OPNET TECHNOLOGIES INC
Form 10-K
June 14, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended March 31, 2006

OR

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

Commission file number: 000-30931

OPNET TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**52-1483235**
(State or other jurisdiction of	**(I.R.S. Employer**
Incorporation or organization)	**Identification No.)**

7255 Woodmont Avenue, Bethesda, Maryland 20814-7900

(Address of principal executive offices) (Zip Code)

Registrant s telephone number; including area code: (240) 497-3000

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

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

Common Stock, $ .001 par value

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer or large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

The aggregate market value of the voting stock held by non-affiliates of the registrant, computed using the closing sale price of the registrant s Common Stock on September 30, 2005, as reported on the NASDAQ National Market, was approximately $85,000,000. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily conclusive for other purposes.

The number of shares of the registrant s Common Stock outstanding on June 1, 2006 was 20,248,714.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the registrant s definitive Proxy Statement for the 2006 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

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OPNET TECHNOLOGIES, INC.

ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED MARCH 31, 2006

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This Annual Report contains forward-looking statements that involve substantial risks and uncertainties. You can identify these statements by forward-looking words such as anticipate, believe, could, estimate, expect, intend, may, plan, potential, should, will, and You should read statements that contain these words carefully because they discuss our future expectations, contain projections of our future results of operations or of our financial position, or state other forward-looking information. We believe that it is important to communicate our future expectations to our investors. However, there may be events in the future that we are not able to predict accurately or control. The factors listed in this Annual Report on Form 10-K under Risk Factors, as well as any cautionary language in this Annual Report on Form 10-K, provide examples of risks, uncertainties, and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements. You should also carefully review the risks outlined in other documents that we file from time to time with the Securities and Exchange Commission, including our Quarterly Reports on Form 10-Q that we will file in fiscal 2007.

The forward-looking statements provided in this Annual Report on Form 10-K represent our expectations as of June 13, 2006. We anticipate that subsequent events and developments will cause our expectations to change. However, while we may elect to update this forward-looking information at some point in the future, we specifically disclaim any obligation to do so. This forward-looking information should not be relied upon as representing our expectations as of any date subsequent to June 13, 2006.

IT Guru®, Netbiz®, Net Doctor®, OPNET®, OPNET Modeler®, SP Guru®, WDM Guru®, OPNET Technologies, Inc.®, OPNETWORK®, VNE Server®, IT Sentinel, SP Sentinel, 3DNV, OPNET Commander, OPNET Panorama, and Report Server are trademarks or service marks of OPNET. Other trademarks or service marks appearing in this Annual Report on Form 10-K are the property of their respective holders.

The years ended March 31, 2007, 2006, 2005, and 2004 are referred to as fiscal 2007 , fiscal 2006 , fiscal 2005 , and fiscal 2004 , respectively, in this Annual Report on Form 10-K.

We are a Delaware corporation, our principal executive office is located at 7255 Woodmont Avenue, Bethesda, Maryland 20814-7900 and our telephone number is (240) 497-3000. Our web site address is www.opnet.com. The information on our web site is not incorporated by reference into this Annual Report on Form 10-K and should not be considered to be a part of this Annual Report on Form 10-K. Our web site address is included in this Annual Report on Form 10-K as an inactive textual reference only.

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PART I

ITEM 1. BUSINESS OVERVIEW

OPNET Technologies, Inc. is a provider of management software for networks and applications. Our solutions address application performance management, network configuration management, capacity planning and design, and network research and development. OPNET differentiates itself from traditional management software providers by focusing on analytics. Traditional management tools emphasize monitoring and reporting, which are inherently reactive processes. In contrast, OPNET focuses on algorithms and modeling to rapidly troubleshoot and resolve performance problems and, even more importantly, to proactively prevent problems from occurring.

Embedded in OPNET software is expert knowledge about how network devices, network protocols, applications, and servers operate and interact. This intelligence enables users in application development, network operations, engineering, planning, and security functions to be more effective in optimizing performance and availability of their networks and applications. We believe our software solutions generate return on investment to a broad customer base, including corporate enterprises, government and defense agencies, network service providers, and network equipment manufacturers by empowering them to make better use of resources, reduce operational problems, and improve competitiveness.

We market focused software solutions for each of our target markets. Since inception, we have sold our products to:

- enterprises such as Blue Cross Blue Shield, Chevron, Citigroup, Heinz, IBM Global Services, Target and Texas Utilities;
- service providers such as British Telecom, Intelsat, NTT, Telus, T-Mobile and Verizon;
- network equipment manufacturers such as Cisco Systems, Ericsson, Hewlett-Packard, Intel Corporation, and Nokia; and
- government agencies such as the FBI, NASA, NATO, United States Department of Defense, United States Department of Homeland Security, and United States Department of State.

Industry Background

Growth and Increased Complexity of Networks and Dependence on Applications

Organizations rely on networks and enterprise software applications to successfully execute their strategies. The increasing use of applications, such as enterprise resource planning, business intelligence, corporate intranets, online transaction processing, e-mail, web meetings, instant messaging, portals, web services, voice over IP, wireless, and streaming multimedia, has resulted in significant growth in underlying network and application infrastructures. In addition, the proliferation and widespread adoption of the Internet and web services architectures have expanded the role of networks beyond organizational boundaries.

Enterprises and service providers must now manage the convergence of voice, data, and video traffic over traditional, wireless, and optical architectures by integrating numerous existing and emerging technologies. The complexity is exacerbated by the current corporate regulatory environment, which requires improved management processes and documentation. As a result of these factors, businesses and government entities are forced to confront significant challenges related to the cost, risk, and performance of IT.

IT infrastructures are sophisticated, dynamic systems that evolve on a daily basis. Applications are typically distributed across many clients, servers, and network segments. New and enhanced business applications are regularly being deployed and re-deployed. The geographic distribution of users relative to IT services shifts due to the consolidation of organizations and infrastructures. Traffic levels exhibit steady growth, necessitating constant evaluation of and improvements to the network-underlying infrastructure in order to maintain business and application performance. However, due to the dependencies among network, server, and application configurations, it is very difficult for IT professionals to identify the true root cause of end-to-end performance

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problems when they occur. The data required to diagnose end-to-end problems is often not available, and when it is, significant expertise is required to perform analysis commonly using manual techniques that are time consuming, and sometimes impractical. When an end-user experiences performance problems with an important business application, the challenge facing a typical IT manager is to determine: whether there is enough bandwidth available; whether the database server has enough capacity; whether network routing protocols are tuned properly; whether protocols on the client and server are likewise tuned properly; and whether the application was designed and implemented efficiently, with end-user performance in mind.

Without a clear understanding of the source of problems and the specific changes required to solve them, IT managers resort to uninformed decision-making that often results in wasteful spending on unnecessary and ineffective server and network upgrades. IT professionals need solutions that enable them to focus their time and resources in the right places when problems occur in distributed enterprise applications, and to maximize the use of existing infrastructure. Further, since modifications to infrastructure have the potential to cause service level degradation or even network failures there is a growing need to plan and implement network changes in a controlled manner, taking into account the potential consequences of each action.

Inadequacy of Traditional Application and Network Management Solutions

Traditional application and network management tools have primarily played an important role in reporting on present and historical performance and availability. These systems typically collect, store and report on data about the status of networks and systems, such as response time and utilization. Traditional application and network management products are limited by their lack of understanding of the underlying technologies that support applications, and the relationships among these technologies. While they provide useful information, they do not automate the next step, which is performing intelligent analysis to transform collected data into actionable information.

