ROBERT A. SCANDLON, JR., on behalf of Himself and All Others Similarly Situated, Plaintiff,

v.

BLUE COAT SYSTEMS, INC., BRIAN M. NESMITH and GORDON C. BROOKS, Defendants.

[CV 11-04293 (RS)] AMENDED COMPLAINT FOR VIOLATIONS OF THE FEDERAL SEC. LAWS
Plaintiff, Inter-Local Pension Fund of the Graphic Communications Conference of the International Brotherhood of Teamsters ("Inter-Local Pension Fund"), by and through undersigned counsel, alleges the following:

1. Plaintiff's allegations are based upon information and belief, except as to those allegations concerning Plaintiff, which are alleged upon personal knowledge. Plaintiff's information and belief are based upon the investigation of counsel, which included a review of filings by Blue Coat Systems, Inc. ("Blue Coat" or the "Company") with the United States Securities and Exchange Commission ("SEC"); interviews with former employees of Blue Coat; regulatory filings and reports; securities analysts' reports and advisories about the Company; press releases and other public statements issued by the Company; and media reports about the Company. Plaintiff believes that substantial additional evidentiary support will exist for the allegations set forth herein after a reasonable opportunity for discovery.

2. Plaintiff's allegations are based, in part, on interviews with former employees of Blue Coat who have knowledge of the relevant aspects of the Company's sales and financial reporting, including:

   a. Confidential Witness 1 ("CW1"), a former order administration specialist from November 2006 until April 2010, who input purchase orders from all regions, including the Europe, Middle East, and Africa region ("EMEA");

   b. Confidential Witness 2 ("CW2"), a former accounting policy manager from June 2007 until September 2009, who worked closely with Blue Coat's Disclosure Committee (of which he was a member) and with former Chief Financial Officer ("CFO") Kevin Royal; assisted in preparing SEC filings (including Forms 10-K and 10-Q); and assisted in preparing the Company's annual report;

   c. Confidential Witness 3 ("CW3"), a former vice president of EMEA marketing from August 1998 to December 2011;
d. Confidential Witness 4 ("CW4"), a former financial systems manager from August 2008 until November 2010, who managed and maintained Hyperion, Blue Coat’s web-based forecasting system and reported to then-interim CFO Defendant Brian NeSmith ("NeSmith") and CFO Defendant Gordon Brooks ("Brooks");

e. Confidential Witness 5 ("CW5"), a former vice president of marketing for the Americas region from August 2010 until April 2011;

f. Confidential Witness 6 ("CW6"), a former technical consultant-systems engineer in the United Kingdom from October 2008 until October 2010, who assisted on the technical aspects of sales transactions;

g. Confidential Witness 7 ("CW7"), a former sales manager of large accounts in the United Kingdom from October 2008 until October 2010; and

h. Confidential Witness 8 ("CW8"), a former regional director of sales for Southern Europe from 2007 until January 2011, and 11 year veteran of Blue Coat.

NATURE OF THE ACTION

3. This is a federal class action on behalf of purchasers of the common stock of Blue Coat between November 24, 2009 and May 27, 2010, inclusive (the "Class Period"), seeking to pursue remedies under the Securities Exchange Act of 1934 (the "Exchange Act").

4. This is a case about a company and certain of its insiders who, during a narrow and focused time period, knowingly misled investors and securities analysts by painting a falsely optimistic picture of Blue Coat’s health, prospects, growth, and the extent of its actual sales. While this was going on, the Company’s CEO took the opportunity to unload 20% of his Blue Coat shares – for proceeds of nearly $5 million – before the Company came clean and its stock price fell. Investors were not as lucky.

5. Blue Coat’s primary product offerings can be generally categorized as related either to web security or wide-area network (WAN) optimization. In 2008, it acquired...
Packeteer, Inc. in an effort to expand its WAN optimization business, which it intended to accomplish through Packeteer’s key product, PacketShaper. Prior to that, Blue Coat had largely focused on selling web security products. Yet, key former employees from its European region noted that this shift from selling web security products to selling WAN optimization products had a detrimental impact on the Company. Indeed, not only did Blue Coat begin losing ground in the highly competitive web security market, but in WAN optimization it was jumping into a market where it had little experience and where there was already a clear market leader in Riverbed Technologies ("Riverbed"). Moreover, Blue Coat’s sales team was focused on selling web security products, not WAN optimization products. Confidential witnesses have noted that Blue Coat’s sales force simply did not properly understand WAN optimization in order to effectively sell it and that this resulted in “a dramatic decline in the user base and new customers.” Ultimately, Blue Coat’s European sales force was “far more comfortable selling security products” even though the emphasis at the top level of management had migrated to the WAN optimization market. CW8 observed that, after the third fiscal quarter of 2009, which ended January 31, 2009 (“3Q 2009”), Blue Coat’s business in EMEA began to soften, with “some weaknesses” readily ascertainable by the second quarter of 2010, which ended October 31, 2009 (“2Q 2010”) and the third quarter of 2010, which ended January 31, 2010 (“3Q 2010”).

6. Blue Coat and members of its senior management were well aware that the Company faced a slackening in demand for its products, severe competitive obstacles, and real difficulties enabling its team to sell the new WAN optimization products. Yet, it took deliberate steps to conceal all of this from investors. And while an increasingly harsh macro-economic environment in Europe was taking hold, Defendants ignored it and misrepresented that the Company was prospering nonetheless. To this point, when Blue Coat presented investors with its financial performance for 2Q 2010 and 3Q 2010, it gave no indication that in the critical EMEA region (which comprised more than 40% of Blue Coat’s sales revenues), heightened competition, the turbulent integration of a major acquisition, and other factors – including a general “softness” in the business – were materially impacting sales.
7. To the contrary, Defendant Brian M. NeSmith, Blue Coat’s Chief Executive Officer, specifically referenced that, with respect to 2Q 2010, “we experienced solid sequential revenue growth in North America and in Europe” and that the Company was “extending its lead in the WAN optimization market.” When revealing Blue Coat’s 3Q 2010 financials, he told investors that “business was strong across all major regions . . . . In Europe, we saw a significant deployment of ProxySG appliances....” This sunny report was echoed by Defendant Gordon Brooks, Blue Coat’s Chief Financial Officer, who told investors that “in Europe the two areas that we saw some strength were in the UK, albeit off of a – weaknesses from prior quarters. And then also in France and Spain so in Southern Europe we had seen some strength....” Defendants went so far as to represent that “[n]et revenue . . . increased . . . due to an increased demand for our products, which we believe primarily resulted from an improvement in the economic environment....”

