and 2007, respectively, based on re-measurement.

**Income Taxes**

Income taxes are accounted for under the asset and liability method in accordance with FASB's guidance on *Accounting for Income Taxes*. Deferred tax assets and liabilities are recognized for future tax consequences

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attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. We provide valuation allowances against the net deferred tax asset for amounts that are not considered more likely than not to be realized (See Note 10 – Income Taxes for disclosure of amounts related to deferred taxes and associated valuation allowances).

In accordance with FASBs guidance on *Accounting for Uncertainty in Income Taxes*, we perform a comprehensive review of our portfolio of uncertain tax positions regularly. In this regard, an uncertain tax position represents our expected treatment of a tax position taken in a filed tax return, or planned to be taken in a future tax return or claim, which has not been reflected in measuring income tax expense for financial reporting purposes. Until these positions are sustained by the taxing authorities, we have not recognized the tax benefits resulting from such positions and report the tax effects as a liability for uncertain tax positions in our consolidated income statements.

**Taxes Collected from Customers and Remitted to Governmental Authorities**

We present taxes collected from customers and remitted to governmental authorities in accordance with the guidance on *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)*, on a net basis.

**Net Income Per Share**

Basic net income per share is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution of securities by including other common stock equivalents, including stock options and restricted stock units, in the weighted-average number of common shares outstanding for a period, if dilutive.

The table below sets forth the reconciliation of the denominator of the net income per share calculation (in thousands):

	Year Ended December 31		
	2009	2008	2007
Shares used in computing basic net income per share	91,926	104,192	101,819
Dilutive effect of stock options and restricted stock units <sup>(1)</sup>	2,140	2,069	3,465
Shares used in computing diluted net income per share	94,066	106,261	105,284

(1) Options to purchase 6,314, 9,126 and 8,331 shares of common stock were outstanding during 2009, 2008 and 2007, respectively, but were not included in the computation of diluted net income per share as inclusion would have been anti-dilutive.

**Share-Based Compensation**

We account for share-based compensation using the fair value recognition provisions per GAAP. We estimate the fair value of stock options granted using a Black Scholes option valuation model and a single option award approach. We use historical data to estimate pre-vesting option forfeitures and record share-based

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compensation expense only for those awards that are expected to vest. We amortize the fair value of stock options on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. We value restricted stock units granted based on the market price of our common stock on the date of the grant. We amortize the value of restricted stock units on a straight-line basis over the restriction period. See Note 13 – Employee Benefit Plans for a description of our share-based employee compensation plans and the assumptions we use to calculate the fair value of share-based employee compensation.

**NOTE 2 — ACQUISITIONS**

**2009 Acquisition**

*PacketTrap Networks, Inc.* – In December 2009 we acquired all of the outstanding shares of PacketTrap Networks, Inc. (“PacketTrap”), a provider of enterprise class network and application management software, for purchase consideration of approximately \$11.0 million. The acquisition of PacketTrap allows us to fill a technical gap in our existing product lines for the network management space and to bolster our focus and product offerings in the mid-market. The PacketTrap purchase agreement provides for earn-out contingency totaling up to \$10.8 million contingent upon the achievement of certain PacketTrap sales targets. The \$4.0 million fair value of the earn-out contingency has been accrued for a total purchase price of \$15.0 million.

The PacketTrap contingent consideration arrangement requires payments of up to \$10.8 million that will be due and payable if certain criteria in relation to amounts billed to customers for PacketTrap products are met during the three-year period subsequent to the close of the acquisition. The fair value of the contingent consideration arrangement of \$4.0 million was determined using the income approach with significant inputs that are not observable in the market. Key assumptions include a discount rate consistent with the level of risk of achievement and probability of meeting those sales targets. The expected outcomes were recorded at net present value. Subsequent changes in the fair value of the liability will be recorded in earnings.

The acquisition has been accounted for as a business combination and the purchase price was allocated primarily to goodwill and other intangible assets. Actual results of operations of PacketTrap are included in our consolidated financial statements from the date of acquisition. Our preliminary allocation of the purchase price to assets and liabilities based upon the fair value determinations was as follows (in thousands):

Current assets	\$ 51
Acquired technologies with a useful life of 3.0 years	1,500
In-process research and development	1,000
Trade name with an indefinite useful life	700
Non-compete agreements with a useful life of 3.0 years	650
Goodwill	10,956
Other non-current assets	204
Current liabilities	(61)
<b>Total purchase price</b>	<b>\$15,000</b>

The preliminary allocation of purchase price for PacketTrap was based upon preliminary valuations and our estimates and assumptions are subject to change. The primary areas of the purchase price allocation that are not yet finalized relate to the valuation of certain intangible assets and goodwill.

The intangible assets will be amortized over the pattern in which the economic benefits of the intangible assets are being utilized, which in general reflects the cash flows generated from such assets. We acquired one

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in-process research and development (“IPR&D”) project. The value assigned to the IPR&D project was determined utilizing the income approach by determining cash flow projections relating to the project. We applied a discount rate of 23% to determine the value of the IPR&D project. The IPR&D project will be assessed for impairment until completed. Upon completion, the project will be amortized over its estimated useful life over the pattern in which the economic benefit of the intangible asset is being utilized. The goodwill associated with this acquisition is reported within our license and service segments of our business, and is not expected to be deductible for tax purposes. The goodwill allocation of 50% to licenses and 50% to services is based on both historical and projected relative contribution from licenses and services revenues. The goodwill results from expected synergies from the transaction, including complementary products that will enhance our overall product portfolio, and opportunities within new markets, which we believe will result in incremental revenue and profitability.

The pro forma effects of PacketTrap would not have been material to our results of operations for fiscal year 2009 or 2008, and therefore are not presented.

**2008 Acquisitions**

*NetPro Computing, Inc.* – In September 2008 we acquired NetPro Computing, Inc. (“NetPro”), a leading provider of Microsoft infrastructure optimization solutions, for purchase consideration of approximately \$79.1 million, including \$0.4 million in transaction costs. The acquisition of NetPro allows Quest to further extend our product portfolio to deliver a comprehensive set of products to manage complex Microsoft infrastructures. The combined product offering is expected to provide robust solutions to better migrate, manage and secure Microsoft Active Directory, Exchange, SharePoint and SQL Server environments. The acquisition has been accounted for as a purchase and the purchase price was allocated primarily to goodwill and other intangible assets. Total goodwill of \$54.1 million was assigned \$32.4 million and \$21.7 million to the license and service segments of our business, respectively, and is not expected to be deductible for tax purposes. The goodwill allocation of 60% to licenses and 40% to services is based on both historical and projected relative contribution from licenses and services revenues. Actual results of operations of NetPro are included in our consolidated financial statements from the date of acquisition. Our allocation of the purchase price to assets and liabilities based upon the fair value determinations was as follows (in thousands):

Cash and cash equivalents	\$ 3,798
Other current assets	3,877
Acquired technologies with a useful life of 4.0 years	16,500
Customer relationships with a weighted average useful life of 4.1 years	18,300
Non-competes agreements with a useful life of 3.0 years	1,000
Goodwill	54,082
Other non-current assets	1,134
Other current liabilities	(4,736)
Deferred revenue	(7,061)
Non-current liabilities	(7,797)
<b>Total purchase price</b>	<b>\$79,097</b>

*PassGo Technologies Limited* – In January 2008 we acquired PassGo Technologies Limited (“PassGo”), a privately held, UK-based leader in access and identity management solutions, for purchase consideration of approximately \$52.2 million, including \$1.1 million in transaction costs. The acquisition has been accounted for as a purchase and the purchase price was allocated primarily to goodwill and other intangible assets. Total

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goodwill of \$34.2 million was assigned \$12.0 million and \$22.2 million to the license and service segments of our business, respectively, and is not expected to be deductible for tax purposes. The goodwill allocation of 35% to licenses and 65% to services is based on both historical and projected relative contribution from licenses and services revenues. Actual results of operations of PassGo are included in our consolidated financial statements from the date of acquisition. Our allocation of the purchase price to assets and liabilities based upon the fair value determinations finalized in June 2008 was as follows (in thousands):

Cash and cash equivalents	\$ 3,070
Other current assets	4,329
Acquired technologies with a weighted average useful life of 4.8 years	9,360
Customer relationships with a weighted average useful life of 5.6 years	9,680
Non-compete agreements with a useful life of 2.0 years	170
Trade name with a useful life of 2.0 years	90
Goodwill	34,158
Other non-current assets	4,443
Other current liabilities	(5,578)
Deferred revenue	(6,951)
Non-current liabilities	(546)
 Total purchase price	 \$52,225

*Other Acquisitions* – We completed three other acquisitions during the twelve months ended December 31, 2008. The aggregate purchase price for these transactions was \$13.1 million and was allocated as follows: \$7.6 million to goodwill, \$1.0 million to in-process research and development which was written off on the date of acquisition, \$5.6 million to intangible assets and \$(1.1) million to assumed liabilities, net of tangible assets acquired. Actual results of operations of these acquisitions are included in our consolidated financial statements from the effective dates of the acquisitions.

The following represents the aggregate allocation of the purchase price for these three acquisitions to amortizing intangible assets, (in thousands):

Acquired technology with a weighted average useful life of 4.9 years	\$3,648
Customer relationships with a useful life of 4.5 years	891
Non-compete agreements with a weighted average useful life of 2.5 years	1,018
 Total intangible assets	 \$5,557

The pro forma effects of all 2008 acquisitions individually or in the aggregate, would not have been material to our results of operations for fiscal year 2008 or 2007, therefore, are not presented.

#### **2007 Acquisitions**

*ScriptLogic Corporation* – In August 2007 we acquired ScriptLogic Corporation (“ScriptLogic”), a privately held company that provides systems lifecycle management solutions for Windows-based networks, for purchase consideration of approximately \$89.5 million, including \$0.6 million in transaction costs. In connection

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with the acquisition, Quest also offered key members of the management team of ScriptLogic an opportunity to participate in a post-closing incentive bonus plan in an aggregate amount of up to \$8.0 million payable over a four-year period (the "Incentive Plan"). A portion of the payments under the Incentive Plan will be based on the satisfaction of financial performance objectives and a portion of the payments will be based solely on continued employment. As of December 31, 2009, we have paid \$1.4 million for this Incentive Plan. All bonus payments have been and will continue to be recorded as compensation expense in the periods such bonuses are earned. Of the cash amount paid at closing, \$12.0 million was deposited in an escrow account to secure certain indemnification obligations of the selling shareholders.

The acquisition has been accounted for as a purchase and the purchase price has been allocated primarily to goodwill and other intangible assets. Total goodwill of \$64.4 million was assigned \$38.6 million and \$25.8 million to the license and service segments of our business, respectively, and is not expected to be deductible for tax purposes. Goodwill allocation of 60% to licenses and 40% to services is based on both historical and projected relative contribution from licenses and services revenues. Actual results of operations of ScriptLogic are included in our consolidated financial statements from the date of acquisition. Our allocation of the purchase price to assets and liabilities based upon the fair value determination was as follows (in thousands):

Cash, cash equivalents and short-term investments	\$ 10,100
Other current assets	4,090
Acquired technologies with a useful life of 5.0 years	15,600
Customer relationships with a useful life of 5.0 years	11,300
Trade name with an indefinite useful life	6,200
Goodwill	64,407
Other non-current assets	2,154
Other current liabilities	(3,423)
Deferred revenue	(11,123)
Non-current deferred tax liability	(9,826)
<b>Total purchase price</b>	<b>\$ 89,479</b>

*Other Acquisitions* – We completed eight other acquisitions, including the remaining 25% interest in Vizioncore, during the twelve months ended December 31, 2007, each of which have been consolidated. The aggregate consideration paid for these transactions totaled \$67.6 million paid in cash, including \$0.7 million of transaction costs, and was allocated as follows: \$51.8 million to goodwill (none of which is expected to be deductible for tax purposes), \$16.0 million to intangible assets and \$0.2 million to assumed liabilities, net of tangible assets acquired. Actual results of operations of these acquisitions are included in our consolidated financial statements from the effective dates of the acquisitions.