Market Opportunity for OPNET Solutions

Organizations need network and application management solutions that possess the analytics required to overcome the limitations of traditional tools for rapidly resolving complex problems, and proactively preventing problems from occurring. OPNET solutions are focused on these areas. They have an operational understanding of networks, applications, and systems for quickly troubleshooting problems and automatically predicting the impact of changes. We believe business executives and IT professionals require these solutions to:

- reduce operating and capital costs;
- increase business productivity; and
- manage risk.

The value proposition from OPNET solutions applies to a broad range of customers including:

- large and medium-sized enterprises that rely on IT to conduct business;
- government/defense agencies;
- service providers, including telecommunications carriers Internet Service Providers, or ISPs; and Managed Service Providers, or MSPs; and
- network equipment manufacturers.

Enterprises require analytics for more effectively identifying the root causes of end-to-end application performance problems, ensuring the successful deployment of new applications, auditing device configurations, validating changes, and performing critical operational and strategic planning functions.

Government and defense agencies have needs similar to those of enterprises, service providers, and network equipment manufacturers. These agencies also sometimes require specialized services to support large projects that incorporate OPNET s technology.

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Service providers require analytics for optimizing their investments in network infrastructure, more effectively troubleshooting network issues, ensuring network configuration integrity and security, planning for services based on new technologies including wireless and optical, and making better use of network resources to increase competitiveness.

Network equipment manufacturers require advanced modeling and simulation solutions for accelerating network research and development, reducing time-to-market for new technologies, developing custom network design and analysis software, and for reducing sales cycles for sophisticated technology products.

OPNET Solutions and Products

OPNET software solutions directly address the application and network management needs of enterprises, government and defense agencies, service providers, and network equipment manufacturers. Our software solutions use a variety of advanced technologies to support the analysis of network, application, and server performance under a wide range of current and future operating conditions. Our products include model libraries that permit the simulation and analysis of major network technologies and communication protocols, such as TCP/IP, IP-QoS, Voice over IP, DWDM, UMTS, Virtual Local Area Networks, or VLANs, Frame Relay, MPLS, data over cable, and ATM. We sell both off-the-shelf and customized products that offer interfaces to third party network management solutions, including those from AlterPoint, BMC, Cisco Systems, Computer Associates, EMC Smarts, Fluke Networks, HP, InfoVista, Micromuse, NetScout, and others. Most OPNET products share a significant amount of core software based on an open architecture. Our product architecture enables us to create new products more efficiently, to foster interoperability of our products, and to provide interfaces to a wide range of external data sources including third party management tools and network topology, traffic, and configuration information.

The following sections summarize the OPNET product portfolio:

Primary Target Market: Enterprise IT (Corporate and Government/Defense)

IT Guru was first introduced in August 1998. IT Guru is a platform product, which is sold with OPNET modules to provide solutions in the following areas: application performance analysis, network configuration analysis, and predictive capacity planning with network, application, server, and mainframe models.

IT Sentinel was first introduced in August 2004. IT Sentinel is an automated solution that provides continuous network configuration integrity and security auditing.

OPNET Panorama was first introduced in December 2004 following OPNET s acquisition of the Altaworks Corporation. Panorama provides real-time system analytics for application performance management. With Panorama focusing on advanced application analysis from the server perspective, and IT Guru s network perspective, we believe that we are well positioned to address the complex issues that our clients will face as they migrate to web services architectures.

OPNET Commander was first introduced in December 2004 following OPNET s acquisition of the Altaworks Corporation. Commander provides active application response time monitoring for web-based applications.

VNE Server was first introduced in June 2002. VNE Server, or Virtual Network Environment Server automatically maintains a detailed, near real time data model of the production IT network. VNE Server includes a suite of adapters that obtain topology, traffic, and other information from network devices as well as a broad range of third party data sources. VNE Server automates the data collection process for other OPNET products, including IT Guru and SP Guru. VNE Server capabilities are included in IT Sentinel and SP Sentinel.

Report Server was first introduced in May 2004. Report Server provides easy publishing and secure archiving of reports generated by OPNET products. Report Server capabilities are included in IT Sentinel and SP Sentinel.

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Primary Target Market: Network Service Providers (both Commercial and Government/Defense)

SP Guru was first introduced in June 2001. SP Guru is a superset of the IT Guru product, and contains analytics that are valuable to service providers for troubleshooting, validating, planning, and designing networks. SP Guru includes modeling and analysis technologies for IP, MPLS, and ATM networks, and when combined with WDM Guru, provides a single environment for network-level and optical transport-level analysis.

WDM Guru was first introduced in December 2001. WDM Guru is an optical network-planning product for designing resilient, cost-efficient optical networks. WDM Guru is also sold to network equipment manufacturers.

SP Sentinel was first introduced in August 2004. SP Sentinel is an automated solution that provides continuous network configuration integrity and security auditing for service providers.

Primary Target Market: Network R&D Organizations (Defense and Equipment Manufacturers)

OPNET Modeler was OPNET s first product, introduced in 1987. OPNET Modeler is a network modeling and simulation solution. It enables users to evaluate how networking equipment, communications technologies, systems, and protocols will perform under simulated network conditions.

OPNET Development Kit is a superset of OPNET Modeler that provides a development environment, enabling customization of other OPNET products, and development of custom software applications.

Primary Target Market: Defense

Network Common Operating Picture, or NETCOP is a solution that combines OPNET software technologies with OPNET customization services to provide real-time visualization and status information for multi-vendor, multi-technology networks. For defense organizations, NETCOP simplifies and improves situational awareness for warfighters. It leverages and merges data from already-deployed event/performance/configuration management tools, and adds analytics automation, and visualization capabilities. The first NETCOP implementation was announced in September 2003. NETCOP is also sold to commercial enterprise and service provider customers.

OPNET Modules

We develop and sell a variety of software modules that provide enhanced functionality to our application and network management software products. Currently available OPNET modules include:

Primary Target Market: Enterprise IT (Corporate and Government/Defense)

Application Characterization Environment, or ACE provides end-to-end application analysis for operational troubleshooting and deployment planning;

ACE Decode provides comprehensive protocol/application decodes for the *ACE* module;

ACE Advanced Console enhances transaction capture for diagnosing intermittent performance problems;

Automation enables automated, unattended execution of *IT Guru* and *SP Guru* workflows;

Distributed Agent Controller provides an integrated workflow for the *ACE* module with third party active monitoring tools;

Flow Analysis predicts and provides visualization of network routing of traffic flows for capacity and resiliency analysis;

Mainframe Modeling provides capacity planning capabilities for mainframe systems, using discrete event simulation;

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Multi-Vendor Import is a lightweight network data import engine for network planning and analysis;

NetDoctor is a network configuration analysis engine for routing, security, policy, and change management;

Server Modeling provides capacity planning capabilities for server systems, using discrete event simulation;

System Performance Module for BMC Performance Assurance enables the direct import of server process data from BMC PATROL Performance Assurance into OPNET server models;

System Performance Module for HP OpenView enables the direct import of application and process data from HP OpenView Performance Manager into OPNET server models.