8. These and many other false and misleading statements were not only made in public filings with the SEC, but to securities analysts who absorbed Defendants’ assertions and, having no internal information with which to contradict them, regurgitated them to investors. For the Company, this had the desired result and Blue Coat’s stock rose after many of these analyst reports – which repeated the positive spin provided by the Company – were issued to the market.

9. Numerous confidential witnesses have directly contradicted the basis for many of the Company’s Class Period statements. These former employees, each of whom had a clear perspective on the true state of Blue Coat’s affairs, have elucidated the improper sales and revenue recognition practices that allowed the Company to meet the high projections that it and analysts – based on Defendants’ statements – had set.

10. Specifically, Defendants were well aware that throughout the Class Period there were concerns within the Company about contract renewals and the fact that EMEA sales “weren’t robust,” in the words of a former Blue Coat accounting policy manager. Indeed, as a former UK-based senior technical consultant and systems engineer succinctly stated, it was very clear that “business was falling off.” Such facts, in conjunction with the macro-economic
conditions in Europe, made it “hard to accurately forecast” Blue Coat’s financial performance, according to the former accounting manager. Yet, Defendant NeSmith nevertheless chose to represent that Blue Coat was “extending its lead in the WAN optimization market” and that “business was strong across all major regions . . . .”

11. During the time Defendant NeSmith was making such statements, Blue Coat was experiencing increased competition in EMEA, and its integration of Packeteer, Inc. and its key WAN optimization business was not proceeding as smoothly as Defendants publicly portrayed. Indeed, the Packeteer integration was, in the words of a former regional sales director for the south of Europe, a “complete disaster.” To compensate for these challenges and to conceal their impact on Blue Coat’s bottom line, the Company, according to information provided by confidential witnesses, engaged in a variety of deceptive practices. For instance, at management’s direction, Blue Coat employees booked incomplete or incorrect orders immediately prior to reporting deadlines to pad revenue and “meet” projections. Indeed, according to a former order administration specialist, management instructed personnel to enter incomplete or incorrect orders so as to meet revenue projections. According to this former employee, she received verbal instructions to book orders that “weren’t ‘sure’ revenue.” If a large order was expected but had not yet come in before the cutoff, “[w]ell, sometimes [her supervisor] would say ‘Go ahead and book it.’” A significant percentage – approximately 20-25% - of orders the orders that this former employee handled for EMEA “weren’t clean” or legitimate.

12. Blue Coat’s senior management knew or were deliberately reckless in not knowing of the sales and pipeline issues facing the Company. According to a former technical consultant and systems engineer based in the United Kingdom, Blue Coat internally used the website “salesforce.com,” as the exclusive means of conveying sales information for use in forecasting “up the chain” to all senior level executives. Salesforce.com, according to its website, is a tool that conveys information in real time to “accurately forecast future sales.” This former Blue Coat employee explained that, “[t]hey [senior level executives] were well aware of what was going on. They had to see what was in the pipeline. We were always told to
report everything – who we were seeing, what the projects were, the value of deals … [Chief Executive Officer Brian NeSmith was]…clued up and knew what he was doing.” Another former employee, sales manager for large accounts in the UK, described this process as “very transparent” for senior management who would have known what was forecasted, what was in the pipeline and what projects needed work in order to close as all information was “rolled up” the line to senior executives. According to this former employee, the Company’s senior management “would have known exactly what was going on.” (Emphasis added.)

13. Management’s failure to be forthright ended up, in a familiar story, costing investors substantial sums of money. On May 27, 2010, Blue Coat shocked the market with its financial results for the fourth quarter of fiscal 2010 (“4Q 2010”) and the full fiscal year (“FY 2010”), which both ended April 30, 2010. The results fell well short of public expectations. But this is not simply about a company missing analysts’ expectations. Indeed, for the first time, Defendants revealed the material weakness in the Company’s European operations and the impact it would have on Blue Coat’s sales and earnings going forward – material weaknesses that Defendants had known about for some time and which were directly contradicted by Defendants optimistic statements to investors and analysts. Expected revenues for the first quarter of fiscal year 2011, which began in May 2011 (“1Q 2011”) were projected to be $121 million to $126 million, well short of the analyst consensus estimate of $131.85 million, and net income was projected to be in the range of $0.21 to $0.26 per diluted share, 5% lower than analyst estimates of $0.40. Moreover, Blue Coat’s CFO, Defendant Gordon Brooks, conceded in a conference call that “[n]et revenue in EMEA declined 5% sequentially, and product revenue declined 9%. This trend was not in line with our expected performance in EMEA.”

14. In effect, Defendants’ bullish statements during the Class Period, their refusal to reveal the slackening demand for Blue Coat’s products, and their failure to timely alert investors about the impact of the deteriorating economic environment in Europe improperly raised market expectations. When those expectations were not met – which Defendants knew or were deliberately reckless in not knowing would be the case – Blue Stock shares lost over a quarter
of their value, plunging $7.37 per share, down to $21.47 on trading volume **16 times** the average volume for the Class Period.

**JURISDICTION AND VENUE**

15. The claims asserted herein arise under and pursuant Sections 10(b) and 20(a) of the Exchange Act [15 U.S.C. §§78j(b) and 78t(a)] and Rule 10b-5 promulgated thereunder by the SEC [17 C.F.R. §240.10b-5].

16. This Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. §1331 and Section 27 of the Exchange Act.

17. Venue is proper in this District pursuant to Section 27 of the Exchange Act and 28 U.S.C. §1391(b). Many of the acts charged herein, including the preparation and dissemination of materially false and misleading information, occurred in substantial part in this District.

18. In connection with the acts alleged in this Complaint, Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the mails, interstate telephone communications and the facilities of the national securities markets.

**PARTIES**

19. Plaintiff Inter-Local Pension Fund purchased the common stock of Blue Coat during the Class Period and has been damaged thereby. See attached Exhibit A, Certification of Plaintiff Inter-Local Pension Fund Graphic Communications Conference of the International Brotherhood of Teamsters Pursuant to Federal Securities Law and Local Rule 3-7(c).