The following represents the aggregate allocation of the purchase price for these eight acquired companies to total identifiable intangible assets (in thousands):

Acquired technology with a weighted average useful life of 4.3 years	\$ 10,868
Customer relationships with a weighted average useful life of 4.6 years	4,025
Non-compete agreements with a weighted average useful life of 2.6 years	816
Trade name with a useful life of 5.0 years	120
Acquired IPR&D	220
<b>Total identifiable intangible assets</b>	<b>\$ 16,049</b>

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The pro forma effects of all 2007 acquisitions individually or in the aggregate, would not have been material to our results of operations for fiscal 2007, therefore, are not presented.

**NOTE 3 — SEGMENT REPORTING**

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by our chief operating decision maker, or decision-making group, in assessing performance and deciding how to allocate resources.

Our reportable operating segments are Licenses and Services. The Licenses segment develops and markets licenses to use our software products. The Services segment provides after-sale support for software products and fee-based training and consulting services related to our software products.

We do not separately allocate operating expenses to these segments, nor do we allocate specific assets to these segments. Therefore, segment information reported includes only revenues, cost of revenues, and gross profit.

Reportable segment data for the three years ended December 31, 2009, is as follows (in thousands):

	<u>Licenses</u>	<u>Services</u>	<u>Total</u>
<b>Year ended December 31, 2009:</b>			
Revenues	\$ 279,238	\$ 415,998	\$ 695,236
Cost of revenues	26,974	58,528	85,502
Gross profit	\$ 252,264	\$ 357,470	\$ 609,734
<b>Year ended December 31, 2008:</b>			
Revenues	\$ 334,083	\$ 401,294	\$ 735,377
Cost of revenues	28,817	62,060	90,877
Gross profit	\$ 305,266	\$ 339,234	\$ 644,500
<b>Year ended December 31, 2007:</b>			
Revenues	\$ 308,652	\$ 322,329	\$ 630,981
Cost of revenues	20,570	55,173	75,743
Gross profit	\$ 288,082	\$ 267,156	\$ 555,238

Revenues are attributed to geographic areas based on the location of the entity to which the products or services were invoiced. Revenues and long-lived assets concerning principal geographic areas in which we operate are as follows (in thousands):

	<u>United States</u>	<u>United Kingdom</u>	<u>Other International (2)</u>	<u>Total</u>
<b>Year ended December 31, 2009:</b>				
Revenues	\$ 434,213	\$ 64,389	\$ 196,634	\$695,236
Long-lived assets <sup>(1)</sup>	81,627	3,539	11,492	96,658
<b>Year ended December 31, 2008:</b>				
Revenues	\$ 430,191	\$ 85,525	\$ 219,661	\$735,377
Long-lived assets <sup>(1)</sup>	89,934	7,793	9,486	107,213
<b>Year ended December 31, 2007:</b>				
Revenues	\$ 372,411	\$ 79,031	\$ 179,539	\$630,981
Long-lived assets <sup>(1)</sup>	76,933	4,838	12,102	93,873

(1) Includes property and equipment, net and other assets.

(2) No single location within Other International accounts for greater than 10% of total revenues.

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**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 4 — CASH AND CASH EQUIVALENTS AND INVESTMENTS**

The following table summarizes our cash and cash equivalents and investments by balance sheet classification at the dates indicated (in thousands):

<u>Classification on balance sheet</u>	December 31			
	2009	Fair Value(1)	2008	Fair Value(1)
	Cost	Cost	Cost	Cost
Cash and cash equivalents	\$ 292,940	\$ 292,940	\$ 215,895	\$ 215,895
Short-term investments	93,459	90,109	632	632
Long-term investments	2,416	2,411	49,925	41,410
Total cash and cash equivalents and investments	\$ 388,815	\$ 385,460	\$ 266,452	\$ 257,937

(1) See Note 15 – Fair Value Measurements for details regarding fair value measurements.

The following table summarizes our investments by investment category at the dates indicated (in thousands):

<u>Investment category:</u>	December 31			
	2009	Fair Value	2008	Fair Value
	Cost	Cost	Cost	Cost
Available-for-sale securities:				
US treasury securities	\$ 34,982	\$ 34,978	\$ —	\$ —
US agency securities	1,500	1,495	—	—
Commercial paper	4,998	4,998	—	—
Certificates/Term deposits	6,820	6,820	632	632
Total available-for-sale securities	48,300	48,291	632	632
Trading securities:				
Municipal auction rate securities	47,575	44,229	49,925	41,410
Total investments	\$ 95,875	\$ 92,520	\$ 50,557	\$ 42,042

At December 31, 2009, we held \$47.6 million par value (with a fair value of \$44.2 million) in municipal notes with an auction reset feature (“auction rate securities” or “ARS”). These securities are collateralized long-term debt instruments that provide liquidity through a Dutch auction process that resets the applicable interest rate at pre-determined intervals, typically every 35 days. Due to a decrease in liquidity in the global credit markets, in February 2008 auctions began failing for the ARS we held. Regularly scheduled auctions for these securities have continued to fail since that time. As of December 31, 2009, we continue to receive and earn interest on all of our ARS. All of the underlying assets of our ARS were in securities collateralized by student loan portfolios, which are guaranteed by the United States government. The ARS were pledged as collateral for the amount drawn on our UBS line of credit. In July 2009, we drew down \$34.4 million, or 70%, of the par value against the value of our ARS.

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

We estimated the fair values of the ARS we held at December 31, 2009 based on a discounted cash flow model that we prepared. Key considerations to our discounted cash flow model included, among other items, the general climate of interest rates, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation of the next time the security is expected to have a successful auction. Using our discounted cash flow model we determined that the fair values of the ARS we held at December 31, 2009 were less than par. As a result, we recorded a decrease in the fair values of those securities for the twelve months then ended.

In October 2008, we entered into agreements (the “Agreements”) with the investment firm that sold us our ARS. By entering into the Agreements, we (1) received the right (“Put Options”) to sell all of our ARS back to the investment firm at par, at our sole discretion, anytime during the period from June 30, 2010 through July 2, 2012, (2) gave the investment firm the right to purchase all of our ARS or sell them on our behalf at par anytime after the execution of the Agreements through July 2, 2012, (3) received an offer for a “no net cost” loan for up to 70% of the par value of the ARS until June 30, 2010, and (4) agreed to release the investment firm from certain potential claims related to the collateralized ARS in certain specified circumstances. On July 6, 2009, we drew down \$34.4 million, or 70% of the par value against the value of our ARS (see Note 8 — Loans Payable for additional details). We elected to measure the Put Options under the fair value option. During the year ended December 31, 2009, we recorded within other income, net a pretax unrealized \$4.5 million loss on our put options which was offset by a pretax unrealized \$5.2 million gain on our ARS. The corresponding offset to the unrealized gains and losses on our Put Options is recorded within prepaid expenses and other current assets. We anticipate that any future changes in the fair value of the Put Options will primarily be offset by the changes in the fair value of the related ARS with no material net impact to the Consolidated Income Statements. The Put Options will continue to be measured at fair value until the earlier of its maturity or exercise. The Put Options have a first exercise date of June 30, 2010, therefore both the ARS and the Put Options were classified to short-term investments and other current assets, respectively in the consolidated balance sheets at December 31, 2009. See Note 15— Fair Value Measurements for further details.

Interest income, included in other income, net in the accompanying consolidated income statements, was \$1.9 million, \$11.0 million and \$18.1 million for the years ended December 31, 2009, 2008 and 2007, respectively.

**NOTE 5 — PROPERTY AND EQUIPMENT, NET**

Net property and equipment consisted of the following (in thousands):

	December 31	
	2009	2008
Building	\$ 38,975	\$ 41,317
Furniture and fixtures	15,693	15,463
Machinery and equipment	6,775	4,610
Computer equipment	51,841	52,326
Computer software	37,867	35,290
Leasehold improvements	14,262	12,569
Land	11,154	12,329
	176,567	173,904
Less accumulated depreciation and amortization	(106,516)	(96,510)
Property and equipment, net	\$ 70,051	\$ 77,394

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**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Total depreciation and amortization expense related to property and equipment was \$15.4 million and \$16.6 million in 2009 and 2008, respectively.

**NOTE 6 — GOODWILL AND INTANGIBLE ASSETS, NET**

The changes in the carrying amount of goodwill by reportable operating segment for the years ended December 31, 2009 and 2008, are as follows (in thousands):

	<u>Licenses</u>	<u>Services</u>	<u>Total</u>
Balance as of December 31, 2007	\$416,462	\$147,304	\$563,766
Acquisitions <sup>(1)</sup>	47,941	46,193	94,134
Adjustments <sup>(1)</sup>	(1,209)	(914)	(2,123)
Balance as of December 31, 2008	463,194	192,583	655,777
Acquisitions <sup>(1)</sup>	5,478	5,478	10,956
Adjustments <sup>(1)</sup>	2,262	1,486	3,748
Balance as of December 31, 2009	\$470,934	\$199,547	\$670,481

<sup>(1)</sup> Primarily from finalization of purchase price allocations for various acquisitions made prior to 2009.

Intangible assets, net are comprised of the following (in thousands):

	2009			December 31			2008		
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Acquired technology and IPR&D <sup>(1)</sup>	\$ 154,247	\$ (117,424)	\$ 36,823	\$ 151,526	\$ (98,000)	\$ 53,526	\$ 151,526	\$ (98,000)	\$ 53,526
Customer relationships	69,577	(39,438)	30,139	69,627	(28,225)	41,402	69,627	(28,225)	41,402
Non-competes agreements <sup>(2)</sup>	13,919	(12,176)	1,743	12,919	(11,100)	1,819	12,919	(11,100)	1,819
Trademarks and trade names	13,080	(5,713)	7,367	12,680	(4,860)	7,820	12,680	(4,860)	7,820
	\$ 250,823	\$ (174,751)	\$ 76,072	\$ 246,752	\$ (142,185)	\$ 104,567	\$ 246,752	\$ (142,185)	\$ 104,567

- <sup>(1)</sup> With our recent acquisition of PacketTrap, one IPR&D project was identified and valued. This project will be assessed for impairment until completed. Upon completion, the project will be amortized over its estimated useful life.
- <sup>(2)</sup> Trademarks and trade names include \$6.2 million and \$0.7 in trade names related to our acquisition of ScriptLogic and PacketTrap that have an indefinite useful life, and as such is not being amortized.

Amortization expense for intangible assets was \$32.6 million, \$31.5 million and \$21.8 million for the twelve months ended December 31, 2009, 2008 and 2007, respectively. Estimated annual amortization expense related to intangible assets reflected on our December 31, 2009 balance sheet is as follows (in thousands):

	<u>Estimated Annual Amortization Expense</u>
2010	\$ 27,331
2011	23,355
2012	15,739
2013	2,464
2014 and thereafter	283
Total accumulated amortization	\$ 69,172

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 7 — COST METHOD INVESTMENTS**

We invested \$3.0 million and \$3.2 million in early stage private companies during the twelve months ended December 31, 2009 and 2008, respectively. Our investments in early stage private companies do not have a readily determined market value and were accounted for under the cost method, given that we do not have the ability to exercise significant influence. We periodically monitor our investments for impairment and will record reductions in carrying values if and when necessary. The fair value of a cost method investment is not estimated if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investment. No such events were noted during 2009. For the year ended December 31, 2008, we identified two investments as impaired. These investments were held at their original cost of \$2.0 million. With the impairment charge we reduced the value of these investments to \$0. The impairment losses were recorded to other income, net on our consolidated income statement for the twelve months ended December 31, 2008 on the basis that the impairments were deemed to be other-than-temporary.

Our cumulative investments are included as part of other assets in our consolidated balance sheet at December 31, 2009 and 2008 and were carried at \$14.4 million and \$11.5 million, respectively.

**NOTE 8 — LOANS PAYABLE**

On February 17, 2009, we entered into a two year revolving line of credit agreement with Wells Fargo Foothill, LLC as the arranger, administrative agent and lender. We intend to use any proceeds from the credit agreement for working capital and other general corporate purposes. The credit agreement allows for cash borrowings and letters of credit under a secured revolving credit facility of up to a maximum of \$100 million. Interest will accrue at a floating rate based on, at the Company's election, (i) LIBOR (subject to reserve requirements and a minimum LIBOR of 2.75%) or (ii) the greatest of (a) 4.0%, (b) the Federal Funds Rate plus 0.5% or (c) Wells Fargo's prime rate, in each case, plus an applicable margin. The credit agreement includes limitations on the Company's ability to, among other things, incur debt, grant liens, make acquisitions and other investments, make certain restricted payments such as dividend payments, and dispose of assets. The credit agreement is secured by substantially all of the Company's assets, subject to certain exceptions including the company headquarters facility, and includes certain financial covenants. Total fees associated with this line of credit paid upfront were approximately \$2.0 million and will be amortized over the life of the credit agreement as interest expense. For the year ended December 31, 2009, \$0.9 million in amortization of these fees was recognized as interest expense within other income, net. As of December 31, 2009, we have a zero balance outstanding under this line of credit.