Primary Target Market: Network R&D Organizations (Defense and Equipment Manufacturers)

3D Network Visualizer, or 3DNV provides 3D visualization of communications for discrete event simulations;

High-Level Architecture enables the building and execution of distributed simulations using the HLA standard;

Terrain Modeling provides advanced modeling of environmental effects on wireless communications for discrete event simulations;

TIREM computes accurate propagation loss due to terrain effects within wireless network simulations, using the de facto United States government standard algorithm;

Wireless models and simulates wireless network communications and mobility;

Specialized discrete event model libraries for simulating *Circuit Switch*, *DOCSIS*, *IPv6*, *MPLS*, *PNNI*, *UMTS*, and WiMAX network technologies.

OPNET Model Libraries

The model libraries are used by OPNET products to simulate and analyze major networking technologies and communication protocols. These libraries provide the building blocks used to generate models of networks. A network model consists of software objects that correspond to the devices, computers, and links that constitute the actual network of interest. The behavior of these objects is controlled by models of devices, computers, applications, communication protocols, and links. *IT Guru, IT Sentinel, SP Guru, SP Sentinel, OPNET Modeler,* and the *OPNET Development Kit* include extensive libraries of popular and emerging networking technologies and communication protocols, such as TCP/IP, hypertext transfer protocol, or HTTP, Open Shortest Path First routing, or OSPF, Asynchronous Transfer Mode, or ATM, frame relay, IP-QoS, and 802.11, or Wi-Fi. Some of our model libraries are included in our base products and others are available for an additional fee as modules.

Our software license agreements provide our customers with perpetual and annual licenses for use by a specified number of concurrent users.

For fiscal 2006, fiscal 2005, and fiscal 2004 we generated 21.7%, 19.1%, and 20.5% respectively, of our total revenue from customers located outside the United States. As of March 31, 2006, greater than 99% of our property and equipment were held inside the United States. As of March 31, 2006, all of our intangible assets were held inside the United States. Note 14 to our consolidated financial statements presents information regarding revenue generated in the United States and internationally.

For fiscal 2006, fiscal 2005 and fiscal 2004, revenue from transactions with United States government agencies was approximately 43%, 47%, and 44% of our total revenue, respectively. We derive a substantial portion of our revenue from sales directly or indirectly to United States government agencies. Government sales are subject to a variety of risks including adequate appropriation of funds by the United States Congress, termination for convenience, contract renegotiations/extensions, and decline in government spending.

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In January 2003, we were awarded a consulting contract with the United States Department of Defense that contributed approximately $3,096 and $3,296 of consulting revenue for fiscal 2004 and fiscal 2003, respectively. The funding under this contract for calendar year 2003 was $3,147. Under the first of four possible contract extensions, the funding under this contract for 2004 was $3,520.

In January 2005, we were awarded the contract option for calendar year 2005 in the amount of $2,965. The option contributed approximately $1,945 and $657 of consulting revenue for fiscal 2006 and fiscal 2005, respectively. Funding under this award may be increased or decreased during the calendar year.

In February 2006, we were awarded the contract option for calendar year 2006 in the amount of $2,899. The option contributed approximately $596 of consulting revenue for fiscal 2006. The option year for calendar year 2007 under this contract may be exercised by the United States Department of Defense at its discretion. Our future results of operations could be adversely affected if any of the remaining options are not exercised or the contract otherwise does not receive additional funding. Funding under this award may be increased or decreased during the calendar year.

Sales and Marketing

We sell our software through our direct sales force, our international subsidiaries, third-party distributors, and a number of original equipment manufacturers, or OEM and value-added resellers. To date, OEMs have not accounted for a material portion of our revenue. In North America, our direct sales force accounts for the majority of our sales. As of March 31, 2006, our sales and marketing teams consisted of 128 employees, including 62 quota-carrying salespersons located in our headquarters in Bethesda, Maryland and our domestic offices in Cary, North Carolina; Dallas, Texas; and Santa Clara, California; and our overseas subsidiaries in Paris, France; Slough, United Kingdom; and Frankfurt, Germany. We intend to expand our sales and marketing organization by recruiting additional qualified individuals.

Our international sales activities are also supported by our 24 distributors that resell our products in Argentina, Australia, China, Finland, France, Germany, Greece, Hong Kong, India, Indonesia, Israel, Japan, Malaysia, Poland, Singapore, South Africa, South Korea, Sweden, Taiwan, Turkey, and Venezuela. Our marketing division works internally with our engineering and sales teams to develop customer value propositions and product messages, and externally with various third parties to develop alliances, brand awareness, and leads for sales. Our external marketing activities are aimed at existing customers, new customer and partner prospects, the media, and industry analysts. These include:

- participation in industry tradeshows;
- technology seminars and users groups;
- advertisements in trade journals and online;
- direct mailings;
- product collateral development and OPNET s website;
- free software for academic use at universities;
- specialized product sales support;

- specialized sales support with OPNET alliance partners;
- briefings with industry analysts; and
- a variety of public relations activities, including our annual international technology conference OPNETWORK.

For each of the last nine years, we have sponsored OPNETWORK, an annual international technology conference convened in Washington, D.C. that focuses on application and network management for professionals in all areas of networking and information technology. OPNETWORK 2005, held in August 2005 in Washington, DC, approximately 650 hours of classes, labs, and panels led by OPNET employees and outside experts. Approximately 1,800 IT and engineering professionals representing 32 countries, participated in the conference. OPNETWORK 2006 is scheduled to be held in Washington, DC in August 2006.

Service and Support

Our service and support offerings include:

- consulting services;
- software maintenance, which includes providing unspecified software updates on a when-and-if-available basis for major and minor revisions;
- technical support by telephone, e-mail, or fax; and
- training, which includes courses that enable our customers to more effectively use our products.

We offer consulting services to assist our clients to facilitate the adoption of our software solutions and to provide installation services for our product offerings. Installation services are performed by our consulting staff, which consists of software development engineers, quality assurance engineers, technical documentation specialists, and project managers. Some customers also choose to engage our consulting services for troubleshooting application performance problems, network planning, network design, communication protocol design and customization services. As of March 31, 2006, our consulting staff consisted of 96 employees.

Our customers may purchase software maintenance and technical support, generally on an annual basis. Purchasers of maintenance are provided with unspecified updates to the software they license from us as the unspecified updates are released. The fee for this service is generally determined as a percentage of the current price of product licenses. Beginning in July 2001, our customers have been able to separately purchase periodic unspecified product updates without purchasing technical support. Customers purchasing technical support are still required to purchase periodic unspecified product updates.

We provide customer support from our support center at our headquarters in Bethesda, Maryland, as well as from support staff in France, the United Kingdom, and Australia. We have designed and implemented a comprehensive information system to ensure that customer inquiries are addressed promptly, tracked until fully resolved, and recorded for future reference. Reports on the overall responsiveness of the technical support infrastructure, and the status of pending customer inquiries, are provided regularly to our technical support staff, technical support management, and executive management.

We have a core team of 12 technical support staff supplemented by a number of product developers and consultants who perform technical support on a rotational basis. This staffing approach ensures that customers have access to the best available product expertise, while simultaneously providing product developers with direct customer feedback, which in turn helps us improve our products.

We regularly offer training courses to our customers to assist them in maximizing the benefit they receive from using our products. Our training classes cover a broad range of topics. Training classes are offered at our headquarters in Bethesda, Maryland, our facilities in Santa Clara, California; Cary, North Carolina; Paris, France; and Slough, United Kingdom; and at our customers locations. As of March 31, 2006, our full time training staff consisted of 4 employees.