20. Defendant Blue Coat, headquartered in Sunnyvale, California, designs, develops, and sells products and services to secure and optimize the delivery of business applications and other information to distributed users over a WAN or over the public Internet/Web.

21. Defendant NeSmith was, at all relevant times, President and Chief Executive Officer ("CEO") of Blue Coat.

22. Defendant Brooks was, at all relevant times, CFO, Principal Accounting Officer and Senior Vice President of Blue Coat.
23. Defendants NeSmith and Brooks are collectively referred to herein as the "Individual Defendants."

24. During the Class Period, the Individual Defendants, as senior executive officers of Blue Coat, were privy to confidential and proprietary information concerning Blue Coat, its operations, finances, financial condition and present and future business prospects. The Individual Defendants also had access to material adverse non-public information concerning Blue Coat, as discussed in detail below. Because of their positions with Blue Coat, the Individual Defendants had access to non-public information about its business, finances, products, markets and present and future business prospects via internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management and/or board of directors meetings and committees thereof and via reports and other information provided to them in connection therewith. Because of their possession of such information, the Individual Defendants knew or recklessly disregarded that the adverse facts specified herein had not been disclosed to, and were being concealed from, the investing public.

25. The Individual Defendants are liable as direct participants in the wrongs complained of herein. In addition, the Individual Defendants, by reason of their status as senior executive officers and/or directors, were "controlling persons" within the meaning of Section 20(a) of the Exchange Act and had the power and influence to cause the Company to engage in the unlawful conduct complained of herein. Because of their positions of control, the Individual Defendants were able to and did, directly or indirectly, control the conduct of Blue Coat's business.

26. The Individual Defendants, because of their positions with the Company, controlled and/or possessed the authority to control the contents of its reports, press releases, and presentations to securities analysts and through them, to the investing public. The Individual Defendants were provided with copies of the Company's reports and press releases alleged herein to be misleading, prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. Thus, the Individual Defendants had the opportunity to commit the fraudulent acts alleged herein.
27. As senior executive officers and/or directors and as controlling persons of a publicly traded company whose common stock was, and is, registered with the SEC pursuant to the Exchange Act, and was, and is, traded on the NASDAQ Stock Market ("NASDAQ") and governed by the federal securities laws, the Individual Defendants had a duty to promptly disseminate accurate and truthful information with respect to Blue Coat's financial condition and performance, growth, operations, financial statements, business, products, markets, management, earnings and present and future business prospects, and to correct any previously issued statements that had become materially misleading or untrue, so that the market price of Blue Coat's common stock would be based upon truthful and accurate information. The Individual Defendants' misrepresentations and omissions during the Class Period violated these specific requirements and obligations. The Individual Defendants were Principle Executive Officers who made certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, certifying that the financial information included in the Company's Forms 10-Q and 10-K "fairly presented in all material respects the financial condition [and] results of operations" of Blue Coat, and certifying that they designed or supervised Blue Coat's internal control over financial reporting such that it "provide[d] reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles."

28. The Individual Defendants are liable as participants in a fraudulent scheme and course of conduct that operated as a fraud or deceit on purchasers of Blue Coat's common stock by disseminating materially false and misleading statements and/or concealing material adverse facts. The scheme: (i) deceived the investing public regarding Blue Coat's business, operations and management and the intrinsic value of Blue Coat's securities; (ii) enabled Defendant NeSmith to sell over 161,000 shares of Blue Coat stock for proceeds of over $4.9 million – including disposing of 116,000 shares for proceeds of $3.7 million over a two-day period during 4Q 2010 but prior to public disclosure of that quarter's results; and (iii) caused Plaintiff and members of the Class to purchase Blue Coat common stock at artificially inflated prices.
CLASS ACTION ALLEGATIONS

29. Plaintiff brings this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of a class consisting of all those who purchased the common stock of Blue Coat between November 24, 2009 and May 27, 2010, inclusive, and who were damaged thereby (the "Class"). Excluded from the Class are Defendants, the officers and directors of the Company, at all relevant times, members of their immediate families and their legal representatives, heirs, successors or assigns and any entity in which Defendants have or had a controlling interest.

30. The members of the Class are so numerous that joinder of all members is impracticable. Throughout the Class Period, Blue Coat common stock was actively traded on the NASDAQ. While the exact number of Class members is unknown to Plaintiff at this time and can only be ascertained through appropriate discovery, Plaintiff believes that there are thousands of members in the proposed Class. Record owners and other members of the Class may be identified from records maintained by Blue Coat or its transfer agent and may be notified of the pendency of this action by mail, e-mail, and/or publication, using the form of notice similar to that customarily used in securities class actions.

31. Plaintiff's claims are typical of the claims of the members of the Class as all members of the Class are similarly affected by Defendants' wrongful conduct in violation of federal law complained of herein.

32. Plaintiff will fairly and adequately protect the interests of the members of the Class and has retained counsel competent and experienced in class action and securities litigation.

33. Common questions of law and fact exist as to all members of the Class and predominate over any questions solely affecting individual members of the Class. Among the questions of law and fact common to the Class are:

   (a) whether the federal securities laws were violated by Defendants' acts as alleged herein;
whether statements made by Defendants to the investing public during the Class Period misrepresented material facts about the business and operations of Blue Coat;

(c) whether the price of Blue Coat common stock was artificially inflated during the Class Period; and

(d) to what extent the members of the Class have sustained damages and the proper measure of damages.

34. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy since joinder of all members is impracticable. Furthermore, as the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it impossible for members of the Class to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

BACKGROUND TO THE CLASS PERIOD

The Company

35. Blue Coat is a provider of web security and wide-area network (WAN) optimization products. The Company's products and services accelerate and optimize the delivery of business applications, web content, and other information to users either across a WAN or on the public Internet. Blue Coat's web security products – such as the ProxySG Appliance – provide visibility, control, and security over employee Internet activity. Its WAN optimization products – such as the PacketShaper – allow businesses to manage the flow of data across a WAN. This includes prioritizing traffic, blocking unwanted traffic, compressing data, and deduplication, among many other functions. Founded in 1996, Defendant Blue Coat describes itself as a "technology leader in Application Delivery Networking." The software and appliances Blue Coat sells control how employees access and use Web-based content and WAN application delivery services. From its early roots in the caching market, the Company evolved from selling proxy cache appliances (used to optimize network performance for big service providers) to appliances that can also limit inappropriate use of the Internet.
36. The Company's product offerings now focus on three core functions: (1) security of the delivery of business applications and protection from malware, spyware or other malicious threats, together with centrally managed policy enforcement that enables an enterprise to set, enforce and measure compliance with its corporate IT policies; (2) acceleration and optimization of the delivery of internal, external, real-time and customized applications across the networks of distributed enterprises; and (3) visibility of applications and users on the network to enable distributed enterprises to discover, classify, prioritize and monitor applications, content, and users according to their corporate IT policies.