On July 6, 2009, we drew down \$34.4 million, or 70%, of the par value against the value of our ARS. The ARS were pledged as collateral for the amount drawn on our UBS line of credit. As this credit line was structured as a "net no cost" loan, any interest charges will be offset by interest earned on the underlying ARS. See Note 4 – Cash and Cash Equivalents and Investments for additional details regarding these investments. As of December 31, 2009, we have a \$32.1 million balance outstanding all of which is recorded on the balance sheet in current portion of loans payable.

On August 3, 2009, we entered into a loan agreement with Mutual of Omaha Bank whereby we borrowed an aggregate principal amount of \$34 million. The loan is secured by our real property at our headquarters in Aliso Viejo, California. We intend to use the proceeds from the loan for working capital and other general corporate purposes. The loan matures in five years, during which time we will make equal monthly principal and interest payments at a 7.03% interest rate on a fixed rate, 25-year amortization schedule. Events of default include, among other things, payment defaults, breaches of covenants and bankruptcy events. In the case of a continuing event of default, the lender may, among other things, accelerate the payment of any unpaid principal and interest

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

amounts, increase the then-current interest rate by 5% and foreclose on the real estate collateral. As of December 31, 2009, we have a \$33.8 million balance outstanding with \$0.5 million recorded as current and \$33.3 million recorded as long-term portion of loans payable.

Scheduled maturities of current and long-term loans payable are as follows (in thousands):

	<b>Year Ending December 31</b>
2010	\$ 32,602
2011	562
2012	597
2013	648
2014	31,485
Total loans payable	\$ 65,894

We were in compliance with all debt-related covenants at December 31, 2009.

**NOTE 9 — OTHER INCOME, NET**

Other income, net consists of the following (in thousands):

	<b>Year Ended December 31</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
Interest income	\$ 1,863	\$10,972	\$18,102
Interest expense	(2,827)	(128)	(243)
Foreign currency gain (loss), net <sup>(1)</sup>	3,640	(7,532)	4,408
Forward foreign currency contracts loss, net <sup>(2)</sup>	(893)	—	—
Unrealized gains (losses) on ARS <sup>(3)</sup>	5,172	(8,515)	—
Unrealized (losses) gains on Put Options <sup>(3)</sup>	(4,543)	7,873	—
Impairment losses on cost method investments	—	(2,001)	—
Other income	137	361	155
Total other income, net	\$ 2,549	\$ 1,030	\$22,422

- (1) Our foreign currency gains or losses are predominantly attributable to translation gains or losses on the re-measurement of our net balances of monetary assets and liabilities in our foreign subsidiaries, including accounts receivable and cash, which were primarily denominated in the Euro, and to a lesser extent, the British Pound and Canadian Dollar. The foreign currency translation adjustments to these balance sheet items are calculated by comparing the currency spot rates at the end of a quarter to the spot rates at the end of the previous quarter.
- (2) Relates to changes in fair value of our forward foreign currency contracts not designated as hedging instruments. See Note 14 — Derivative Instruments of our Notes to Consolidated Financial Statements for further details.
- (3) See Note 4 — Cash and Cash Equivalents and Investments for details.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 10 — INCOME TAXES**

The provision for income taxes consists of the following (in thousands):

	Year Ended December 31		
	2009	2008	2007
Current:			
Federal	\$ 3,509	\$12,226	\$26,198
State	1,674	4,244	4,516
Foreign	12,871	2,804	10,276
Deferred:			
Federal	1,791	(1,289)	(9,176)
State	1,284	(1,074)	(533)
Foreign	(5,451)	(2,592)	(3,692)
Total income tax provision	\$15,678	\$14,319	\$27,589

The reconciliations of the U.S. federal statutory rate to the effective income tax rate are as follows:

	Year Ended December 31		
	2009	2008	2007
Tax provision at U.S. federal statutory rates	35.0%	35.0%	35.0%
State taxes	2.0	2.7	3.0
Foreign taxes and foreign losses with tax benefit	(19.8)	(21.1)	(9.8)
Change in U.S. valuation allowance	(0.3)	1.3	—
Research and development credits	(2.1)	(5.3)	—
Other	3.4	4.8	2.2
	18.2%	17.4%	30.4%

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of our deferred taxes are as follows (in thousands):

	December 31	
	2009	2008
Deferred tax assets:		
Accounts receivable and sales returns reserves	\$ 767	\$ 2,594
Accrued liabilities	7,689	7,594
Deferred revenue	2,265	3,672
Foreign net operating loss carry-forwards	20,602	26,394
U.S. net operating loss carry-forwards	5,938	10,233
Stock compensation	24,634	22,048
Tax credits	14,647	15,025
Fixed assets	3,587	5,975
Other	10,083	9,627
<b>Total gross deferred tax assets</b>	<b>90,212</b>	<b>103,162</b>
Deferred tax liability – Intangibles	(21,120)	(29,882)
Valuation allowance	(23,133)	(26,794)
<b>Net deferred income taxes</b>	<b>45,959</b>	<b>46,486</b>
Less current portion	(11,832)	(18,460)
<b>Non-current portion</b>	<b>\$ 34,127</b>	<b>\$ 28,026</b>

At December 31, 2009, our valuation allowance was approximately \$23.1 million on certain of our deferred tax assets. Based on the weight of available evidence, we believe that it is more likely than not that these deferred tax assets will not be realized. The change of \$3.7 million in our valuation allowance primarily relates to a net decrease in allowances related to foreign net operating losses as a result of the adjustments proposed by the French Tax Authority during their audit of our French subsidiary. The allowances related to the French net operating losses are now included within our unrecognized tax benefits as of December 31, 2009.

At December 31, 2009, we have estimated federal and state net operating loss carry-forwards of approximately \$10.2 million from acquired subsidiaries. Additionally, we have certain federal net operating losses of approximately \$5.4 million related to an acquired subsidiary that, as a result of federal consolidation rules, are not available to offset current or future income of our other U.S. entities. At December 31, 2009, we also have foreign net operating loss carry-forwards of approximately \$88.1 million, which begin to expire in 2010. Approximately \$17.3 million of the foreign net operating loss carry-forwards were incurred by subsidiaries prior to the date of our acquisition of such subsidiaries. We established a valuation allowance of approximately \$4.0 million at the date of acquisitions related to these subsidiaries.

At December 31, 2009 we have state tax credit carry-forwards of \$7.9 million, which will carry forward indefinitely until utilized. At December 31, 2009, we have \$1.9 million of acquired federal tax credits that are subject to ownership change limitations and will begin to expire in 2021.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

During the current year, we realized net tax benefits of \$5.4 million from the exercise of stock options. That amount was allocated and credited (debited) to the following items (in thousands):

Stockholders' equity	\$ 903
Goodwill	(33)
Deferred income tax asset	(6,194)
Income tax provision	(32)
<b>Total</b>	<b>\$(5,356)</b>

Income before income taxes consists of the following components (in thousands):

	Year Ended December 31		
	2009	2008	2007
United States	\$14,953	\$32,379	\$48,289
Foreign	71,084	49,983	42,419
<b>Total</b>	<b>\$86,037</b>	<b>\$82,362</b>	<b>\$90,708</b>

At December 31, 2009, we had not provided for U.S. income taxes or foreign withholding taxes on undistributed earnings from continuing operations of subsidiaries operating outside of the United States. Gross undistributed earnings of our foreign subsidiaries were approximately \$197.6 million as of December 31, 2009. Such undistributed earnings are considered permanently reinvested.

*Uncertain Tax Positions* – We adopted the provisions in accordance with GAAP in 2007. As a result of such implementation, we performed a comprehensive review of our portfolio of uncertain tax positions in accordance with recognition standards established by the interpretation. As a result of this review, we adjusted the estimated value of our uncertain tax positions on January 1, 2007, by recognizing additional liabilities totaling \$7.7 million through a \$2.7 million charge to retained earnings and \$5.0 million to net deferred income tax assets.

As of December 31, 2009, the estimated liability for our uncertain tax positions was approximately \$51.3 million, which includes accrued interest and penalties of \$5.4 million. Penalties and tax-related interest expense are reported as a component of our income tax provision.

The change in unrecognized tax benefits, excluding interest, is as follows (in thousands):

	Year Ended December 31	
	2009	2008
Unrecognized tax benefit at the beginning of the year	\$ 47,477	\$37,578
Additions from tax positions taken in the current year	9,129	9,176
Additions from tax positions taken in prior years	7,467	10,785
Reductions from tax positions taken in prior years	(10,665)	(3,663)
Settlements of tax audits	(2,076)	(6,399)
<b>Unrecognized tax benefit at the end of the year</b>	<b>\$ 51,332</b>	<b>\$47,477</b>

- (1) Such amounts in 2009 primarily relate to unrecognized tax benefits on deferred tax assets and are currently being broken out to reflect the liability in the tabular roll forward on a gross basis.

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Included in the unrecognized tax benefit at December 31, 2009 is \$41.8 million of tax benefits that, if recognized, would affect the effective tax rate. Also included in the unrecognized tax benefits at December 31, 2009 are \$8.0 million of tax benefits that, if recognized would result in adjustments to deferred tax assets and long term income taxes payable or valuation allowances.

During the years ended December 31, 2009 and 2008, we recorded approximately \$5.4 million and \$4.5 million for tax-related interest and penalties within the income tax provision, respectively.

As of December 31, 2009, we are no longer subject to U.S. federal audits and California state audits for years through December 31, 2004 and December 31, 2006, respectively. We continue to be subject to examination in the U.S. federal jurisdiction for years from 2005 through 2008, as well as various state and foreign jurisdictions for the tax years from 2000 through 2008.

During 2008, we entered into the appeals process with the Interregional Inspectorate of the Federal Tax Service of Russia as a result of the tax adjustments proposed for the years ended 2004 through 2006. As of December 31, 2009, the matter was still pending with the courts. On February 4, 2010, we received notification from our attorneys that the outstanding matter was resolved in our favor. However, the decision may be appealed to a higher authority by the Interregional Inspectorate of the Federal Tax Service of Russia, and therefore we continue to consider this item pending. Additionally during 2008, we filed requests with the French Tax Authority and the Internal Revenue Service to enter into the Mutual Agreement Procedure pursuant to Article 26 of the US-France Income Tax Treaty. During 2009, we received notification from the French Tax Authorities of a resolution reached with the Internal Revenue Service. The resolution provided for additional income to be recognized in France and less income to be recognized in the United States for the tax years ended December 31, 2000 through March 31, 2003.

During 2009, we filed requests with Irish Inland Revenue and the French Tax Authority to enter into the Mutual Agreement Procedure pursuant to Article 24 of the Ireland-France Income Tax Treaty. This request attempts to resolve the adjustments proposed by the French Tax Authority during their audit of our French subsidiary for the period April 1, 2003 through December 31, 2004.

Additionally we are currently under examination by the French Tax Authority for the years ended December 31, 2005 – 2008, the Canada Revenue Agency for the years ended December 31, 2006 – 2007, the German Tax Authority for the years ended December 31, 2005 – 2007 and Her Majesty's Revenue & Customs (UK) for the year ended December 31, 2006. In December 2009, we received a tax assessment from the French Tax Authority for the years ended December 31, 2005 – 2006, which we are currently appealing and has not been incorporated into the current Mutual Agreement Procedure pursuant to Article 24 of the Ireland-France Income Tax Treaty.

We believe appropriate provisions for all outstanding issues have been made for all jurisdictions and all open years. However, due to the risk that audit outcomes and the timing of audit settlements are subject to significant uncertainty and as we continue to evaluate such uncertainties in light of current facts and circumstances, our current estimate of the total amounts of unrecognized tax benefits could increase or decrease for all open tax years. As of the date of this report, we do not anticipate that there will be any material change in the unrecognized tax benefits within the next twelve months.