Research and Development

We believe that our ability to enhance our current products and create new products in response to the needs of our customer base will be an important factor for our future success. Accordingly, we intend to continue to commit significant resources to product research and development. We expect to accomplish a large part of our product improvements and new product development through internal development efforts. New capabilities may also be integrated into our product lines through the acquisition of technologies or businesses, or the licensing of externally developed technologies.

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Our total expenses for research and development for fiscal 2006, 2005, and 2004 were $18,643, $15,455, and $13,040, respectively. Our research and development efforts to date have been conducted at our offices in Bethesda, Maryland; Cary, North Carolina; Nashua, New Hampshire; and Ghent, Belgium. All related costs have been expensed as incurred. As of March 31, 2006, our research and development staff consisted of 150 engineers and technical professionals.

Our research and development efforts are directed at increasing our revenue by expanding the scope of our solutions to address additional customer requirements. Our existing customers provide a meaningful source of information, which we use in order to guide our future product development. In addition, we invest in research and analysis of trends in our industry and our product markets, and we expect that our future products will reflect the results of these analyses.

Competition

The market for our products is evolving rapidly and is highly competitive. We believe that this market is likely to become more competitive as the demand for intelligent application and network management solutions continues to increase. Although we believe that none of our competitors offers a solution that is identical to ours, we are subject to current and potential competition from:

- software vendors with networked application troubleshooting and predictive analysis offerings, such as Compuware and its Vantage product line;
- consultants who offer advisory services related to intelligent application and network management; and
- customers who develop their own network and application management capabilities, either internally or through outsourcing.

Also, it is possible that other vendors as well as some of our customers or distributors will develop and market competitive solutions in the future. Many of our current and potential competitors are larger and have substantially greater financial and technical resources than we do.

We believe the principal competitive factors affecting the market for our software products are the following:

- scope, quality, and cost-effectiveness of application and network management solutions;
- industry knowledge and expertise embedded in the software;
- the interoperability of solutions with existing network management solutions;
- product performance, accuracy, technical features, ease of use, and price; and
- customer service and support.

Intellectual Property

We rely on a combination of copyright, trademark, patent, and trade secret laws, confidentiality agreements, and contractual provisions to protect our intellectual property. However, we believe that these laws and agreements afford us only limited protection. Despite our efforts to protect our intellectual property, unauthorized parties may infringe upon our proprietary rights. In addition, the laws of some foreign countries do not provide as much protection of our proprietary rights as do the laws of the United States.

We currently hold registered trademarks in the United States for OPNET, IT Guru, Netbiz, OPNET Modeler, NetDoctor, SP Guru, VNE Server, and WDM Guru. We have pending applications in the United States for the trademark registrations of IT Sentinel, SP Sentinel, 3DNV, OPNET Panorama, and OPNET Commander. We also hold additional registered trademarks in the United States and have additional pending applications. If not renewed, our registered trademarks will expire at various times between February 2008 and May 2013. We have applied for trademark protection in a number of international jurisdictions, and hold a registered trademark for OPNET in Japan, France, the Peoples Republic of China, and Taiwan that will expire at various times between January 2009 and October 2012.

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In addition, we have five patents granted by the Patent and Trademark Office of the United States for technology related to the OPNET product suite that will expire in 2017, 2021, 2022 (two), and 2023. We also received the Notice of Allowance on a sixth patent in fiscal 2005 and expect it to be issued early in fiscal 2007. In addition, we have forty-six pending United States patent applications that if granted would expire approximately twenty years from the filing date of the applications. Of these, thirty-one are provisional patent applications that have been filed with United States Patent and Trademark Office and for which we expect to pursue non-provisional applications within the next year. We believe that, because of the rapid pace of change in our industry, intellectual property protection for our products and the knowledge, abilities, and experience of our employees will be significant factors for our future success.

On September 27, 2004, OPNET received notice of a lawsuit filed by Compuware Corporation, in the United States District Court for the Eastern District of Michigan alleging patent infringement and seeking injunctive relief and unspecified monetary damages. On February 6, 2006, OPNET filed a lawsuit against Compuware Corporation in Montgomery County, Maryland, Circuit Court, seeking damages and injunctive relief for Compuware s misappropriation and misuse of OPNET s trade secrets, confidential and proprietary information and unfair competition; however, the lawsuit was not served on Compuware. On April 10, 2006, we signed a confidential settlement agreement with Compuware Corporation that amicably resolved all disputed matters in the lawsuits filed by each company in Michigan and in Maryland on terms OPNET believes are favorable to it. Specifically, no material amounts were exchanged by the parties and the settlement agreement does not entail a royalty or licensing agreement between the parties.

Executive Officers and Directors of the Registrant

Our executive officers and directors, and their ages as of June 1, 2006, are as follows:

Name	Age	Position
Marc A. Cohen	42	Chairman of the Board and Chief Executive Officer
Alain J. Cohen	39	President, Chief Technology Officer and Director
Mel F. Wesley	34	Vice President and Chief Financial Officer
Steven G. Finn, PhD (1)(2)(3)	60	Director
Ronald W. Kaiser (1)(3)	52	Director
William F. Stasior (1)(2)(3)	65	Director

(1) Member of the Audit Committee
(2) Member of the Compensation Committee
(3) Member of the Nominating Committee

Set forth below is information regarding the professional experience for each of our executive officers and directors. These executive officers and directors were elected to serve until their successors have been elected. Marc A. Cohen and Alain J. Cohen are brothers. There is no other family relationship between any of our other executive officers or between any of these officers and any of our directors.

Marc A. Cohen, one of our founders, has served as our Chairman of the Board since our inception in 1986 and as our Chief Executive Officer since 1994. From 1986 to 1992, Mr. Cohen was also a consultant with Booz Allen Hamilton Inc., or Booz Allen, an international management and consulting company. Mr. Cohen received a bachelor s degree in engineering science from Harvard University and a master s degree in electrical engineering from Stanford University. Mr. Cohen also serves as a Trustee and as a member of the Board of Directors of the Dana Farber Cancer Institute in Boston, Massachusetts.

Alain J. Cohen, one of our founders, has served as our President and Chief Technology Officer and as a member of our Board of Directors since our inception in 1986. Mr. Cohen received a bachelor s degree in electrical engineering from the Massachusetts Institute of Technology, or M.I.T.

Mel F. Wesley has served as our Vice President and Chief Financial Officer since July 2005. Mr. Wesley served as our Acting Chief Financial Officer from December 2004 to July 2005 and our Corporate Controller from June to December 2004. From August 2003 to June 2004, Mr. Wesley served as Corporate Controller for SteelCloud, Inc., a publicly traded corporation that provides design, development and manufacturing of network appliances and infrastructure server products. From October 2000 to August 2003, Mr. Wesley served as an Assistant Controller for Learning Tree International, Inc., a publicly traded corporation that provides training to information technology professionals and managers. From December 1999 to October 2000, Mr. Wesley served as Financial Accounting Manager of Learning Tree.

Dr. Steven G. Finn has served as a member of our Board of Directors since March 1998. Dr. Finn has been a principal research scientist and lecturer at M.I.T. since 1991. Dr. Finn has also served as a consultant with Matrix Partners, a venture capital firm, since 1991.