37. Blue Coat's application intelligence is designed to enable enterprises to align network investments with business requirements, speed decision-making, and secure business applications for a long-term competitive advantage.

38. The Company sells its products and services globally. It claims its products are installed in over 15,000 enterprises worldwide, including 88% of the Fortune Global 500 and 8 out of the 10 largest global service providers. It maintains support centers in Sunnyvale, London, Tokyo, Kuala Lumpur, Waterloo (Ontario), and Dubai.

39. Blue Coat is particularly dependent upon its European sales, which traditionally comprised 40% of its sales revenues.

40. The Company's principal products include:
   
a. ProxySG Appliance, which serves as a foundation for secure Web Gateway products and WAN optimization offerings;

b. ProxySG Virtual Appliance, which is a software that provides WAN optimization functionality and operates on a virtual environment;

c. CacheFlow 5000 Appliance, which is designed to address the problems typically facing telecommunications service providers;

d. Blue Coat ProxyAV Appliance, which is designed to be used with ProxySG appliances to provide inline threat protection and malware scanning of web content at the Internet gateway;
e. Blue Coat WebFilter Software, a content filtering database that operates on ProxySG Appliance and includes client-based software for remote workers;

f. PacketShaper Appliance, which enables an information technology administrator to monitor the applications running on the enterprise's network; and

g. Blue Coat Cloud Service, a subscription-based service that delivers its functionality through the Internet on demand.

41. Blue Coat also offers hardware and software support, as well as professional and training services.

42. Because the Company's “primary end user customers are large and medium distributed enterprises, including finance, health care, and other business enterprises, along with U.S. Federal, state and local, and foreign government agencies” who “deploy [its] products in their data centers and branch offices, at Internet gateways and on mobile devices worldwide,” Blue Coat’s sales cycle is long and involved and Blue Coat engineers work directly with potential and existing customers as part of the sales process. According to Defendants, the life span of its product offerings is four to five years, at which time customers either purchase new appliances and/or software with Blue Coat, or they move onto another provider.

Expansion of Blue Coat's WAN Optimization Business

43. In 2008, the Company acquired Packeteer, Inc., a company whose products aid in bandwidth management. Blue Coat's goal in this acquisition was to expand its WAN optimization business, which it intended to accomplish through Packeteer's key product, PacketShaper.

44. WAN optimization is a process which allows businesses to manage the flow of data across a WAN. This includes prioritizing traffic, blocking unwanted traffic, compressing data, and deduplication, among many other functions. In its Form 10-Q for 2Q 2010, filed with the SEC on December 1, 2009, the Company stated that it acquired Packeteer to “add to our
product portfolio products that identify and classify the applications on the network and monitor
application response times and utilization.”

45. According to CW6, when Defendant NeSmith announced the acquisition of
Packeteer, it was clear that Blue Coat’s CEO planned to move Blue Coat into the WAN
optimization market. Specifically, Defendant NeSmith “bought [Packeteer] so that he could be
less hindered by competition.”

46. Until acquiring Packeteer, the Company’s primary focus was selling its security
products, such as the ProxySG Appliance. As described by several key former employees from
the European region, the shift in focus to selling WAN optimization products – and specifically,
the integration of Packeteer – had a detrimental impact on the Company. For example,
according to CW4, “[a]s Blue Coat tried to finish up Packeteer and to combine the two
technologies into one, they had some execution problems. They weren’t successfully merging
the two technologies into one.”

47. Likewise, according to CW6, a former employee of both Blue Coat and
Packeteer, Defendants did not effectively leverage the revenue potential associated with the
Packeteer acquisition:

I had been very successful selling PacketShaper [when employed at
Packeteer]. But Blue Coat was only interested in sucking that technology
into their own product and not selling the PacketShaper line. So we were
looking at something like a 67 percent drop in the sales of PacketShaper
and they [Blue Coat] ceased research and development. They stagnated
that product [which had been] a very good market-leading product.

48. When CW6 tried to engage his supervisor, systems engineering manager Graham
Henderson, about his concerns regarding the Company’s focus on WAN optimization and the
missed opportunities surrounding the PacketShaper product line, he was taken aside and
reprimanded. CW6 explained, “[t]hey would section you apart from everybody else. It was
almost like a divide-and-conquer mentality. They don’t want those concerns voiced among
your peer group.” CW6 learned that his colleagues had experienced similar treatment from
Graham Henderson when expressing similar concerns.
49. According to CW3, Blue Coat's senior management did not appear to appreciate the fact that web security and WAN optimization were two very different markets. As CW3 explained:

The important thing the Company should have realized is how different those two markets are – even if you are selling through to the same company end-user, you are selling through different channel partners. Our mistake was to think that people who understood the security message could also communicate the networking message. It’s a typical problem in the high-tech industry when an organization with one solution tries to get into another market.

50. CW6 explained that prior to the Packeteer acquisition, the majority of Blue Coat’s sales were security products, but with the Packeteer acquisition, “the focus definitely changed. [Blue Coat] de-focused on the security product, which put dispersions in the channel.” According to CW6, channel partners had become “disillusioned,” as the partners “had a far-reaching security base.” CW6 reported that Blue Coat told its employees to “push WAN optimization when talking to customers about security. So there was a disconnect.”

51. According to CW6, Blue Coat was losing ground in the “very cut throat” security market. CW6 described the shift in the Company’s focus as one where “Blue Coat, which had never focused on WAN optimization, went up against a market leader in Riverbed, which didn’t have to worry about Blue Coat because it [Blue Coat] was a de-focused security company dabbling in WAN optimization.”