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**NOTE 11 — STOCKHOLDERS' EQUITY**

On August 9, 2009, the Board of Directors authorized a plan to repurchase up to \$100 million of Quest's common stock. Any stock repurchases may be made through open market and privately negotiated transactions, at times and in such amounts as management deems appropriate, including pursuant to one or more Rule 10b5-1 trading plans. Rule 10b5-1 permits Quest to establish, while not in possession of material nonpublic information, prearranged plans to buy stock at a specific price in the future, regardless of any subsequent possession of material nonpublic information. The timing and actual number of shares repurchased will depend on a variety of factors including market conditions, corporate and regulatory requirements, and capital availability. The stock repurchase program does not have an expiration date and may be limited or terminated at any time without prior notice. As of December 31, 2009, we repurchased 655,069 shares under this plan at a weighted average price per share of \$17.10 for a total cost of \$11.2 million.

In June 2009, we commenced a modified "Dutch Auction" tender offer to purchase up to 10,715,000 shares of our common stock. In July 2009, we accepted for purchase 6,850,871 shares in the tender offer, at a price of \$14.00 per share, for a total cost of \$95.9 million excluding approximately \$1.3 million in fees and expenses related to the tender offer.

In March 2009, our Board of Directors authorized a stock repurchase of up to \$100 million of our common stock. This stock repurchase authorization was terminated in connection with the commencement of the June 2009 tender offer as discussed above. During the year ended December 31, 2009, we repurchased 341,639 shares under this stock repurchase authorization at a weighted-average price per share of \$11.37, for a total cost of \$3.9 million.

On December 16, 2008 we accepted for purchase 11,440,000 shares in a modified "Dutch auction" tender offer, at a price of \$12.50 per share, for a total cost of \$143.0 million, not including \$2.3 million in fees and expenses related to the tender offer. The 11,440,000 shares purchased in the tender offer represent 10.8% of the shares outstanding on December 9, 2008.

**NOTE 12 — RELATED PARTY TRANSACTIONS**

In August 2007 we acquired ScriptLogic (see Note 2 – Acquisitions for details). Certain venture capital funds associated with Insight Venture Partners (the "Insight Funds") previously holding shares of ScriptLogic's preferred stock became entitled to receive (in respect of those shares of preferred stock) cash in an aggregate amount of up to approximately \$37.7 million (subject to claims against an indemnity escrow fund).

Jerry Murdock, a former director of Quest Software, is a Managing Director and the co-founder of Insight Venture Partners and an investor in the Insight Funds. Vincent C. Smith, Quest's Executive Chairman of the Board, and Raymond J. Lane and Paul A. Sallaberry, directors of Quest Software, are passive limited partners in one or more of the Insight Funds. As a result of their interests in the Insight Funds, Messrs. Murdock, Smith, Lane and Sallaberry had interests in the ScriptLogic transaction. We believe that the financial interests of Messrs. Smith, Lane and Sallaberry in this transaction were not material to them.

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

In 2000, we received a note receivable with a face amount of \$15.8 million from one of our then executive officers for the purchase of 339,200 shares of our common stock at a purchase price of \$46.50 per share. The officer granted Quest a security interest in the shares and also assigned, transferred, and pledged the shares to Quest to secure his obligations under the note. The Company maintains physical possession of the certificates representing the shares purchased as collateral until payment of the principal and interest under the note is made. The former officer remained employed by Quest as of December 31, 2009. The original maturity date of the note receivable was August 2007. In December 2009, the former executive officer and Quest signed a letter extending the due date of the note receivable until June 2010, when the principal amount and accrued interest became due and payable. The note receivable bears interest at 6.33% per annum. The note receivable is deemed to be a non-recourse obligation of the former officer for financial reporting purposes as such we recorded the note as a reduction to stockholders' equity and recorded a corresponding credit to common stock.

We believe that all of the transactions set forth above were made on terms no less favorable to us than could have been otherwise obtained from unaffiliated third parties.

**NOTE 13 — EMPLOYEE BENEFIT PLANS**

**Profit Sharing Plan**

In 2008, our senior management adopted the Managing for Results ("MFR") Profit Sharing Plan, which is intended to reward and recognize key management and individual contributors capable of affecting the long-term growth, profitability, and major market successes of the global corporation. The participating employees are awarded performance plan unit(s) that are payable at the discretion of the Compensation Committee of our Board of Directors in either restricted stock units (RSUs) or cash upon the achievement of certain performance objectives and service requirements. In 2008 we satisfied our payment obligation by granting employees RSUs. For 2009, we expect to again grant RSUs, so all performance plan units awarded under this plan are considered equity awards. If earned, the number of RSUs granted are based on the volume weighted average price of our stock for the performance period, which is the twelve month period ended December 31 for any given performance period. These awards, if earned, will then be subject to a three-year quarterly vesting schedule. Eligible employees must maintain active employment status on each quarterly vesting date to maintain eligibility to receive the shares of stock underlying the RSUs. Any RSUs granted under the profit sharing plan will be granted pursuant to the terms of our 2008 Stock Incentive Plan described below. We recorded share-based compensation expense of \$4.4 million and \$0.6 million for MFR awards for the year ended December 31 2009 and 2008, respectively. Total unrecognized share-based compensation expense related to these unvested awards which is expected to be recognized over a weighted average period of two years was \$5.1 million as of December 31, 2009.

**Share-Based Compensation Plans**

In March 2008, our Board of Directors adopted the Quest Software, Inc. 2008 Stock Incentive Plan (the "2008 Plan"). The 2008 Plan, which was approved by our stockholders in May 2008, is the successor to the Quest Software, Inc. 1999 Stock Incentive Plan, as amended (the "1999 Plan") and the Quest Software, Inc. 2001 Stock Incentive Plan (the "2001 Plan" and, together with the 1999 Plan, the "Prior Plans"). The 2008 Plan became effective and replaced the Prior Plans effective July 1, 2008. Our Board adopted the 2008 Plan to provide a means to secure and retain the services of our employees, directors, and consultants, to provide a means by which such eligible individuals may be given an opportunity to benefit from increases in the value of our Common Stock through the grant of stock awards, and thereby align the long-term compensation and interests of those individuals with our stockholders.

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

We had previously authorized for issuance an aggregate 38.5 million shares of common stock available to employees, directors and consultants under the Prior Plans. Any shares remaining available for issuance pursuant to the exercise of options or settlement of stock awards under the Prior Plans are available for issuance pursuant to stock awards granted under the 2008 Plan. Any shares subject to outstanding stock awards granted under the Prior Plans that expire or terminate for any reason prior to exercise or settlement shall become available for issuance pursuant to stock awards granted under the 2008 Plan.

The 2008 Plan provides for the discretionary grant of incentive stock options, non-statutory stock options, restricted stock awards, restricted stock unit awards, stock appreciation rights, and other forms of equity compensation (collectively, the "stock awards"). Incentive stock options granted under the 2008 Plan are intended to qualify as "incentive stock options" within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, or the "Code." Non-statutory stock options granted under the 2008 Plan are not intended to qualify as incentive stock options under the Code. The 2008 Plan also provides for the automatic grant of stock options to non-employee Board members over their period of service on our Board, continuing the similar program for automatic stock option grants to non-employee directors under the 1999 Plan.

Non-qualified stock options granted under the 2008 Plan and Prior Plans generally have a 10-year life and vest ratably over a four to five year period, generally at the rate of 20% one year after the grant date and 10% semi-annually thereafter. All outstanding stock awards granted under the Prior Plans will continue to remain subject to the terms and conditions of those predecessor plans. All stock awards granted after the July 1, 2008 effective date of the 2008 Plan will be subject to the terms of the 2008 Plan. The exercise price of all options granted under the 2008 Plan is to be established by the Plan Administrator; provided, however, that the exercise price of stock options shall not be less than the market value of our Common Stock on the date of grant. The Plan Administrator for the 2008 Plan is the Compensation Committee of the Board of Directors. Except as otherwise noted, the terms of stock awards granted under the 2008 Plan are substantially similar to those granted under the Prior Plans.

The number of shares of Common Stock available for issuance under the 2008 Plan is 29.1 million as of December 31, 2009. The number of shares of Common Stock reserved for issuance under the 2008 Plan will be reduced by 1.94 shares for each share of Common Stock issued under the 2008 Plan pursuant to a restricted stock award, restricted stock unit award, or other stock award. As of December 31, 2009, there were 14.6 million shares available for grant under the 2008 Plan.

Our Board may amend or modify the 2008 Plan at any time, subject to any required stockholder approval. To the extent required by applicable law or regulation, stockholder approval will be required for any amendment that (a) materially increases the number of shares available for issuance under the 2008 Plan; (b) materially expands the class of individuals eligible to receive stock awards under the 2008 Plan; (c) materially increases the benefits accruing to the participants under the 2008 Plan or materially reduces the price at which shares of common stock may be issued or purchased under the 2008 Plan; (d) materially extends the term of the 2008 Plan; or (e) expands the types of awards available for issuance under the 2008 Plan.

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**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

*Stock Option Awards*

A summary of the activity of employee stock options during the year ended December 31, 2009, and details regarding the options outstanding and exercisable at December 31, 2009, are provided below:

	Number of Shares (in thousands)	Weighted-Average Exercise Price (per share)	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands) <sup>(1)</sup>
Outstanding at December 31, 2008	15,262	\$ 16.05		
Granted	2,356	\$ 16.02		
Exercised	(3,516)	\$ 12.31		
Canceled/forfeited/expired	(702)	\$ 21.06		
Outstanding at December 31, 2009	13,400	\$ 16.77	4.39	\$ 53,614
Vested or expected to vest at December 31, 2009	12,990	\$ 16.79	4.24	\$ 52,645
Exercisable at December 31, 2009	10,425	\$ 17.06	3.11	\$ 45,722

(1) These amounts represent the difference between the exercise price and \$18.40, the closing price of Quest Software, Inc. stock on December 31, 2009 as reported on the NASDAQ National Market, for all in-the-money options outstanding.

No options were granted or exercised during 2007. The weighted-average fair value of options granted during the years ended December 31, 2009 and 2008 was \$6.54 and \$7.51, respectively. The total intrinsic value of options exercised was \$14.5 million and \$22.6 million for the years ended December 31, 2009 and 2008, respectively. The total fair value of options vested during the years ended December 31, 2009, 2008 and 2007 was \$8.8 million, \$15.6 million and \$19.8 million, respectively.

We took action in the third quarter of 2006 to block exercises of all stock options based on our determination that doing so was necessary to prevent violations of applicable securities law and as a result employees separating from the Company were no longer able to exercise vested options that were in-the-money prior to expiration of the post-separation exercise period provided for by the various Company stock incentive plans. As a result, the Company's Compensation Committee approved an arrangement whereby the post-separation exercise period was suspended while the Company's exercise block remained in effect. Once the exercise block was removed in January 2008 the affected employees had 30 days to exercise any vested options. As a result of this modification to extend the life of the affected options, we recorded incremental share-based compensation expense of \$0.6 million in the twelve months ended December 31, 2007.

In connection with our stock option investigation and related restatement completed in December 2007, we determined that the accounting measurement dates for most of our options granted between June 1998 and May 2002, covering options to purchase 21.8 million shares of our common stock, differed from the measurement dates previously used for such awards. As a result, there were potential adverse tax consequences that may apply to holders of affected options. In June 2008, pursuant to a Tender Offer ("TO"), we amended or replaced certain of these affected options by adjusting the exercise price for each such option. Participants whose affected options were amended or replaced pursuant to the TO became entitled to a special cash payment with respect to those options. As a result, we made cash payments of \$1.2 million in January 2009 to reimburse affected U.S. employees, and we made cash payments of \$0.3 million in July 2008 to reimburse affected Canadian employees, for the increases in their exercise prices. As a result of this modification to make cash payments for the affected

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**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

options, we recorded incremental share-based compensation expense of \$0.8 million in the twelve months ended December 31, 2008.

*Restricted Stock Unit Awards*

RSUs have been granted to selected executives pursuant to our Executive Incentive Plan. We have also granted RSUs to key employees pursuant to the MFR Profit Sharing Plan described above. All of our outstanding RSUs vest over three years with vesting contingent upon continuous service and meeting certain company-wide performance goals, including sales, operating profit margin, and cash flow targets. We estimate the fair value of RSUs using the market price of our common stock on the date of the grant. The fair value of these awards is amortized on a straight-line basis over the vesting period.