Ronald W. Kaiser has served as a member of our Board of Directors since October 2003. Mr. Kaiser presently serves as Vice President and Chief Financial Officer of Pharmathene, Inc, a privately held bio-defense company. Mr. Kaiser served as Chief Financial Officer, Treasurer and Secretary of Air Cargo, Inc., a privately-held firm and provider of United States and European cargo transportation logistics from February 2003 through March 2005. Air Cargo filed for Chapter 11 bankruptcy on December 7, 2004. Mr. Kaiser served as Chief Financial Officer and Treasurer of OTG Software, Inc., or OTG from June 1998 until the sale of OTG to Legato Systems, Inc. in May 2002. OTG was a publicly traded corporation that provided online data storage and data access software solutions for business applications, email management and related services. From April 1998 to June 1998, Mr. Kaiser was an employee of Network Associates, Inc., an Internet security company, following the acquisition of Trusted Information Systems, Inc. by Network Associates, Inc. From May 1996 to April 1998, Mr. Kaiser served as the Chief Financial Officer of Trusted Information Systems, Inc., an information security company.

William F. Stasior has served as a member of our Board of Directors since March 1998. Since October 1999, he has served as Senior Chairman of Booz Allen. From 1991 to 1999, he served as Chairman and Chief Executive Officer of Booz Allen. Mr. Stasior currently serves on the Boards of Directors of SkyTerra Communications, Inc., a telecommunications service provider, and Vanu Inc., a privately-held software company.

Employees

As of March 31, 2006, we had 433 full-time employees, 406 of whom were located in the United States. These included 128 in sales and marketing, 112 in professional services and support, 150 in engineering, research, and development, and 43 in general and administrative functions. Our employees are not represented by a collective bargaining agreement and we consider our relations with our employees to be good.

Availability of SEC Reports

Our web site address is www.opnet.com. We make available free of charge on our web site our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission, or SEC. The information on our web site is not incorporated by reference into this Annual Report and should not be considered to be a part of this Annual Report. Our web site address is included in this Annual Report as an inactive textual reference only.

We file our reports with the SEC electronically via the SEC s Electronic Data Gathering, Analysis and Retrieval system, or EDGAR. The SEC maintains a website that contains reports, proxy and information statements, and other information regarding companies that file electronically with the SEC via EDGAR. The address of this website is www.sec.gov.

Any reports, statements or other information that we file with the SEC may be read or copied at the SEC s Public Reference Room at 100 F Street, N.E., Room 1580, Washington, DC 20549. Copies of these documents can be requested upon payment of a duplicating fee, by writing to the SEC. Please call the SEC at 1 (800) SEC-0330 for further information on the operation of the Public Reference Room.

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Code of Business Conduct and Ethics

On May 4, 2004 we adopted a code of business conduct and ethics for all directors, officers, and employees pursuant to Section 406 of the Sarbanes-Oxley Act of 2002. The Code of Business Conduct and Ethics is available on our website at *www.opnet.com.* Suspected violations of this Code may be reported on a confidential or anonymous basis by telephone, facsimile, or by e-mail to our General Counsel and to the Chairman of the Audit Committee of the Board of Directors. We intend to disclose any amendment to, and any waiver from, any provision of this Code that applies to any director, the Chief Executive Officer, Chief Financial Officer, or any other executive officer and that relates to any element of this Code enumerated in Item 406(b) of Regulation S-K, on Form 8-K.

ITEM 1A. RISK FACTORS

The following important factors, among others, could cause actual results to differ materially from those indicated by forward-looking statements made in this Annual Report and presented elsewhere by management from time to time.

Our operating results may fluctuate significantly as a result of factors outside of our control, which could cause the market price of our stock to decline.

Our operating results have fluctuated in the past, and are likely to fluctuate significantly in the future. Our financial results may as a consequence fall short of the expectations of public market analysts or investors, which could cause the price of our common stock to decline. Our revenue and operating results may vary significantly from quarter to quarter due to a number of factors, many of which are beyond our control. Factors that could affect our operating results include:

- the timing of large orders;
- changes in the proportion of software arrangements requiring contract accounting;
- changes in the mix of our sales, including the mix between higher margin software products and lower margin services and maintenance, and the proportion of our license sales requiring us to make royalty payments;
- the timing and amount of our marketing, sales, and product development expenses;
- the cost and time required to develop new software products;
- the introduction, timing, and market acceptance of new products introduced by us or our competitors;
- changes in network technology or in applications, which could require us to modify our products or develop new products;
- general economic conditions, which can affect our customers purchasing decisions, the length of our sales cycle, and our customers ability to pay us on time, if at all;
- changes in our pricing policies or those of our competitors; and

the timing and size of potential acquisitions by us.

We expect to make significant expenditures in all areas of our business, particularly sales and marketing operations, in order to promote future growth. Because the expenses associated with these activities are relatively fixed in the short term, we may be unable to adjust spending quickly enough to offset any unexpected shortfall in revenue growth or any decrease in revenue levels. In addition, our revenue in any quarter depends substantially on orders we receive and ship in that quarter. We typically receive a significant portion of orders in any quarter during the last month of the quarter, and we cannot predict whether those orders will be placed and shipped in that period. If we have lower revenue than we expect, we probably will not be able to respond quickly enough to reduce our operating expenses. Therefore, any significant shortfall in revenue or delay of customer orders could have an immediate adverse effect on our operating results in that quarter.

For all of these reasons, quarterly comparisons of our financial results are not necessarily meaningful and you should not rely on them as an indication of our future performance.

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The market for intelligent network management software is new and evolving, and if this market does not develop as anticipated, our revenue could decline.

We derive all of our revenue from the sale of products and services that are designed to allow our customers to manage the performance of networks and applications. Accordingly, if the market for intelligent network management software does not continue to grow, we could face declining revenue, which could ultimately lead to our becoming unprofitable. The market for intelligent network management software solutions is in the early stages of development. Therefore, we cannot accurately assess the size of the market and may be unable to identify an effective distribution strategy, the competitive environment that will develop, and the appropriate features and prices for products to address the market. If we are to be successful, our current and potential customers must recognize the value of intelligent network management software solutions, decide to invest in the management of their networks, and, in particular, adopt and continue to use our software solutions.

Our customers are primarily in four target groups and our operating results may be adversely affected by changes in one or more of these groups.

Our software solutions and services are designed to meet the needs of enterprises, United States government agencies, service providers, and network equipment manufacturers, and we market our solutions and services to those four customer groups. Consequently, our financial results depend, in significant part, upon the economic conditions of enterprises, United States government agencies, service providers, and network equipment manufacturers. An economic downturn or adverse change in the regulatory environment or business prospects for one or more of these customer groups may decrease our revenue or lower our growth rate.

The United States Department of Defense may not extend one consulting contract with us, which could harm our business.

In January 2003, we were awarded a consulting contract with the United States Department of Defense. The funding under this contract for calendar year 2003 was $3,070, and there are four successive option years under the contract that may be exercised by the United States Department of Defense in its discretion. In January 2004, the United States Department of Defense exercised the first of four possible contract extensions. The funding under this contract for calendar year 2004 was $3,509. In January 2005, United States Department of Defense exercised the second of four possible contract extensions. The funding under this contract for calendar year 2005 was $2,965. In February 2006, United States Department of Defense exercised the third of four possible contract extensions. The funding under this contract for calendar year 2006 was $2,899. Our results of operations could be adversely affected if any of the remaining options are not exercised, the contract otherwise does not receive additional funding, or has a reduction in funding.

A decline in information technology spending may result in a decrease in our revenue or lower our growth rate.

A decline in the demand for information technology among our current and prospective customers may result in decreased revenue or a lower growth rate for us because our sales depend, in part, on our customers budgets for new or additional information technology systems and services. A continued economic downturn may cause our customers to reduce or eliminate information technology spending and force us to lower prices of our solutions, which would substantially reduce the number of new software licenses we sell and the average sales price for these licenses. Accordingly, we cannot assure you that we will be able to increase or maintain our revenue.