52. CW7, another former employee of both Packeteer and Blue Coat, reported similar issues. Specifically, “the ability to sell the Packeteer product was compromised and it was no secret that to sell the Packeteer product you have to understand it.” According to CW7, the Blue Coat sales force was accustomed to selling security products and “didn’t understand WAN optimization.” The overall result was “a dramatic decline in the user base and new customers.” CW7 attributed this “decline” to “poor management and poor integration.”

53. As CW8 explained, Blue Coat acquired Packeteer in 2008 intending to become a major player in WAN optimization. However, Riverbed Technologies was already the established leader in that field and Riverbed’s European sales team “had been evangelizing in Europe” for a few years already. According to CW8, Riverbed was well established in the
European market at a time when Blue Coat was fighting for a toehold in the WAN optimization category. Ultimately, Blue Coat's European sales force was "far more comfortable selling security products" even though the public emphasis was on the WAN optimization market. CW8 observed that after 3Q 2009, Blue Coat's business in EMEA began to soften, with "some weaknesses" readily ascertainable by 2Q 2010 and 3Q 2010.

DEFENDANTS' FALSE AND MISLEADING CLASS PERIOD STATEMENTS

Second Quarter 2010

54. The Class Period begins on November 24, 2009, when Blue Coat issued a press release announcing its financial results for the 2Q 2010, ended October 31, 2009. For the quarter, the Company reported revenue of $120.4 million and net income of $8.4 million, or $0.19 per diluted share. With regard to the Company's outlook for the 3Q 2010, Defendants stated that they expected revenue of $121 million to $126 million and GAAP net income of $0.01 to $0.12 per diluted share. Defendant NeSmith, commenting on the results, emphasized, in pertinent part, the growth being experienced in the Company's European sales:

I am very pleased with Blue Coat's financial performance in the second quarter and believe it further validates that our unique Application Delivery Network strategy is resonating strongly in the market.

In the quarter, we experienced solid sequential revenue growth in North America and in Europe. We saw strong demand in both the U.S. Federal and enterprise segments of our business for Application Delivery Network solutions, which help contain network and bandwidth costs, enhance business productivity, and mitigate exposure to evolving threat environments.

Defendant Brooks also commented on the results, stating as follows:

Blue Coat's second quarter results featured strong improvement in operating profitability, which is an important initiative for the company in Fiscal 2010. In the quarter, our non-GAAP operating margin percentage increased sequentially 300 basis points to 15.5% compared with 12.5% in the prior quarter. This improvement further highlights our commitment to increasing operating profitability.

(Emphasis added.)

55. Following the 2Q 2010 earnings announcement, Defendants held a conference call with analysts and investors to discuss Blue Coat's earnings and business. In response to a
question about business in the United Kingdom, Defendants NeSmith and Brooks painted an optimistic picture of business in Europe, stating in pertinent part:

Richard Sherman - MKM Partners: [C]an you [talk] about how business was in the UK and maybe also then provide some color on the large transactions, the million dollar deals kind of the vertical markets or the geographic dispersion of those?

Brian NeSmith: UK business was – last year was actually a very good business. So I don't know if there is very much else I can add there.... *Europe in general was -- performed very well. We know that France and Germany again remained strong, but we also saw, I think in general just across Europe, we had a good business everywhere. As far as the large deals, what we highlighted was five over a million, but none more than 5 million.* In general these tend to be -- I think most of them, I think four to five are large enterprises and I think one of them was a carrier customer. So, it's -- I think when we broke it out, we highlighted a couple in the U.S. and I think I'm not sure about how many were in Europe, so there was one or two. But it's spread out. I wouldn't -- I think we made clear about this before, you have to be careful -- you don't -- when we look at our forecast we're a little more cautious when we get to big deals, because they create some lumpiness in the business, but this is fairly typical for us, having this many deals of this size, and when you look at the pipeline you see similar sorts of things as we go forward in the future.

Gordon Brooks: And I think one of the ideas of breaking out this metric this way is to show that this quarter wasn't due to extreme lumpiness from big deals, it was an outfit that has been relatively consistent over the last four quarters?

(Emphasis added.)

56. During that conference call, Defendant NeSmith represented that Blue Coat’s WAN optimization business was performing extremely well:

Recent reports from [market research companies] Infonetics and Forrester confirm that we are either extending or maintaining our lead in the **WAN Optimization** and Secure Web Gateway markets. Infonetics second calendar quarter report shows Blue Coat **extending its lead in the WAN optimization market** for the second consecutive quarter, increasing its market share to 31% in calendar Q2 from 24% a year ago.

(Emphasis added.)

57. Additionally, in response to questions regarding deal processing length and closure rates, Defendants NeSmith and Brooks stated, in pertinent part:

Alex Henderson - Miller Tabak: Can you give us some sense of what the deal processing lengths look like? Did you see any stretching out or contraction of the amount of time it takes to do transactions?
Brian NeSmith: We don't track it in an analytical sort of way. But
anecdotally I didn't notice anything...

Gordon Brooks: Not anything different from Q1.

Brian NeSmith: [I]t's been generally consistent for the last three or four
quarters.

Alex Henderson - Miller Tabak: So, fairly stable. And the closure rates, I
know you had made a comment on it. Could you just reiterate your closure
rates in the quarter sequentially were comparable or improved?

Brian NeSmith: They were a little better than the previous quarter.

Alex Henderson - Miller Tabak: But in your guidance you’re assuming
the same level as the current quarter?

Brian NeSmith: Well, we assume a range, obviously because we give a
range of guidance. The pipeline number we know and the range comes
from what we think the closure rates are going to range between.

58. Further, Blue Coat’s 2Q 2010 Form 10-Q explained the $7.4 million increase in
net revenue derived from EMEA was “driven by a $3.4 million increase in product revenue
primarily from sales our Proxy appliances in addition to a $4.0 million increase in service
revenue driven by continued growth in our installed base, resulting in an increase in revenue
from renewal service contracts.” In connection with these statements, Defendants NeSmith and
Brooks certified, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, that the financial
information included in the 2Q 2010 Form 10-Q “fairly presented in all material respects the
financial condition [and] results of operations” of Blue Coat, and that they designed or
supervised Blue Coat’s internal control over financial reporting such that it “provide[d]
reasonable assurance regarding the reliability of financial reporting and the preparation of
financial statements for external purposes in accordance with generally accepted accounting
principles.”