A summary of our RSUs activity during the year ended December 31, 2009 is provided below:

	<u>Number of Shares</u>	<u>Weighted-Average Grant Date Fair Value (per share)</u>
Nonvested at January 1, 2009	266,290	\$ 13.83
Granted	806,299	\$ 12.49
Vested	(326,649)	\$ 12.93
Forfeited	(32,491)	\$ 12.49
Nonvested at December 31, 2009	713,449	\$ 12.79

The total fair value of RSUs vested during the year ended December 31, 2009 was \$4.2 million.

*Share-Based Compensation Expense*

The following table presents the income statement classification of all share-based compensation expense for the years ended December 31, 2009, 2008 and 2007 (in thousands):

	<u>Year Ended December 31,</u>		
	<u>2009</u>	<u>2008</u>	<u>2007</u>
Cost of licenses	\$ 1	\$ 3	\$ 5
Cost of services	737	877	1,029
Sales and marketing	4,997	6,829	6,931
Research and development	5,385	5,800	6,533
General and administrative	4,058	4,726	3,020
Total share-based compensation	15,178	18,235	17,518
Tax benefit associated with share-based compensation expense (1)	6,071	7,294	7,007
Reduction of net income	\$ 9,107	\$10,941	\$10,511

- (1) The recognized tax benefit related to share-based compensation expense is estimated to be 40% in order to approximate the blended Federal and State statutory tax rate after the benefit for state taxes. Historically we have used the effective tax rate for all periods presented. However, due to variances in the effective tax rate between comparative periods, we utilized a blended statutory tax rate which provides a more accurate estimate of the current and deferred tax benefits ultimately received from share-based compensation.

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

As of December 31, 2009, total unrecognized share-based compensation cost related to unvested stock option awards was \$18.2 million, which is expected to be recognized over a weighted-average period of 3.5 years and total unrecognized share-based compensation expense related to unvested RSUs was \$7.1 million, which is expected to be recognized over a weighted-average period of 1.76 years.

*Determining Fair Value*

*Valuation and Amortization Method.* We estimate the fair value of stock options granted using the Black-Scholes option valuation model utilizing a single option approach. For equity awards that are expected to be settled with RSUs, but not yet granted (related to the MFR Profit Sharing Plan), we measure the value of these awards based on the market price of our common stock as of the date of the end of each reporting period. Once an RSU is granted (approved by the Compensation Committee of our Board of Directors and communicated to the participating employees) we estimate the fair value of RSUs using the market price of our common stock on the date of the grant. The fair value of all share-based awards is generally amortized on a straight-line basis over the vesting period.

We have reviewed our historical pattern of option exercises and have determined that meaningful differences in option activity existed among employees. Therefore, for all stock options granted after January 1, 2006, we have categorized these awards into two separate groups of employees. The employees within each group have similar historical exercise behavior for valuation purposes.

Determining the fair value of stock option awards at the grant date requires judgment, including estimating the expected term, expected volatility, risk-free interest rate and dividend yield. We may use different assumptions under the Black-Scholes option valuation model in determining the fair value of any option grants in future years, which could materially affect the measurement of the fair value of those options.

*Expected Term.* The expected term of options granted represents the period of time such options are expected to be outstanding. We estimate the expected terms of options granted based on historical exercise patterns across two different groups of employees. We believe these estimates are reasonably representative of each group's likely future behavior.

*Expected Volatility.* As of January 1, 2009, expected volatilities are based on historical volatilities of Quest's stock, which is a departure from past practice of using implied volatilities derived from the market prices of our traded options with similar terms. We decided to make this change because we have significantly reduced the level of option award granting activity and both analyses produced similar results.

*Risk-Free Interest Rate.* We base the risk-free interest rate on the U.S. Treasury zero-coupon issues in effect at the time of option grant for equivalent remaining terms.

*Dividend Yield.* We do not expect to pay any dividends and, therefore, we use an expected dividend yield of zero.

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**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

We used the following assumptions to estimate the fair value of options granted during the years ended December 31, 2009 and 2008 (no options were granted during 2007):

	2009		Year Ended December 31 2008		2007	
	Range:	Weighted Average:	Range:	Weighted Average:	Range:	Weighted Average:
Risk-free interest rate	1.6% to 3.2%	2.6%	2.9% to 3.9%	3.5%	N/A	N/A
Expected term (in years)	5.4 to 5.9	5.85	6.1 to 7.0	6.9	N/A	N/A
Expected volatility	36% to 40%	38%	43% to 44%	43%	N/A	N/A
Expected dividend yield	None	None	None	None	None	None

**Employee 401(k) Plan**

We sponsor the Quest Software, Inc. 401(k) Plan (“401(k) Plan”) covering substantially all of our employees. As allowed under Section 401(k) of the Internal Revenue Code, the 401(k) Plan provides tax-deferred salary deductions for eligible employees. Employees may contribute from 1% to 100% of their annual compensation to the 401(k) Plan, limited to a maximum annual amount as set periodically by the Internal Revenue Service. Participant contributions and discretionary matching contributions to employees with three years of service vest immediately, while discretionary matching contributions made to employees with less than three years of service have certain vesting requirements. Our discretionary matching contributions totaled \$2.6 million and \$2.0 million for the years ended December 31, 2009 and 2008, respectively.

**NOTE 14 — DERIVATIVE INSTRUMENTS**

*Foreign Exchange Risk Management Policy*

In February 2009, our Board of Directors approved our Foreign Exchange Risk Management Policy. The policy identifies target exposures such as balance sheet, cash flow and income statement risks, program objectives, approved financial instruments and counterparties, accounting and tax treatment, as well as oversight, reporting and controls. The functional currency of all our subsidiaries is the U.S. Dollar. Our exposure to foreign exchange risk originates both from our foreign operations net profits and losses denominated in currencies other than the U.S. Dollar, as well as our net balances of monetary assets and liabilities within our foreign subsidiaries. These exposures have the potential to produce either gains or losses depending on the directional movement of the foreign currencies versus the U.S. Dollar and our operational profile in foreign subsidiaries. Certain balance sheet items are re-measured each period and the changes in value are recorded within other income, net.

In March 2009, we initiated a limited balance sheet hedging program with the stated objective of reducing volatility within other income, net. Under this program, we use derivatives in the form of forward foreign currency contracts to hedge certain balance sheet exposures. We do not designate these contracts as hedging instruments and therefore do not require hedge accounting. Accordingly, these outstanding non-designated derivatives are recognized on the consolidated balance sheet at fair value and the changes in fair value from these contracts are recorded in other income, net, in the consolidated income statement. These derivative contracts typically have a one month term.

In September 2009, we initiated a limited cash flow hedging program primarily focused on reducing volatility in our forecasted research and development cash expenses; some of which are denominated in non-U.S. Dollar currencies. Under this program, we use derivatives in the form of forward foreign currency contracts to hedge certain forecasted cash expense transactions. These derivatives are designated as hedging

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

instruments with durations ranging from less than one month to nine months and therefore elect hedge accounting. Accordingly, these outstanding designated derivatives are recognized on the consolidated balance sheet at fair value. Changes in value that are highly effective are recognized in Accumulated other comprehensive income ("AOCI") on the consolidated balance sheets, until the hedged item is recognized in the income statement. Any ineffective portion of a derivative's change in fair value is recorded in other income, net, in the consolidated income statement. There was no material ineffectiveness in our cash flow hedging program for the year ended December 31, 2009.

As of December 31, 2009, we had the following notional amounts and fair values for our outstanding forward foreign currency contracts (in thousands):

<u>Currency</u>	<u>Notional Amount</u>	<u>Fair Value</u>
<b>Derivatives designated as hedging instruments</b>		
Australian Dollar	\$ 2,545	\$ 65
Canadian Dollar	11,554	125
Israeli Shekel	1,947	(14)
Russian Ruble	5,586	106
Euro	6,440	2
Total	\$28,072	\$ 284
<b>Derivatives designated as non-hedging instruments</b>		
Danish Krone	1,214	61
Euro	15,551	512
British Pound	9,965	263
Total	\$26,730	\$ 836

As of December 31, 2009, the fair value of our forward foreign currency contracts, net was \$1.1 million recorded in prepaid expenses and other current assets of our consolidated balance sheet.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)***The Effect of Derivative Instruments on Financial Performance*

The following tables provide the effect derivative instruments had on our AOCI and results of operations for the year ended December 31, 2009 (in thousands):

	<u>Amount of gain recognized in AOCI (effective portion)</u>	<u>Location of gain reclassified from accumulated AOCI into income statement (effective portion)</u>	<u>Amount of gain reclassified from accumulated AOCI (effective portion)</u>
<b>Derivatives designated as hedging instruments</b>			
Forward foreign currency contracts	\$ 196	Operating expenses	\$ 221
		<u>Location of loss recognized on derivative instruments</u>	<u>Amount of loss recognized on derivative instruments</u>
<b>Derivatives not designated as hedging instruments</b>			
Forward foreign currency contracts		Other income, net	\$ (893)

**NOTE 15 — FAIR VALUE MEASUREMENTS**

Effective January 1, 2009, we adopted FASB's new guidance for nonfinancial assets and nonfinancial liabilities measured at fair value on a nonrecurring basis. We performed impairment testing for goodwill at the reporting unit level on an annual basis, or more frequently if we believe indicators of impairment exist.

Effective January 1, 2008, we adopted the guidance which permits companies to choose to measure certain financial assets and liabilities at fair value (the "fair value option"). The fair value election is irrevocable and may generally be made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to fair value. We chose not to elect the fair value option for our financial assets and liabilities existing on January 1, 2008, and did not elect the fair value option for any financial assets and liabilities transacted thereafter, except for Put Options related to our auction rate securities that were recorded in conjunction with settlement agreements with one of our investment firms, as more fully described in Note 4 – Cash and Cash Equivalents and Investments.

Effective January 1, 2008, we adopted FASB's guidance for financial assets and liabilities. This standard defines fair value, provides guidance for measuring fair value and requires certain disclosures. This standard does not require any new fair value measurements, but rather applies under other accounting pronouncements that require or permit fair value measurements. The standard discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow) and the cost approach (cost to replace the service capacity of an asset or replacement cost). The statement establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

- Level 1: Observable inputs such as quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
- Level 3: Unobservable inputs that reflect the reporting entity's own assumptions when there is little or no market data.

As of December 31, 2009, we held certain assets that are required to be measured at fair value on a recurring basis. These assets included cash equivalents and investments. Included in our investments at December 31, 2009 was \$47.6 million par value (with a fair value of \$44.2 million) in ARS. We estimated the fair values of the ARS and related Put Options we held at December 31, 2009 based on a discounted cash flow model that we prepared. Key considerations to our discounted cash flow model included, among other items, the general climate of interest rates, the collateralization underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, and the expectation of the next time the security is expected to have a successful auction. Using our discounted cash flow model we determined that the fair values of the ARS we held at December 31, 2009 were less than par.

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**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following table represents our fair value hierarchy for financial assets (cash equivalents, investments and derivatives) and contingent consideration liability measured at fair value on a recurring basis as of December 31, 2009 (in thousands):

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Money market funds	\$178,303	\$ 178,303	\$ —	\$ —
U.S. treasuries	55,371	55,371	—	—
U.S. agency securities	1,495	1,495	—	—
Certificates of deposit	8,598	8,598	—	—
Commercial paper	29,991	29,991	—	—
ARS	44,229	—	—	44,229
Put Options <sup>(1)</sup>	3,330	—	—	3,330
Forward foreign currency contracts <sup>(2)</sup>	1,120	—	1,120	—
<b>Total</b>	<b>\$322,437</b>	<b>\$ 273,758</b>	<b>\$ 1,120</b>	<b>\$ 47,559</b>
Level 3 as % of total				14.7%
<b>Liability:</b>				
Contingent consideration <sup>(3)</sup>	\$ 4,000	\$ —	\$ —	\$ 4,000

(1) See Note 4 – Cash and Cash Equivalents and Investments for details.

(2) See Note 14 – Derivative Instruments for details.

(3) Relates to acquisition of PacketTrap. \$2.0 million was recorded in Other Accrued Expenses and the remainder was recorded in Other Long-term Liabilities on our consolidated balance sheets. See Note 2 – Acquisitions for details.