Our sales to United States government agencies subject us to special risks that could adversely affect our business.

We derive a substantial portion of our revenue from sales directly or indirectly to United States government agencies. Transactions with United States government agencies accounted for approximately 43%, 47%, and 44% of our total revenue for fiscal 2006, fiscal 2005, and fiscal 2004, respectively. Government sales entail a variety of risks including:

Government contracts are subject to the approval of appropriations by the United States Congress to fund the expenditures by the agencies under these contracts. Congress often appropriates funds for

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government agencies on a yearly basis, even though their contracts may call for performance over a number of years.

A significant decline in government expenditures generally, or a shift in budget priorities away from agencies or programs that we support, could cause a material decline in our government business. In particular, a decline in government spending on information technology or related services could hurt our government business.

Our products and services are included on a General Services Administration, or GSA schedule. We believe that the GSA schedule facilitates our sales to United States government agencies. The loss of the GSA schedule covering our products and services could adversely affect our results of operations.

We must comply with complex federal procurement laws and regulations in connection with government contracts, which may impose added costs on our business.

Some of our government business requires that we maintain facility security clearances, and requires some of our employees to maintain individual security clearances. If we were to lose these clearances, our government business might decline.

The federal government audits and reviews the performance of federal contractors on contracts, pricing practices, cost structure, and compliance with applicable laws, regulations, and standards. An audit of our work could result in a finding that we overcharged the government, which could result in an adjustment to our previously reported operating results. If a government audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines, and suspension or debarment from doing business with United States federal government agencies.

Many of our government contracts are firm fixed-price contracts. To the extent that the assumptions we have used in pricing these contracts prove inaccurate, we could incur and accrue losses on contracts, which would adversely affect our operating results.

A portion of our sales to the United States government are made indirectly as a subcontractor to another government contractor, referred to as the prime contractor, who has the direct relationship with the government. We also team with prime contractors to bid on competitive government opportunities for which we hope to serve as a subcontractor. If prime contractors lose existing business on which we serve as a subcontractor, or fail to win the competitive bids on which we team with them, our government business would be hurt.

We could face expense and delay if any or our competitors, or competitors of the prime contractors to which we serve as a subcontractor, protest or challenge contract awards made to us or our prime contractors pursuant to competitive bidding.

Federal government contracts contain provisions and are subject to laws and regulations that provide government clients with rights and remedies not typically found in commercial contracts. These rights and remedies allow government clients, among other things, to terminate existing contracts, with short notice, for convenience without cause; reduce or modify contracts or subcontracts; and claim rights in products, systems, and technology produced by us.

If our newest products, particularly those targeted primarily for enterprises and United States government agencies, do not gain widespread market acceptance, our revenue might not increase and could even decline.

We expect to derive a substantial portion of our revenue in the future from sales to enterprises and United States government agencies of version 11.5 of *IT Guru,* which was released in October 2005, and its associated modules including *Application Characterization Environment*, *ACE Decode Module*, *ACE Advanced Console, NetDoctor, Planning and Design, and Flow Analysis, and VNE Server 3.5,* which was released in

October 2005. Our business depends on customer acceptance of these products and our revenue may not increase, or may even decline, if our target customers do not adopt and expand their use of our products. In addition, sales of our *OPNET Modeler* product, which we have been selling since 1987, have fluctuated from quarter-to-quarter, including periods of declining sales. Sales of our *OPNET Modeler* could decline in the future for a variety of reasons, including market saturation and the financial condition of network equipment manufacturers, and if sales of our newer products do not grow at a rate sufficient to offset the shortfall, our revenue would decline.

We may not be able to grow our business if service providers do not buy our products.

An element of our strategy is to increase sales to service providers of *SP Guru* and *WDM Guru*, both launched in fiscal 2002, and *VNE Server*, which was launched in fiscal 2003. Accordingly, if our products fail to perform favorably in the service provider environment, or fail to gain wider adoption by service providers, our business and future operating results could suffer.

Our lengthy and variable sales cycle makes it difficult to predict operating results.

It is difficult for us to forecast the timing and recognition of revenue from sales of our products because prospective customers often take significant time evaluating our products before licensing them. The period between initial customer contact and a purchase by a customer may vary from three months to more than a year. During the sales process, the customer may decide not to purchase or may reduce proposed orders of our products for various reasons, including changes in budgets and purchasing priorities. Our prospective customers routinely require education regarding the use and benefit of our products. This may also lead to delays in receiving customers orders.

If we do not successfully expand our sales force, we may be unable to increase our sales.

We sell our products primarily through our direct sales force, and we must expand the size of our sales force to increase revenue. If we are unable to hire or retain qualified sales personnel, if newly hired personnel fail to develop the necessary skills to be productive, or if they reach productivity more slowly than anticipated, our ability to increase our revenue and grow our business could be compromised. Our sales people require a long period of time to become productive, typically three to nine months. The time required to reach productivity, as well as the challenge of attracting, training, and retaining qualified candidates, may make it difficult to meet our sales force growth targets. Further, we may not generate sufficient sales to offset the increased expense resulting from growing our sales force, or we may be unable to manage a larger sales force.

Our ability to increase our sales will be impaired if we do not expand and manage our indirect distribution channels.

To increase our sales, we must, among other things, further expand and manage our indirect distribution channels, which consist primarily of international distributors and original equipment manufacturers and resellers. If we are unable to expand and manage our relationships with our distributors, our distributors are unable or unwilling to market and sell our products effectively, or we lose existing distributor relationships, we might not be able to increase our revenue. Our international distributors and original equipment manufacturers and resellers have no obligation to market or purchase our products. In addition, they could partner with our competitors, bundle or resell competitors products, or internally develop products that compete with our products.

We may not be able to successfully manage our expanding operations, which could impair our ability to operate profitably.

We may be unable to operate our business profitably if we fail to manage our growth. Our growth has sometimes strained, and may in the future continue to strain, our managerial, administrative, operational, and financial resources and controls. We plan to continue to expand our operations and increase the number of our full-time employees. Our ability to manage growth will depend in part on our ability to continue to enhance our operating, financial, and management information systems. Our personnel, systems, and controls may not be adequate to support our growth. In addition, our revenue may not continue to grow at a sufficient rate to absorb the costs associated with a larger overall employee base.

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If we are unable to introduce new and enhanced products on a timely basis that respond effectively to changing technology, our revenue may decline.

Our market is characterized by rapid technological change, changes in customer requirements, frequent new product and service introductions and enhancements, and evolving industry standards. If we fail to develop and introduce new and enhanced products on a timely basis that respond to these changes, our products could become obsolete, demand for our products could decline and our revenue could fall. Advances in network management technology, software engineering, and simulation technology, or the emergence of new industry standards, could lead to new competitive products that have better performance, more features, or lower prices than our products and could render our products unmarketable.

Our future revenue is substantially dependent upon our existing customers continuing to license additional products, renew maintenance agreements, and purchase additional services.

Our existing customers have traditionally generated additional revenue from consulting services, renewed maintenance agreements, and purchase of additional software licenses, which represents a majority of our annual revenue. The maintenance agreements are generally renewable at the option of the customers and there are no mandatory payment obligations or obligations to license additional software. In addition, customers may decide not to purchase additional products or services. If our existing customers fail to renew their maintenance agreements or purchase additional products or services, our revenue could decrease.