59. As set forth in ¶54 through 58 above, Defendants made various statements with
respect to the Company’s 2Q 2010 financial performance that were false and misleading when
made. These included remarks about Blue Coat’s purportedly “solid sequential revenue growth
in North America and in Europe”, that during the “second quarter results featured strong
improvement in operating profitability”, that “Europe in general ... performed very well”, that
“we are either extending or maintaining our lead in the WAN Optimization and Secure Web Gateway markets", and that “we believe that our ability to differentiate WAN optimization with our traditional secure web gateway products and technologies . . . is fundamental to our current and continued success.”

60. Contrary to Defendants’ public statements made with respect to 2Q 2010, Blue Coat (a) was actually facing increasingly harsh economic conditions in Europe; (b) was encountering significant challenges in the WAN optimization market and its shift in focus from security products to WAN optimization products with the acquisition of Packeteer; and (c) was experiencing pipeline problems and failing to close sales during the Class Period. Importantly, the “solid sequential revenue growth” that showed “strong improvement” was only achieved through means of accounting trickery which the Company used in order to “meet” revenue projections.

61. Blue Coat’s European business had begun to deteriorate by 2009. As former Blue Coat employees have abundantly stated, the weakness in Europe developed no later than 2009, in the wake of the Company’s acquisition of Packeteer and its shift in strategy from its core security products to WAN optimization. According to CW4, a former Blue Coat financial systems manager, beginning in 2009, management felt the Company was “falling behind the market” and was worried about losing market share in EMEA. Internally, Blue Coat employees believed in 2009 that the Company’s growth forecasts were too high and that the forecasts should have been more conservative. CW4 reported that turnover was high in the Research and Development and Sales departments. CW4 explained that, “R & D [Research and Development] was fundamental to create and get product out there.” Yet, Research and Development “was reorganizing about two times a year.” According to CW4, the sales department “drives sales,” so with turnover being high, sales execution was difficult. This constant internal reshuffling manifested itself in Blue Coat’s “falling behind the market.” And yet, in direct contrast to the true state of affairs, Defendant NeSmith falsely touted Blue Coat as having “performed very well” and having “a good business everywhere [throughout Europe]” during 2Q 2010.
62. Similarly, former Blue Coat employees have stated that, by late summer 2009, the economic situation in Europe had made business uncertain such that forecasting was difficult to accomplish with any accuracy – a fact which undercuts the optimism conveyed by Defendants during the 2Q 2010 earnings announcement and conference call. As CW2, a former accounting policy manager, stated: “[Internally,] I don’t recall [company executives] saying EMEA sales were strong ... I don’t recall them saying their forecasts showed EMEA would be strong or that they had projections that EMEA would be strong.” In fact, according to CW2, by that point in time, the economic situation in Europe was deteriorating so rapidly that “it became hard to accurately forecast.”

63. Contrary to Defendants’ optimistic statements, according to CW2, the Company’s EMEA sales “weren’t robust” in September 2009. Because approximately 40 percent of the Company’s revenues were derived from EMEA, “there was a lot of concern about making numbers.”

64. Defendants’ statements about Blue Coat “extending its lead in the WAN optimization market” were likewise false and misleading. As Defendants well knew, the lack of familiarity with the WAN optimization products acquired in the Packeteer merger, and the shift in focus from security products to WAN optimization, was having an adverse impact on sales. There was thus within Blue Coat a “concern about making numbers” in EMEA, as key former Blue Coat employees have stated. These former employees, who had direct knowledge of the Company’s success in Europe, explained that the shift in focus to selling WAN optimization products – and specifically, the integration of Packeteer – had a detrimental impact on the Company, one that Defendants deliberately concealed from investors. For example, according to CW4, “[a]s Blue Coat tried to finish up Packeteer and to combine the two technologies into one, they had some execution problems. They weren’t successfully merging the two technologies into one.” Thus, in the words of CW3, “the important thing the Company should have realized is how different those two markets [for web security and WAN optimization] are....”
65. CW7, another former employee of both Packeteer and Blue Coat, reported similar issues. Specifically, "the ability to sell the Packeteer product was compromised and it was no secret that to sell the Packeteer product you have to understand it." According to CW7, the Blue Coat sales force was accustomed to selling security products and "didn't understand WAN optimization." The overall result was, according to CW7, "a dramatic decline in the user base and new customers," which CW7 attributed to "poor management and poor integration."

66. As CW8 explained, Blue Coat faced a major established WAN optimization competitor in Europe in the form of Riverbed, a company which was already the established leader in that field. By contrast, CW8 described Blue Coat’s European sales force as "far more comfortable selling security products," which was problematic since the top level of management at Blue Coat had decided to emphasize WAN optimization sales. Yet, the Blue Coat sales force was unable to successfully sell WAN optimization to the degree expected, as several key former employees have stated. As such, according to these former employees, Defendants’ public position that Blue Coat was “extending its lead in the WAN optimization market” – as Defendant NeSmith represented during the 2Q 2010 earnings conference call – was simply not true.

67. In response to the weakening demand for its products since shifting its focus from web security products to WAN optimization, as well as the higher competition in EMEA and the difficulties posed by the economic environment in that region, Defendants took steps to create the false impression that the Company was well positioned to meet or exceed forecasts. One way in which this was accomplished was by falsifying sales – and hence, revenues.

68. Specifically, at the end of reporting periods, including 2Q 2010, according to CW1, Company employees were instructed to enter purchase orders that were incomplete or incorrect in order to show revenue that would then be “backed out of the system” as a credit after the reporting period ended. The purpose and effect of this “back it out” practice was to fraudulently “meet” the Company’s revenue projections. Through this practice, the Company was able to report revenues on orders that Company managers knew were incomplete or incorrect. This practice enabled Defendant NeSmith to publicly portray Blue Coat’s European
sales as having “performed very well,” as he did during the 2Q 2010 earnings call, despite clear knowledge to the contrary.

69. In situations where orders had not yet come in before the midnight reporting deadline, Company employees, including CW1, working right up to the midnight deadline, were instructed by the director of order management, Scott Hashiguchi, to “go ahead and book it.” According to CW1, “[t]hen we had to back it out or credit the order after the close of the reporting period, which wasn’t legal.” For instance, just before the reporting deadline in November 2009, CW1 was instructed to input a $1.5 million order from a U.S. insurance company knowing that the order was incorrect. CW1 was told to “back it out [of the Company’s system] the following day [after the reporting deadline].”