The following table presents our assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at December 31, 2009 (in thousands):

	Significant Unobservable Inputs (Level 3)
Balance at December 31, 2008	\$ 49,283
Unrealized gains on ARS included within other income, net	5,172
Unrealized losses on put options included within other income, net	(4,543)
Sale of ARS	(2,353)
<b>Balance at December 31, 2009</b>	<b>\$ 47,559</b>

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following table presents our liability measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at December 31, 2009 (in thousands):

	<b>Significant Unobservable Inputs (Level 3)</b>
Balance at December 31, 2008	\$ —
Contingent consideration	4,000
Balance at December 31, 2009	\$ 4,000

*Other Financial Assets and Liabilities*

The carrying amounts of our financial instruments including cash and cash equivalents, accounts receivable, derivatives, accounts payable and accrued liabilities approximate their respective fair values because of the relatively short period of time between origination of the instruments and their expected realization or because they are carried at fair value.

The book value and fair value of our current and long-term portion of loans payable as of December 31, 2009 are as follows (in thousands):

	<b>Book Value</b>	<b>Fair Value (1)</b>
Current portion of loans payable	\$ 32,602	\$ 32,602
Long-term portion of loans payable	33,292	33,292
	\$ 65,894	\$ 65,894

(1) Estimated fair value of long-term debt is based on quoted prices for similar liabilities for which significant inputs are observable.

**NOTE 16 — COMMITMENTS AND CONTINGENCIES**

*Leases.* We lease office facilities and certain equipment under various operating leases. A majority of these leases are non-cancelable and obligate us to pay costs of maintenance, utilities, and applicable taxes. The leases on most of the office facilities contain escalation clauses and renewal options. Rental expense is recorded on a straight-line basis over the life of the lease. Total rent expense was \$17.8 million, \$18.7 million and \$15.1 million for the years ended December 31, 2009, 2008 and 2007, respectively.

Minimum lease commitments under non-cancelable operating leases as of December 31, 2009 are as follows (in thousands):

<b><u>Year ending December 31:</u></b>	<b><u>Minimum Lease Commitment</u></b>
2010	\$ 16,667
2011	10,769
2012	8,359
2013	6,134
2014	2,135
Thereafter	1,291
Total minimum lease commitments	\$ 45,355

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

*Securities Litigation.* In October 2006, a purported shareholder class action was filed in the United States District Court for the Central District of California against Quest and certain of its current or former officers and directors (the “Options Class Action”). The plaintiff alleged that (i) the Company improperly backdated stock options, resulting in false or misleading disclosures concerning, among other things, Quest’s financial condition and (ii) the individual defendants sold Quest stock while in possession of material nonpublic information resulting in damages to the putative plaintiff class, in violation of Sections 10(b), 20(a) and 20A of the Securities Exchange Act of 1934 and Rule 10b–5 promulgated thereunder.

Pursuant to a Stipulation and Agreement of Settlement entered into on November 6, 2009, the Company, the class representative and certain current and former officers and directors of the Company agreed to settle the Options Class Action for a payment of \$29.4 million. On December 7, 2009, the U.S. District Court preliminarily approved the settlement. Shortly thereafter, the Company funded its share, \$19.0 million, of the \$29.4 million settlement, with the remainder being funded directly by the Company’s liability insurance carriers. No class members opted out of or objected to the settlement prior to the February 15, 2010 deadline for doing so. A final hearing before the U.S. District Court is scheduled for March 15, 2010 to approve the settlement. If the settlement is approved by the U.S. District Court following the final hearing, the court will enter a judgment dismissing the Option Class Action with prejudice as to all defendants, including the Company. Plaintiffs included in the class will have thirty days to appeal the judgment, after which the judgment will become final. If the settlement is not approved for any reason, the case will resume.

We have indemnification agreements with present and former directors and officers under which we are generally required to indemnify them against expenses, including attorney’s fees, judgments, fines and settlements, arising from the foregoing legal proceedings and investigations (subject to certain exceptions, including liabilities arising from willful misconduct or conduct that is knowingly fraudulent or deliberately dishonest or results in improper personal benefit). The Company is currently paying or reimbursing legal expenses being incurred in connection with these matters by a number of its current and former directors and officers. The maximum potential amount of the future payments we could be required to make under these indemnification obligations could be significant.

*Acquisitions.* As of December 31, 2009, purchase consideration payable to certain former shareholders of PacketTrap of \$0.5 million is included in restricted cash, all of which has been paid as of the filing date of this Report.

*General.* The Company and its subsidiaries are also involved in other legal proceedings, claims and litigation arising in the ordinary course of business. The foregoing discussion includes material developments that occurred during the twelve months ended December 31, 2009 or thereafter in our material legal proceedings.

In the normal course of our business, we enter into certain types of agreements that require us to indemnify or guarantee the obligations of other parties. These commitments include (i) intellectual property indemnities to licensees of our software products, (ii) indemnities to certain lessors under office space leases for certain claims arising from our use or occupancy of the related premises, or for the obligations of our subsidiaries under leasing arrangements, (iii) indemnities to customers, vendors and service providers for claims based on negligence or willful misconduct of our employees and agents, (iv) indemnities to our directors and officers to the maximum extent permitted under applicable law, and (v) letters of credit and similar obligations as a form of credit support for our international subsidiaries and certain resellers. The terms and duration of these commitments varies and, in some cases, may be indefinite, and certain of these commitments do not limit the maximum amount of future payments we could become obligated to make there under; accordingly, our actual aggregate maximum exposure related to these types of commitments cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for obligations of this nature, and no liabilities have been recorded for these obligations in our financial statements included in this report.

**QUEST SOFTWARE, INC. AND SUBSIDIARIES**  
**FINANCIAL STATEMENT SCHEDULE**  
**SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS**

<u>Description</u>	<u>Balance at Beginning of Period</u>	<u>Acquired Balances</u>	<u>Charges, Costs and Expenses</u>	<u>Additions/ Deductions</u>	<u>Balance at End of Period</u>
Year ended December 31, 2009:			(In Thousands)		
Allowance for bad debt	\$ 847	\$ —	\$ 72	\$ (384)	\$ 535
Allowance for sales returns and cancellations	\$ 7,537	\$ 1	\$ 1,062	\$ (3,530)	\$ 5,070
Year ended December 31, 2008:					
Allowance for bad debt	\$ 434	\$ —	\$ 1,358	\$ (945)	\$ 847
Allowance for sales returns and cancellations	\$ 7,603	\$ 1,315	\$ 2,174	\$ (3,555)	\$ 7,537
Year ended December 31, 2007:					
Allowance for bad debt	\$ 590	\$ —	\$ 302	\$ (458)	\$ 434
Allowance for sales returns and cancellations	\$ 8,499	\$ 646	\$ 1,942	\$ (3,484)	\$ 7,603

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### 2009 Form 10-K Exhibit List

<u>Exhibit Number</u>	<u>Exhibit Title</u>
3.1*	Certificate of Incorporation of Quest Software, Inc. (incorporated by reference to our Current Report on Form 8-K filed on April 30, 2009)
3.2*	Bylaws of Quest Software, Inc. (incorporated by reference to our Current Report on Form 8-K filed on April 30, 2009)
4.1*	Form of Registrant's Specimen Common Stock Certificate (incorporated by reference to our Registration Statement on Form S-1 and all amendments thereto filed on June 11, 1999 (File No. 333-80543))
10.1*	Form of Directors' and Officers' Indemnification Agreement (incorporated by reference to our Registration Statement on Form S-1 and all amendments thereto filed on June 11, 1999 (File No. 333-80543))
10.2* ++	Quest Software, Inc. 1999 Stock Incentive Plan, as amended (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.3* ++	Form of Stock Option Agreement used under the Quest Software, Inc. 1999 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended September 30, 2004)
10.4* ++	Form of Restricted Stock Unit Award Agreement used under the Quest Software, Inc. 1999 Stock Incentive Plan, as amended (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.5* ++	Quest Software, Inc. 2001 Stock Incentive Plan, as amended (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.6* ++	Form of Stock Option Agreement used under the Quest Software, Inc. 2001 Stock Incentive Plan (incorporated by reference to our Registration Statement on Form S-8 (File No. 333-82784) filed on February 14, 2002)
10.7* ++	Quest Software, Inc. 2008 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.8* ++	Form of Stock Option Agreement used under the Quest Software, Inc. 2008 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.9* ++	Form of Restricted Stock Unit Award Agreement used under the Quest Software, Inc. 2008 Stock Incentive Plan (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2008)
10.10* ++	Quest Software, Inc. Executive Incentive Plan (incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2007)
10.11*	Credit Agreement dated as of February 17, 2009 between Quest Software, Inc. and Wells Fargo Foothill, LLC (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2009)
10.12*	Security Agreement dated as of February 17, 2009 among Quest Software, Inc., Aelita Software Corporation, ScriptLogic Corporation, Vizioncore, Inc., NetPro Computing, Inc. and those additional entities that hereafter become parties hereto, and Wells Fargo Foothill, LLC (incorporated by reference to our Quarterly Report on Form 10-Q for the period ended March 31, 2009)
10.13* ++	Voting Agreement dated June 1, 2009 by and between Quest Software, Inc. and Vincent C. Smith (incorporated by reference to our Current Report on Form 8-K filed on June 1, 2009)

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<u>Exhibit Number</u>	<u>Exhibit Title</u>
10.14*	Loan and Security Agreement, dated as of August 3, 2009, between Quest Software, Inc. as Borrower and Mutual of Omaha Bank as Lender (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)
10.15*	Secured Promissory Note, dated as of August 3, 2009, from Quest Software, Inc. as Maker to Mutual of Omaha Bank as Payee (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)
10.16*	Deed of Trust, Security Agreement, Assignment of Rents and Leases, and Fixture Filing, dated as of August 3, 2009, by and among Quest Software, Inc. as Trustor, Mutual of Omaha Bank as Beneficiary, and Fidelity National Title Company as Trustee (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)
10.17*	Environmental Certification and Indemnity Agreement, dated as of August 3, 2009, by Quest Software, Inc. as Obligor in favor of Mutual of Omaha Bank as Lender (incorporated by reference to our Current Report on Form 8-K filed on August 7, 2009)
14.1	Code of Conduct and Ethics
21.1	Subsidiaries of the Registrant
23.1	Consent of Deloitte & Touche LLP
31.1	Certification of the Principal Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification of the Principal Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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\* Incorporated by reference

++ Indicates a management contract or compensatory arrangement

**QUEST SOFTWARE, INC.**  
**CODE OF CONDUCT AND ETHICS**  
**(As Amended November, 2009)**

**Introduction**

Quest Software, Inc. ("Quest") is committed to maintaining and meeting the highest standards of business conduct and ethics in everything we do. Our corporate integrity and reputation depends on the honesty, fairness and integrity brought to the job by each person associated with Quest. We expect employees to exercise common sense, good judgment and the highest personal ethical standards in their decisions and any conduct that affects their work performance, other employees or Quest's legitimate business interests.

The Code cannot possibly describe every practice or principle related to ethical conduct or address every situation involving an ethical or moral issue. The Code addresses certain behaviors that are particularly important to proper dealings with the people and entities with which we interact, but reflects only a part of our commitment. In addition, the Code is intended to supplement the Quest Employee Handbook and any policies established by Quest. Officers, managers and other supervisors are expected to instill in employees a sense of commitment to the spirit, as well as the letter, of the Code. Managers and other supervisors are also expected to ensure that all agents and contractors conform to Code standards when performing work for or on behalf of Quest.

Questions or concerns should be brought to a manager or to the Compliance Officer, David Cramer, Vice President and General Counsel. In addition, employees should be alert to and report possible violations of the Code by others without fear of any form of retaliation. Any employee found to have violated the standards in the Code may be subject to disciplinary action, up to and including termination and, in appropriate cases, to civil legal action or referral for criminal prosecution.

**1. Legal Compliance**

Obeying the law, both in letter and in spirit, is the foundation of this Code. Our success depends upon each employee's operating within legal guidelines and cooperating with local, national and international authorities. It is therefore essential that employees understand the legal and regulatory requirements applicable to their area of responsibility and the importance of compliance with these requirements. All employees are expected to comply with the relevant laws, rules and regulations associated with their employment, including laws concerning antitrust, business practices and insider trading.

Due to the nature and scope of Quest's business, it would be impractical to cover all of the legal requirements that may apply to each employee's function or location, and we certainly

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do not expect all employees to be knowledgeable about legal requirements in countries other than those in which they are based. However, there are a few general standards we expect all employees to understand, as described in this Code, and employees are expected to have a basic working knowledge of the applicable laws and prohibited activities related to their work for Quest.