Increases in professional services revenue as a percentage of total revenue could decrease overall margins.

We realize lower margins on professional service revenue than we do on other types of revenue. As a result, if professional services revenue increases as a proportion of total revenue, our gross margins will be lower.

If we fail to retain our key personnel and attract and retain additional qualified personnel, we might not be able to maintain our current level of revenue.

Our future success and our ability to maintain our current level of revenue depends upon the continued service of our executive officers and other key sales and research and development personnel. The loss of any of our key employees, in particular Marc A. Cohen, our Chairman of the Board and Chief Executive Officer, and Alain J. Cohen, our President and Chief Technology Officer, could also adversely affect our ability to pursue our growth strategy. We do not have employment agreements or any other agreements that obligate any of our officers or key employees to remain with us.

We must also continue to hire highly qualified individuals, particularly software engineers and sales and marketing personnel. Our failure to attract and retain technical personnel for our product development, consulting services, and technical support teams may limit our ability to develop new products or product enhancements. Competition for these individuals is intense, and we may not be able to attract and retain additional highly qualified personnel in the future. In addition, limitations imposed by federal immigration laws and the availability of visas could impair our ability to recruit and employ skilled technical professionals from other countries to work in the United States.

Our international operations subject our business to additional risks, which could cause our sales or profitability to decline.

We plan to increase our international sales activities, but these plans are subject to a number of risks that could cause our sales to decline or could otherwise cause a decline in profitability. These risks include:

- difficulty in attracting distributors that will market and support our products effectively;
- greater difficulty in accounts receivable collection and longer collection periods;
- the need to comply with varying employment policies and regulations that could make it more difficult and expensive to manage our employees if we need to establish more direct sales or support staff outside the United States;

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- potentially adverse tax consequences;
- the effects of currency fluctuations; and
- political and economic instability.

We expect to face increased competition, which could cause us to lose sales, resulting in lower profitability.

Increasing competition in our market could cause us to lose sales and become unprofitable. We believe that the market for intelligent network management software is likely to become more competitive as it evolves and the demand for intelligent network management solutions continues to increase. At least one of our current competitors and many of our potential competitors are larger and have substantially greater financial and technical resources than we do. In addition, it is possible that other vendors as well as some of our customers or distributors will develop and market solutions that compete with our products in the future.

If our products contain errors and we are unable to correct those errors, our reputation could be harmed and our customers could demand refunds from us or assert claims for damages against us.

Our software products could contain significant errors or bugs that may result in:

- the loss of or delay in market acceptance and sales of our products;
- the delay in introduction of new products or updates to existing products;
- diversion of our resources;
- injury to our reputation; and
- increased support costs.

Bugs may be discovered at any point in a product s life cycle. We expect that errors in our products will be found in the future, particularly in new product offerings and new releases of our current products.

Because our customers use our products to manage networks that are critical to their business operations, any failure of our products could expose us to product liability claims. In addition, errors in our products could cause our customers networks and systems to fail or compromise their data, which could also result in liability to us. Product liability claims brought against us could divert the attention of management and key personnel, could be expensive to defend, and may result in adverse settlements and judgments.

Our software products rely on our intellectual property, and any failure to protect our intellectual property could enable our competitors to market products with similar features that may reduce our revenue and could allow the use of our products by users who have not paid the required license fee.

If we are unable to protect our intellectual property, our competitors could use our intellectual property to market products similar to our products, which could reduce our revenue. In addition, we may be unable to prevent the use of our products by persons who have not paid the required license fee, which could reduce our revenue. Our success and ability to compete depend substantially upon the internally developed technology that is incorporated in our products. Policing unauthorized use of our products is difficult, and we may not be able to prevent misappropriation of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as those in the United States. Others may circumvent the patents, copyrights, and trade secrets we own. In the ordinary course of business, we enter into a combination of confidentiality, non-competition, and non-disclosure agreements with our employees.

These measures afford only limited protection and may be inadequate, especially because our employees are highly sought after and may leave our employ with significant knowledge of our proprietary information. In addition, any confidentiality, non-competition and non-disclosure agreements we enter into may be found to be unenforceable, or our copy protection mechanisms embedded in our software products could fail or could be circumvented.

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Our products employ technology that may infringe on the proprietary rights of others, and, as a result, we could become liable for significant damages.

We expect that our software products may be increasingly subject to third-party infringement claims as the number of competitors in our industry segment grows and the functionalities of products in different industry segments overlap.

Regardless of whether these claims have any merit, they could:

- be time-consuming to defend;
- result in costly litigation;
- divert our management s attention and resources;
- cause us to delay or cease product shipments; or
- require us to enter into royalty or licensing agreements.

These royalty or licensing agreements may not be available on terms acceptable to us, if at all. A successful claim of product infringement against us or our failure or inability to license the infringed or similar technology could adversely affect our business because we would not be able to sell the affected product without redeveloping it or incurring significant additional expense.

Future interpretations of existing accounting standards could adversely affect our operating results.

The Securities and Exchange Commission, American Institute of Certified Public Accountants and various other authoritative accounting bodies continue to issue interpretations and guidance for applying the relevant standards to a wide range of sales contract terms and business arrangements that are prevalent in the software industry. Future interpretations of existing accounting standards or changes in our business practices could result in future changes in our revenue recognition accounting policies that could have a material adverse effect on our results of operations.

As with other software vendors, we may be required to delay revenue recognition into future periods, which could adversely affect our operating results.

We have in the past had to, and in the future may have to, defer recognition for license fees due to several factors, including whether:

- software arrangements include undelivered elements for which we do not have vendor specific evidence of fair value;
- we must deliver services for significant customization, enhancements and modifications of our software;
- the transaction involves material acceptance criteria or there are other identified product-related issues;
- the transaction involves contingent payment terms or fees;

we are required to accept a fixed-fee services contract; or

we are required to accept extended payment terms.

Because of the factors listed above and other specific requirements under accounting principles generally accepted in the United States of America for software revenue recognition, we must have very precise terms in our software arrangements in order to recognize revenue when we initially deliver software or perform services. Negotiation of mutually acceptable terms and conditions can extend the sales cycle, and sometimes we do not obtain terms and conditions that permit revenue recognition at the time of delivery.

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If we undertake acquisitions, they may be expensive and disruptive to our business and could cause the market price of our common stock to decline.

We completed the NetMaker, WDM NetDesign and Altaworks acquisitions in March 2001, January 2002 and October 2004, respectively. We may continue to acquire or make investments in companies, products or technologies if opportunities arise. Any acquisition could be expensive, disrupt our ongoing business, distract our management and employees, and adversely affect our financial results and the market price of our common stock. We may not be able to identify suitable acquisition or investment candidates, and if we do identify suitable candidates, we may not be able to make these acquisitions or investments on commercially acceptable terms or at all. If we make an acquisition, we could have difficulty integrating the acquired technology, employees, or operations. In addition, the key personnel of the acquired company may decide not to work for us.

We also expect that we would incur substantial expenses if we acquired other businesses or technologies. We might use cash on hand, incur debt, or issue equity securities to pay for any future acquisitions. If we issue additional equity securities, our stockholders could experience dilution and the market price of our stock may decline.

Our products are subject to changing computing environments, including operating system software and hardware platforms, which could render our products obsolete.