70. The “back it out” procedure was used for purchase orders from all regions, including EMEA. According to CW1, up until she stopped processing EMEA purchase orders in early 2008, a significant percentage – approximately 20-25% - of the orders that she handled for EMEA “weren’t clean” or legitimate. While CW1 processed orders in the Asia-Pacific (“APAC”) and Americas regions after early 2008, she observed that this practice continued, up through and including 2Q 2010.

71. CW5 reported that during her employment she heard from employees that the Company engaged in a “channel-stuffing scheme” operated by the Company’s vice president of worldwide channel sales Jim Harold. Through this scheme, which CW5 had heard “was happening and had been happening,” product was shipped to a channel partner’s warehouse so that it could be booked as revenue during a specific period. (Emphasis added.) After the close of the period, the product would then be returned by the channel partner and credited. CW5 described this practice as a “revenue-recognition numbers game.” She explained that the Company was “stuffing the pipeline and then allowing huge returns.” CW5 had heard that Jim Harold had engaged in this “channel-stuffing scheme” at another company prior to his employment at Blue Coat. The purpose and effect of this scheme, similar to the “back it out” procedure reported by CW1, was to fraudulently “meet” the company’s revenue projections, a
practice which, as discussed *infra*, violates Generally Accepted Accounting Principles ("GAAP").

72. This scheme directly contradicted the revenue recognition protocols that Blue Coat represented were in place during the Class Period. For instance, according to the Form 10-Q filed on December 1, 2009, and repeated in subsequent SEC filings during the Class Period, Blue Coat claims only to recognize revenue when “persuasive evidence of an arrangement exists; delivery or performance has occurred; the sales price is fixed or determinable; and collection is probable.” According to those same SEC filings, persuasive evidence of an arrangement required “customer purchase orders and, in certain instances, sales contracts or agreements.” By recording revenue with incomplete or incorrect orders, Blue Coat was violating its own standard and protocol, as well as GAAP, and creating fictitious revenues.

73. Had Blue Coat not engaged in these revenue falsifying practices, the truth about the weak demand and weak sales in Europe, stemming in large part from the Company’s failed WAN optimization transition, would have been revealed far earlier, no later than 2Q 2010, as the Company would have failed to meet its projections no later than 2Q 2010. Defendants’ 2Q 2010 statements about the success of the Company’s WAN optimization sales and “perform[ing] very well [in Europe]” were simply untrue.

74. Defendants’ false and misleading portrayal of Blue Coat’s financial position had an artificially inflationary impact on the stock price. In reaction to the Company’s 2Q 2010 financial results and outlook for 3Q 2010, shares of the Company’s stock rose $1.60 per share, to close at $27.27 per share, on November 25, 2009.

**Third Quarter 2010**

75. On February 23, 2010, Blue Coat issued a press release announcing its financial results for 3Q 2010, which ended January 31, 2010. For the quarter, the Company reported revenue of $127.1 million and net income of $6.9 million, or $0.15 per share. Defendants also stated that for 4Q 2010, ending April 30, 2010, the Company expected net revenue in the range of $129 million to $134 million, and $0.25 to $0.31 per share on a GAAP basis. Defendant
NeSmith, commenting on the results, again emphasized as he did in the prior quarter the strength in the Company’s European sales. In particular, he stated that:

The third quarter marked a period of continued growth for Blue Coat. In the quarter, business was strong across all major geographic regions, as customers continue to value our unique ADN product portfolio. We will continue to invest in strategic opportunities in the ADN market to accelerate growth while not sacrificing the bottom line.

(Emphasis added.) Likewise, in response to the Company’s financial results, Defendant Brooks stated, in pertinent part:

I am particularly pleased with the strong improvement in non-GAAP operating profitability and record operating cash flow in the third quarter. Our non-GAAP operating margin percentage increased sequentially 440 basis points to 19.9%, and our trailing 12 month operating cash flow was $76 million, an increase of 24%.

76. Following the 3Q 2010 earnings announcement, Defendants held a conference call with analysts and investors to discuss Blue Coat’s earnings and business. Defendant NeSmith took this opportunity to again tout the strength of the Company’s European sales. In particular, Defendant NeSmith stated that:

Looking at the geographies, business was strong across all major regions as we benefited from a moderate year-end budget flush. . . . In Europe, we saw a significant deployment of ProxySG appliances at T-Systems, T-Online, the enterprise customer division of Deutsche Telecom, to optimize and secure applications delivery for more than 12 million users....

* * * *

Alex Kurtz, Analyst, Merriman & Co.: Yeah, thanks for taking the question. So just looking at the geographic results – the geo results here. EMEA looked like it was up pretty strongly sequentially, but America off a bit. . . . and obviously APJ up. Can you just give us a little color on what happened between the three different GOs and how they performed during the quarter.

* * * *

Gordon Brooks: I believe that in Europe the two areas that we saw some strength were in the UK, albeit off of a – weaknesses from prior quarters. And then also in France and Spain so in Southern Europe we had seen some strength.... So I think those are probably some flavors around the key countries in each of the region[s].

(Emphasis added.)
77. In its Form 10-Q for 3Q 2010, filed with the SEC on February 25, 2010, Defendants gave investors no indication that demand was slipping or that macro-economic factors were adversely impacting Blue Coat’s sales. To the contrary, in that Form 10-Q, Defendants stated:

Net revenue . . . increased . . . due to an increased demand for our products, which we believe primarily resulted from an improvement in the economic environment and enterprise IT spending for products that help customers improve their ability to manage bandwidth costs, security and network performance. Net product revenue primarily includes revenue from sales of our ProxySG and PacketShaper appliances and licenses to our WebFilter product.

(Emphasis added.)

78. Blue Coat also revealed in its 3Q 2010 Form 10-Q that it experienced net revenue growth from its EMEA region. For 3Q 2010, net revenues generated from EMEA were $50.531 million, up from $43.905 million in 3Q 2009. While net revenue from EMEA in 3Q 2010 decline slightly as a percentage of overall sales compared to 3Q 2009 (from 40.1% to 39.8%), the total net revenue nearly equaled that generated by sales to the Americas region (which generated $53.561 million in 3Q 2010). In connection with these statements, Defendants NeSmith and Brooks certified, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, that the financial information included in the 3Q 2010 Form 10-Q “fairly presented in all material respects the financial condition [and] results of operations” of Blue Coat, and that they designed or supervised Blue Coat’s internal control over financial reporting such that it “provide[d] reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.”