If you have a question in the area of legal compliance, it is important that you not hesitate to seek answers from a supervisor or the Compliance Officer.

## **2. Conflicts of Interest; Related Parties**

Employees may not engage in any conduct that poses a conflict of interest with Quest's business. A "conflict of interest" exists when an employee's personal interest may conflict or interfere in any way with the interests of Quest or otherwise cast doubt on his or her objectivity in dealing with Quest business. Even the appearance of a conflict of interest can be very damaging and should be strictly avoided. In addition, employees are expected to devote their full attention to the business of Quest, and are prohibited from engaging any activity that interferes with their performance or responsibilities to Quest, or is otherwise in conflict with, or prejudicial to, Quest.

If you have any questions about a potential conflict or if you become aware of an actual or potential conflict, you should discuss the matter with your manager or the Compliance Officer. If you observe a situation involving another employee that you believe, in good faith, might involve an actual or potential conflict, you must also report the situation to your manager or the Compliance Officer. If a manager is involved in the potential or actual conflict, you should go directly to the Compliance Officer. Reports from employees will be handled as confidentially as possible and appropriate for the circumstances.

The following are examples of situations that may involve or create an actual or apparent conflict of interests:

- **Involvement of you or one of your family members as an employee, director, consultant or otherwise with one of Quest's competitors, customers or vendors.**

To clarify this point, we understand that many employees have spouses or family members who are employed by other companies, many of which are competitors, customers or vendors. We do not necessarily expect the employee or his or her family members to change their employment relationships. There may be situations where, by reason of the level or responsibility or access to sensitive business information, we may not be able to permit the employee to continue in his or her current role. But in most cases, this won't be required, and our basic expectation is that the employee disclose the fact of his or her family member's employment in any situation where the employee is involved in business decisions or activities in which his or her family member's employer is involved with Quest, and for the employee not to remain involved in that situation.

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- **Owning, directly or indirectly, a significant financial interest in any entity that does business, seeks to do business or competes with Quest.**

For this purpose, a “significant financial interest” will be deemed to exist if an employee owns 1% or more of the other company, as actual conflicts of interest are not likely to exist below this level.

- **Soliciting gifts, favors, loans or preferential treatment from any person or entity that does business or seeks to do business with Quest, or making or accepting inappropriate gifts (see Section 6, “Gifts and Entertainment” below).**
- **Soliciting contributions for any charity or for any political candidate from any person or entity that does business or seeks to do business with us.**
- **Taking advantage of corporate opportunities (see Section 3, “Corporate Opportunities” below).**
- **Using corporate assets, including Quest’s time, name, information, equipment or facilities, for personal use.**
- **Conducting business transactions as an employee of Quest with your relative, significant other or a business in which you have a significant financial interest.**

To further clarify the first point above, you may not conduct Quest business with a relative or with a business in which you or a relative holds a senior management role, except in accordance with this Code. This type of activity is referred to as a “related party transactions.” If you are proposing a related party transaction or one is unavoidable, you must fully disclose the nature of the related party transaction in writing to the Quest Vice President responsible for your business function or location and the Compliance Officer (or, in the case of the Compliance Officer, the Audit Committee of the Board of Directors). If the Compliance Officer determines that the related party transaction is material to Quest, or involves an executive officer or Board member, then Quest’s Audit Committee of the Board must give prior approval of the related party transaction before you can complete the transaction. In addition, the related party transaction must be conducted in a manner that does not provide the related party with preferential treatment.

### **3. Corporate Opportunities**

Employees have a duty to advance Quest’s interests whenever the opportunity arises. Employees may not take personal advantage of opportunities that are presented to them or discovered as a result of their position with Quest or through use of Quest property or information, unless properly authorized. Even opportunities that are acquired privately by employees may be questionable if they are related to Quest’s existing or proposed lines of business. No employee may use his or her position with Quest or company property or

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information for improper personal gain, or compete with Quest in any way. You may not exploit for your own personal gain any such opportunities unless you disclose the opportunity fully in writing to the Compliance Officer or to the Board of Directors, and the Compliance Officer or Board of Directors determines that the Company will decline to pursue such opportunity.

#### **4. Books and Records; Financial Integrity; Public Reporting**

Quest is committed to compliance with all applicable securities laws and regulations, accounting standards, accounting controls and audit practices. The integrity of Quest's records and public disclosure depends on the validity, accuracy and completeness of the information supporting the entries to the books of account. Therefore, employees must ensure that all corporate and business records are completed accurately and honestly. The making of false or misleading entries, whether they relate to financial results or test results, is strictly prohibited. Quest's records serve as a basis for managing our business and are important in meeting our obligations to customers, suppliers, creditors, employees, and others with whom we do business. As a result, it is important that our books, records and accounts accurately and fairly reflect, in reasonable detail, our assets, liabilities, revenues, costs and expenses, as well as all transactions and changes in assets and liabilities.

We require that:

- the terms of all sales transactions must be reflected accurately in the documentation for those transactions;
- employees must prepare all documentation in accordance with Quest's policies, the documentation you submit in accordance with a transaction must be complete, and you will not enter into side letters or other unauthorized communications with a customer;
- no entry has been or will be made in our books and/or records that intentionally hides or disguises the nature of any transaction or of any of our liabilities, or misclassifies any transactions as to accounts or accounting periods;
- all transactions are and will be supported by appropriate documentation;
- employees have been complying and will comply with our system of internal controls at all times; and
- no cash or other assets have been or will be maintained for any purpose in any unrecorded or "off-the-books" fund.

Quest's accounting records are also relied upon to produce reports for our management, shareholders and creditors, as well as for governmental agencies. In particular, we rely upon our accounting and other business and corporate records in preparing the periodic and current reports that we file with the SEC. It is imperative that these reports provide full, fair, accurate, timely and understandable disclosure and that they fairly present our financial condition and results of operations.

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All employees responsible for preparing, accumulating or analyzing data or information for the preparation or filing of, or any other activity in connection with Quest's periodic filings with the SEC or any other public communications must ensure that their duties are performed in such a manner that promotes, facilitates and enables Quest to provide full, fair, accurate, timely, and understandable disclosure.

Any employee who becomes aware of any departure from these standards has a responsibility to report his or her knowledge promptly to his or her manager or the Compliance Officer, and may do so without fear of dismissal or retaliation.

The Audit Committee of Quest's Board of Directors will oversee treatment of employee complaints and concerns in this area. In order to facilitate the reporting of employee complaints, our Audit Committee has established procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls, or auditing matters and the confidential, anonymous submission by employees of complaints or concerns regarding questionable accounting or auditing matters. Please refer to our corporate intranet or your Employee Handbook for more information concerning these procedures.

If you believe a violation of our financial reporting requirements has occurred, please contact the Compliance Officer. You may also contact the Audit Committee at [auditcommittee@quest.com](mailto:auditcommittee@quest.com) or, if you wish to do so anonymously, by visiting the website located at [www.Quest.com/audit](http://www.Quest.com/audit) or by calling the hotline at 1-877-226-2315. The hotline and website are operated by an independent third party to maintain confidentiality and where appropriate, anonymity.

## **5. Fair Dealing; Business Practices**

Quest strives to outperform the competition fairly and honestly. Advantages over our competitors are to be obtained through superior performance of our products and services, never through unethical or illegal business practices. Acquiring proprietary information from others through improper means, possessing trade secret information that was obtained without the owner's consent, or inducing improper disclosure of confidential information from past or present employees of other companies is prohibited, even if motivated by an intention to advance Quest's interests. If information is obtained by mistake that may constitute a trade secret or other confidential information of another business, or if you have any questions about the legality of proposed information gathering, you must consult your manager or the Compliance Officer.

You are expected to deal fairly and honestly with our customers, suppliers, employees and anyone else with whom you have contact in the course of performing your job. No employee may take unfair advantage of anyone through misuse of confidential information, misrepresentation of material facts or any other unfair dealing practice.

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Employees involved in procurement have a special responsibility to adhere to principles of fair competition in the purchase of products and services by selecting suppliers based exclusively on normal commercial considerations, such as quality, cost, availability, service and reputation. Quest will not tolerate special favors or arrangements with suppliers that impair, or appear to impair, unfettered competition for our business.

#### **6. Gifts and Entertainment**

Unless express permission is received from a manager, the Compliance Officer or the Audit Committee, entertainment and gifts cannot be offered, provided or accepted by any employee or family member of an employee unless consistent with customary business practices and not (a) excessive in value relative to the net worth or income of the recipient, (b) in cash, (c) intended (or is perceived as intended), directly or indirectly, to be in exchange for business or to influence any business decision or action, or is otherwise susceptible to being construed as a bribe or kickback or (d) in violation of any laws. If approved, the gifts and/or business entertainment will be intended only to create goodwill and sound working relationships and never to gain unfair advantage with customers or facilitate approvals from government officials. This principle applies to our transactions everywhere in the world, even where the practice is widely considered "a way of doing business." If you are uncertain about the appropriateness of any proposed entertainment or gift, discuss it with your manager or the Compliance Officer.

#### **7. Antitrust**

Antitrust laws are designed to protect the competitive process and to protect consumers and competitors against unfair business practices. These laws generally prohibit agreements or actions that unreasonably restrain trade. Examples of agreements among competitors that generally violate antitrust laws include agreements, formal or informal, to fix or control prices, including the price at which a reseller may sell products; to divide or allocate customers, markets or territories; to boycott specific suppliers; or to limit the sale of products or product lines for anticompetitive purposes.

Arrangements or contracts with customers or suppliers which involve exclusive dealing, tie-in sales or other restrictive provisions or price discrimination may also be unlawful and should not be entered into without approval of the Quest Legal Department.

Certain kinds of information, such as pricing, production and inventory, should never be exchanged with competitors, regardless of how innocent or casual the exchange may be and regardless of the setting, whether business or social.

Deceptive practices and unfair methods of competition are also prohibited. Examples of these include falsely disparaging a competitor or its products, making product claims without the facts to support them, making false or misleading claims about Quest products, and using another company's trademarks in a way that might confuse customers as to the source of the product.

Understanding the requirements of antitrust and unfair competition laws of the various jurisdictions where we do business can be quite difficult, and employees are urged to seek assistance from their managers or the Compliance Officer whenever a question arises.

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## **8. Payments to Government Personnel**

The U.S. Foreign Corrupt Practices Act prohibits giving anything of value, directly or indirectly, to officials of foreign governments or foreign political candidates in order to obtain or retain business. Making illegal payment to government officials of any country is strictly prohibited.

In addition, the U.S. government has a number of laws and regulations regarding business gratuities that may be accepted by U.S. government personnel. The promise, offer or delivery of a gift, favor or other gratuity to an official or employee of the U.S. government in violation of these rules would not only violate Company policy but could also be a criminal offense. State and local governments, as well as foreign governments, may have similar rules. The Compliance Officer can provide further guidance in this area.

## **9. Protection and Proper Use of Company Assets**

All employees are expected to protect our assets and ensure their efficient use. Unauthorized use or removal of Quest property, carelessness and waste have a direct impact on our profitability. Office supplies, computer equipment, buildings, products and other Quest properties are expected to be used only for legitimate business purposes, although incidental personal use may be permitted. Any misuse or suspected misuse of Quest assets must be immediately reported to your supervisor or the Compliance Officer.

## **10. Business Communications**

All business records and communications should be clear, truthful and accurate. Employees should be aware that conduct and records, including emails, are subject to internal and external audits, and that business records and communications often become public through litigation, government investigations and the media. Employees should be particularly mindful of the lack of secrecy inherent within IT and email systems. Accordingly, we should avoid exaggeration, colorful language, guesswork, legal conclusions and derogatory remarks or characterizations of people and companies in our communications. This applies to communications of all kinds, including email and informal notes or memos.

In order for Quest to ensure that its' confidential information is protected and also to ensure that the Company's electronic communication system is not being misused, employees should be mindful of the fact that Quest retains the right (subject in all cases to applicable law, including consent requirements) to monitor information transmitted, received or stored using our electronic equipment, with or without an employee's or third party's knowledge, consent or approval. In certain countries, employees are required to consent to such monitoring as a condition of their employment.

Misuse of the Company's email system may lead to disciplinary action including dismissal.