The evolution of existing computing environments and the introduction of new popular computing environments may require us to redesign our products or develop new products. Computing environments, including operating system software and hardware platforms, are complex and change rapidly. Our products are designed to operate in currently popular computing environments. Due to the long development and testing periods required to adapt our products to new or modified computing environments, our research and development efforts could be distracted and we could experience significant delays in product releases or shipments, which could result in lost revenue and significant additional expense.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

Our corporate office and principal facility is located in Bethesda, Maryland and consists of approximately 60,000 square feet of office space held under a lease that expires on January 31, 2011, exclusive of renewal options. We also lease office space in the following locations: Cary, North Carolina; Dallas, Texas; Santa Clara, California; Nashua, New Hampshire; Ghent, Belgium; Paris, France; and Slough, United Kingdom.

ITEM 3. LEGAL PROCEEDINGS

We are involved in various claims and legal proceedings arising from our normal operations. We do not regard any of those matters to be material. On September 27, 2004, OPNET received notice of a lawsuit filed by Compuware Corporation, in the United States District Court for the Eastern District of Michigan alleging patent infringement and seeking injunctive relief and unspecified monetary damages. On February 6, 2006, OPNET filed a lawsuit against Compuware Corporation in Montgomery County, Maryland, Circuit Court, seeking damages and injunctive relief for Compuware s misappropriation and misuse of OPNET s trade secrets, confidential and proprietary information and unfair competition; however, the lawsuit was not served on Compuware. On April 10, 2006, we signed a confidential settlement agreement with Compuware Corporation that amicably resolved all disputed matters in the lawsuits filed by each company in Michigan and in Maryland on terms OPNET believes are favorable to it. Specifically, no material amounts were exchanged by the parties and the settlement agreement does not entail a royalty or licensing agreement between the parties.

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

No matters were submitted to a vote of our stockholders during the fourth quarter of fiscal 2006.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

Market for Common Stock

Our common stock began trading on the NASDAQ National Market on August 2, 2000, under the symbol OPNT. The following table sets forth, on a per share basis, for the indicated periods, the high and low sale prices of our common stock as reported by the NASDAQ National Market.

	Quarterly Common Stock-Price for the Year Ended March 31,			
	2006		2005	
Quarter ended	High	Low	High	Low
June 30	$ 8.87	$ 7.24	$ 16.91	$ 12.44
September 30	8.91	7.06	13.40	7.03
December 31	9.77	8.00	10.62	6.97
March 31	10.72	8.53	9.48	6.94

Number of Stockholders of Record

As of June 1, 2006, we had approximately 88 holders of record of common stock. Because many of these shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these holders of record.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information regarding our current equity compensation plans as of March 31, 2006.

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options (a)	Weighted-average exercise price of outstanding options (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c) (1)
Equity compensation plans approved by security holders	3,233,537	$ 10.37	2,516,216 (2)
Equity compensation plans not approved by security holders			
Total	3,233,537	$ 10.37	2,516,216

(1) In addition to being available for future issuance upon exercise of options that may be granted after March 31, 2006, all of the remaining 2,268,945 shares under the Company s Amended and Restated 2000 Stock Incentive Plan may instead be issued in the form of restricted stock, stock appreciation rights or other stock-based awards.

(2) Includes 217,271 shares issuable under the Company s 2000 Employee Stock Purchase Plan, including shares issuable in connection with the current offering period which ends on July 31, 2006. Also includes 2,268,945 shares issuable under the 2000 Plan. Under the 2000 Plan, the number of shares available for issuance automatically increases on the first trading day of each calendar year by an amount equal to 3% of the shares of Common Stock outstanding on the last trading day of the preceding calendar year, not to exceed an annual increase of 1,000,000 shares, or a lessor amount determined by the Board of Directors, or the Board. The Board did not approve any increase in shares for issuance on the first trading day of calendar year 2006.

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Dividends

We have never paid or declared any cash dividends on our common stock or other securities. Our loan agreement with a commercial bank prohibits the payment of dividends. We currently intend to retain all future earnings, if any, for use in the operation of our business, and therefore, do not anticipate paying cash dividends in the foreseeable future.

Use of Proceeds

In August 2000, we closed an initial public offering of our common stock. The Registration Statement on Form S-1 (No. 333-32588) was declared effective by the Securities and Exchange Commission on August 1, 2000 and we commenced the offering on that date. After deducting the underwriting discounts and commissions and the offering expenses, the net proceeds from the offering were approximately $54,114.

Stock Repurchase Plan

Issuer Purchases Of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
January 1 31, 2006				650,162
February 1 28, 2006	60,000	$ 9.50	60,000	590,162
March 1 31, 2006				590,162

(1) On January 31, 2005, we announced a stock repurchase program pursuant to which we are authorized to purchase up to 1,000,000 shares of common stock from time to time on the open market or in privately negotiated transactions. This program does not have a specified termination date. Any repurchased shares will be available for use in connection with our stock plans or other corporate purchases.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with our consolidated financial statements and the related notes and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Annual Report. The statement of operations data for the years ended March 31, 2006, 2005, and 2004, and the balance sheet data as of March 31, 2006 and 2005, are derived from our audited consolidated financial statements included in this Annual Report. The balance sheet data as of March 31, 2004, 2003 and 2002 and the statement of operations data for the years ended March 31, 2003 and 2002 are derived from our consolidated financial statements that are not included in this annual report. Historical results are not necessarily indicative of results that may be expected for any future period.

	Year Ended March 31,				
	2006	2005	2004	2003	2002
	(in thousands, except per share data)				
Statement of Operations Data:					
Revenue:					
New software license revenue	$ 31,976	$ 29,507	$ 28,164	$ 22,187	$ 24,435
Software license updates and technical support	24,226	19,805	15,152	12,667	10,384
Professional services	19,913	14,931	13,137	11,573	9,743
Total revenue	76,115	64,243	56,453	46,427	44,562
Cost of revenue:					
New software licenses	657	778	831	829	453
Software license updates and technical support	2,637	2,348	1,730	1,710	1,767
Professional services	13,705	10,154	7,510	4,637	4,102
Amortization of acquired technology	832	651	509	504	434
Total cost of revenue	17,831	13,931	10,580	7,680	6,756
Gross profit	58,284	50,312	45,873	38,747	37,806
Operating expenses:					
Research and development	18,643	15,455	13,040	12,909	12,339
Sales and marketing	26,300	22,803	19,446	18,245	16,866
General and administrative	13,375	9,742	5,717	4,897	4,655
Total operating expenses	58,318	48,000	38,203	36,051	33,860
Income (loss) from operations	(34)	2,312	7,670	2,696	3,946
Interest and other income, net	2,680	1,384	594	879	1,740
Income before provision for income taxes	2,646	3,696	8,264	3,575	5,686
Provision for income taxes	509	1,644	2,506	832	1,307
Net income	$ 2,137	$ 2,052	$ 5,758	$ 2,743	$ 4,379
Basic net income per common share	$ 0.10	$ 0.10	$ 0.29	$ 0.14	$ 0.23
Diluted net income per common share	$ 0.10	$ 0.10	$ 0.28	$ 0.14	$ 0.22
Basic weighted average shares outstanding	20,374	20,158	19,697	19,273	18,953
Diluted weighted average shares outstanding	20,604	20,624	20,650	19,974	20,014

Balance Sheet Data (end of period):					
Cash, cash equivalents and marketable securities	$ 85,861	$ 82,185	$ 81,493	$ 70,251	$ 62,240
Total assets	127,347	125,186	116,682	100,641	95,317