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## 11. Proprietary Information; Confidentiality

One of Quest's most important assets is its proprietary information and intellectual property. Proprietary information is defined as information that was developed, created or discovered by Quest, or that became known by or was conveyed to Quest, that has commercial value in our business. Employees who have received or have access to proprietary information must take every precaution to keep this information confidential. This includes software programs and subroutines, source and object code, trade secrets, copyrights, ideas, technologies, know-how, inventions (patentable or not), and any other information of any type relating to designs, configurations, algorithms, flowcharts, works of authorship, formulae, mechanisms, research and development or marketing plans and strategies, financial information, product architecture, engineering ideas, designs, databases, customer lists, pricing, personnel data (including salaries and other terms of compensation), personally identifiable information pertaining to our employees, customers or other individuals (including, for example, names, addresses, telephone numbers and social security numbers), and similar types of information, including information provided to us by our customers, vendors and partners. This information may be protected by patent, trademark, copyright and trade secret laws.

Except when disclosure is authorized or legally mandated, you must not share Quest confidential information or that of our suppliers or customers with third parties or others within Quest who have no legitimate business purpose for receiving that information. Doing so would constitute a violation of the proprietary information and inventions agreement that you signed upon joining Quest. Unauthorized use or distribution of this information could also be illegal and result in civil liability and/or criminal penalties.

The use of confidential and proprietary information – whether belonging to Quest or a third party – is usually covered by a written agreement. In addition to the obligations imposed by that agreement, all employees should comply with the following duties:

- Confidential information should be received and disclosed only under the terms of a written agreement
- Confidential information should be disclosed only to those Quest employees who need to access it to perform their jobs for Quest
- Confidential information of a third party should not be used or copied by any Quest employee except as permitted by the third-party owner (usually, as specified in a written agreement)
- Unsolicited third-party confidential information should be refused or, if inadvertently received by a Quest employee, returned unopened to the third party or transferred to the Legal Department for appropriate disposition.

Employees must refrain from using any confidential information belonging to former employers, and such information must never be brought to Quest or provided to other Quest employees.

If you feel it is appropriate to share confidential information with our business partners or potential business partners, it is essential that your supervisor or the Compliance Officer

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approves the proposed disclosure in advance and that the receiving party is bound by an appropriate nondisclosure agreement. You must not sign a third party's nondisclosure agreement or accept changes to Quest's nondisclosure agreement without review and approval by the Legal Department or Contracts Department.

You should also take care not to inadvertently disclose confidential information. Materials that contain confidential information, such as memos, notebooks, computer disks and laptop computers must be stored securely. Unauthorized posting or discussion of any information concerning our business, information or prospects on the Internet is prohibited. You may not discuss our business, information or prospects in any "chat room," regardless of whether you use your own name or a pseudonym. Be cautious when discussing sensitive information in public places like elevators, airports, restaurants and "quasi-public" areas within Quest, such as cafeterias. All Quest emails, voicemails and other communications are presumed confidential and must not be forwarded or otherwise disseminated outside of Quest, except where required for legitimate business purposes.

In addition to the above responsibilities, if you are handling information protected by any privacy policy published by Quest, such as our website privacy policy, then you must handle that information solely in accordance with the applicable policy.

## **12. Waivers**

Any waiver of this Code for executive officers (including, where required by applicable laws, our principal executive officer, principal financial officer, principal accounting officer or controller (or persons performing similar functions)) or directors may be authorized only by Quest's Board of Directors and are subject to disclosure in Quest's public filings as required by applicable laws, rules and regulations.

## **13. Compliance Standards and Procedures**

We have established the position of Compliance Officer to oversee our legal compliance and ethics program. The Compliance Officer is a person to whom you can address any questions or concerns. The Compliance Officer is located at our Aliso Viejo, California office and can be reached at extension 48023.

If you encounter a situation or are considering a course of action and the appropriateness is unclear, discuss the matter promptly with your supervisor or the Compliance Officer. If you are uneasy about a situation or action that seems to fall within technical compliance of the Code, take steps to clarify your concerns; even the appearance of impropriety can be very damaging and is to be avoided. If you are aware of suspected or actual violations of Code standards by others, you have a responsibility to report it.

Your most immediate resource is your direct supervisor. He or she may have the information you need, or may be able to refer the question to another appropriate source. There may, however, be times when you prefer not to go to your supervisor. In these instances, you should feel free to discuss your concern with the Compliance Officer. Whether you choose to speak with your supervisor or the Compliance Officer, you should do so without fear of any form

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of retaliation. If you are uncomfortable speaking with the Compliance Officer because he or she works in your department or is one of your supervisors, please contact Human Resources.

We have also established a toll-free voice hotline at 1-877-226-2315, and a website located at [www.Quest.com/ethics](http://www.Quest.com/ethics), for those who wish to ask questions about Quest policy, seek guidance on specific situations or report violations of the Code. The hotline and website are operated by an independent third party to maintain confidentiality and where appropriate, anonymity. Whether you identify yourself or remain anonymous, your telephone or email contact will be kept strictly confidential to the extent reasonably possible within the objectives of the Code. Again, anyone contacting us with an ethics issue will not be subject to retaliation for having made the contact and reporting the concern.

Your ethics question or concern will be taken seriously. The Compliance Officer will work with you to arrive at the actions that will be taken to address your concern and, if you wish, will advise you of the follow-up steps taken. As needed, the Compliance Officer will consult with the legal department, the Human Resources department and/or the Audit Committee of the Board of Directors. If you prefer to remain anonymous, you should use the toll-free voice mail box number, or call the Compliance Officer using an outside line. Anyone found to be in violation of the Code may be subject to disciplinary action, up to and including termination. In some cases, Quest may pursue civil action or referral for criminal prosecution. There is no set pattern that the corrective action may follow. Certain conduct may result in immediate dismissal, without a "second chance."

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**Code of Conduct and Ethics Policy**

**EMPLOYEE ACKNOWLEDGMENT**

I have been provided with a copy of the Code of Conduct and Ethics Policy for Quest Software, Inc. I understand that it is my responsibility to read the policy and that I will be expected to comply with the guidelines established. I further understand that failure to comply with such guidelines may lead to disciplinary action up to and including termination.

Dated: \_\_\_\_\_

\_\_\_\_\_  
Employee Signature

\_\_\_\_\_  
Employee – Print Name

## SUBSIDIARIES OF QUEST SOFTWARE, INC.

<u>Name</u>	<u>Jurisdiction Of Organization</u>
1397639 Ontario Ltd.	Ontario, Canada
881229 Alberta Ltd.	Alberta, Canada
Fastlane Technologies (UK) Limited	United Kingdom
Fastlane Technologies Corporation	Delaware
Active Concepts Pty, Ltd.	Australia
Active Concepts, Inc.	California
Fresh Dew Investments Limited	British Virgin Islands
Murecia Investments Limited	British Virgin Islands
Quest Software France SARL	France
Quest Software (UK) Ltd.	United Kingdom
Quest Software Pty., Ltd.	Australia
Q.S.I. Quest Software Israel Limited	Israel
Quest Software Company Limited	Ireland
Quest Software International Limited	Ireland
Quest Software GmbH	Germany
Quest Holding Company, LLC	California
Quest Softair, Inc.	California
Quest Software, Ltda	Brazil
Quest Software Spain SL	Spain
Quest Software Mexico S. de R.L. de C.V.	Mexico
Quest Software Nederland B.V.	Netherlands
Quest Software Norge AS	Norway
Quest Scandinavia AS	Denmark
QSFT Svenska AB	Sweden
Quest Software Switzerland GmbH	Switzerland
Quest Software Belgium	Belgium
Quest Software Java Support Centre B.V.	Netherlands
Safari Limited Partnership	Canada
Quest Software Canada	Canada
eCritical Incorporated	California
QSI Development Corporation	Delaware
Quest Acquisition Corporation	California
Quest Software K.K.	Japan
Quest Software Sales Sdn Bhd	Malaysia
Quest Software Singapore Pte LTD	Singapore
Quest Software Limited	Hong Kong
Quest Software Korea LTD	Korea
QSFT India Private Limited	India
Aelita Software Corporation	Delaware
Aelita Software Limited	United Kingdom
Lecco Technology (Canada) Inc.	Canada
Lecco Technology (UK) Limited	United Kingdom
Lecco Technology (USA), Inc.	Delaware
Quest Software Italia – S.R.L. Unipersonale	Italy
Quest Software Greater China Limited	Hong Kong
Quest Software Beijing Company Limited	China
Quest Software (Zhuhai) Limited	China
Quest Software Public Sector, Inc.	Delaware
Vintela, Inc.	Utah

<u>Name</u>	<u>Jurisdiction Of Organization</u>
Vintela Pty. Ltd.	Australia
Vintela Australia Pty. Ltd.	Australia
Wedgetail Communications Incorporated	Delaware
Imceda Software, Inc.	Delaware
Imceda Technologies Pty. Ltd.	Australia
Imceda Software Australia Pty. Ltd.	Australia
DB Associates IT Pty. Ltd.	Australia
Quest Software New Zealand Limited	New Zealand
Charonware s.r.o.	Czech Republic
Magnum Technologies, Inc.	Minnesota
Invirtus, Inc.	Delaware
ScriptLogic Corporation	Delaware
ScriptLogic UK Ltd.	United Kingdom
ScriptLogic Australia Pty. Ltd.	Australia
Vizioncore, Inc.	Illinois
PassGo Technologies Ltd.	United Kingdom
PassGo Technologies Trustees Ltd.	United Kingdom
VirtualFabrix, Inc.	California
NetPro Computing, Inc.	Delaware
NetPro Europe, Inc.	Arizona
NetPro Engineering, Inc.	Arizona
NetPro Computing France, Inc.	Arizona
NetPro Computing Canada, Inc.	Arizona
NetPro Computing Germany, Inc.	Arizona
NetPro Computing UK, Inc.	Arizona
Safari I, Inc.	Delaware
Safari II, Inc.	Delaware
PacketTrap Networks, Inc.	Delaware
Messagewise, Inc.	Ontario, Canada

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in Registration Statement Nos. 333-49668, 333-96183, 333-113927, 333-125398, 333-126585, and 333-152064 on Form S-8 of our reports dated February 19, 2010, relating to the consolidated financial statements and financial statement schedule of Quest Software, Inc. (the "Company") (which expresses an unqualified opinion and includes an explanatory paragraph regarding the Company's changes in its method of accounting in 2007 for income taxes as a result of adopting new accounting guidance on the accounting for uncertainty in income taxes) and the effectiveness of the Company's internal control over financial reporting, appearing in the Annual Report on Form 10-K of the Company for the year ended December 31, 2009.

/s/ Deloitte & Touche LLP

Costa Mesa, California  
February 19, 2010

## CERTIFICATION

I, Douglas F. Garn, certify that:

1. I have reviewed this Annual Report on Form 10-K of Quest Software, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 19, 2010

\_\_\_\_\_  
/s/ Douglas F. Garn  
Douglas F. Garn  
President and Chief Executive Officer

## CERTIFICATION

I, Scott J. Davidson, certify that:

1. I have reviewed this Annual Report on Form 10-K of Quest Software, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 19, 2010

/s/ Scott J. Davidson  
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Scott J. Davidson  
Senior Vice President and Chief Financial Officer

**Certification of Chief Executive Officer and Chief Financial Officer Pursuant to  
18 U.S.C. Section 1350, as Adopted Pursuant to  
Section 906 of the Sarbanes–Oxley Act of 2002**

Pursuant to the requirement set forth in Rule 13a–14(b) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350), Douglas F. Garn, Chief Executive Officer of Quest Software, Inc. (the “Company”), and Scott J. Davidson, Chief Financial Officer of the Company, each hereby certifies that, to the best of his or her knowledge:

1. The Company’s Annual Report on Form 10–K for the period ended December 31, 2009, to which this Certification is attached as Exhibit 32.1 (the “Annual Report”) fully complies with the requirements of Section 13(a) or Section 15(d) of the Exchange Act, and
2. The information contained in the Annual Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

**In Witness Whereof**, the undersigned have set their hands hereto as of the 19<sup>th</sup> day of February, 2010.

\_\_\_\_\_  
/s/ Douglas F. Garn  
Douglas F. Garn  
President and Chief Executive Officer

\_\_\_\_\_  
/s/ Scott J. Davidson  
Scott J. Davidson  
Senior Vice President and Chief Financial Officer

This certification accompanies the Form 10–K to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Quest Software, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10–K), irrespective of any general incorporation language contained in such filing.