79. As set forth in ¶75 through 78 above, Defendants made various statements with respect to the Company’s 3Q 2010 financial performance that were false and misleading when made. These included remarks that Blue Coat’s 3Q 2010 marked a period of “continued growth” and that “business was strong across all major geographic regions”, that the Company was seeing strength throughout Europe, including in the UK, France, and Spain, and that net revenue increased for the quarter “due to an increased demand for our products . . . .”
80. For the reasons discussed herein, contrary to Defendants' public statements made with respect to 3Q 2010, Blue Coat (a) was actually facing increasingly harsh economic conditions in Europe; (b) was encountering significant challenges in the WAN optimization market and its shift in focus from security products to WAN optimization products with the acquisition of Packeteer; and (c) was experiencing pipeline problems and failing to close sales during the Class Period. Importantly, the "continued growth", strong sales across all major geographic regions, and the net revenue increase for the quarter that was purportedly "due to an increased demand for [Blue Coat's] products . . ." were only achieved through means of accounting trickery which the Company used in order to "meet" revenue projections.

81. As Defendants well knew at the time, Blue Coat's European business had begun to deteriorate in 2009. According to several former Blue Coat employees, the weakness in Europe developed no later than 2009, in the wake of the Company's acquisition of Packeteer and its shift in strategy from its core security products to WAN optimization.

82. According to CW4, a former Blue Coat financial systems manager, beginning in 2009, management felt the Company was "falling behind the market" and was worried about losing market share in EMEA. Internally, Blue Coat employees believed in 2009 that the Company's growth forecasts were too high and that the forecasts should have been more conservative. CW4 reported that turnover was high in the Research and Development and sales departments. CW4 explained that, "R & D [Research and Development] was fundamental to create and get product out there." Yet, Research and Development "was reorganizing about two times a year." According to CW4, the sales department "drives sales," so with turnover being high, sales execution was difficult. This constant internal reshuffling, contemporaneous with Blue Coat's "falling behind the market," directly conflicts with: (a) Defendant NeSmith's representation that "business was strong across all major geographic regions"; and (b) Defendant Brooks' representation that "in Europe ... [Blue Coat] saw some strength ... in the UK ... also in France and Spain so in Southern Europe [Blue Coat] had seen some strength...." Of note, Defendant Brooks referred to the individual countries referenced in the 3Q
2010 conference call with analysts – the UK, France and Spain – as “the key countries ... in the region.”

83. Additionally, former Blue Coat employees stated that by late summer 2009, the economic situation in Europe had made business uncertain such that forecasting was difficult to accomplish with any accuracy. As CW2, a former accounting policy manager, stated: “I don’t recall [company executives] saying EMEA sales were strong ... I don’t recall them saying their forecasts showed EMEA would be strong or that they had projections that EMEA would be strong.” In fact, according to CW2, by that point in time, the economic situation in Europe was deteriorating so rapidly that “it became hard to accurately forecast.”

84. According to CW2, the Company’s EMEA sales “weren’t robust” in September 2009. Because at least 40 percent of the Company’s revenues came from EMEA, “there was a lot of concern about making numbers.” This concern which began as early as 2009, clearly existed and was more prevalent by 2Q and 3Q 2010.

85. In early 2010, CW4 was asked by the Company’s Chief Information Officer Jim Haar to analyze “how much future revenue [could] be generated” from renewals or contracts approaching maturity. According to CW4, the Company’s management was concerned that “a lot of customers were not going to renew.”

86. According to CW5, a former Vice-President of Marketing for the Americas, she was hired into the Company’s marketing department that was “obliterated” in early calendar year 2010 due to layoffs and resignations – hardly the sign of a “strong” company with “continued growth,” as Defendants publicly described Blue Coat in the 3Q 2010 earnings announcement and conference call. Immediately upon joining the Company, CW5 noticed that Blue Coat did not have appropriate systems in place to drive the pipeline. According to CW5, the sales and marketing departments were a “mess” with “no flow, documentation or accountability” which had a negative impact on the pipeline. One of CW5’s “biggest concerns was that there was a huge break between leads that were being generated and leads that were being followed up on.” According to CW5, in order to set revenue expectations, “you have to know whether you have deals in the working. If you don’t have deals working today, which
take six [to] nine months to close, how are you going to close those deals in the future? But everybody was just always focused on the current quarter.” CW5 explained that it was her understanding that “this is how [the Company] had always done it.” These pipeline problems as described by CW5 did not occur overnight and certainly were in place prior to the Company’s 3Q 2010 earnings announcement and conference call.

87. Similarly, Defendant NeSmith’s portrayal of the Company’s WAN optimization sales as successful was achieved by “cherry picking” one selective customer’s purchases; it was hardly reflective of the overall state of the Company’s WAN optimization initiative. Former key employees of Blue Coat from the European region have painted a far different picture of the Company’s success or lack thereof in selling WAN optimization. These former employees, who had direct knowledge of the Company’s success in Europe, explained that the shift in focus to selling WAN optimization products – and specifically, the integration of Packeteer – had a detrimental impact on the Company. For example, as discussed above, according to CW4, “[a]s Blue Coat tried to finish up Packeteer and to combine the two technologies into one, they had some execution problems. They weren’t successfully merging the two technologies into one.” According to CW7, the Blue Coat sales force was accustomed to selling security products and “didn’t understand WAN optimization.” The overall result was “a dramatic decline in the user base and new customers,” which CW7 attributed to “poor management and poor integration.”

88. Moreover, as CW8 explained, Riverbed was a major competitor in the WAN optimization market, and it was already the established leader in that field. CW8 described Blue Coat’s European sales force as “far more comfortable selling security products” even though the highest levels of Blue Coat management were pressuring WAN optimization sales. Thus, Defendants NeSmith’s representations of Blue Coat successfully selling its WAN optimization product to one particular customer deliberately misled investors.

89. Aware of the weakening demand for its products since shifting to focus on WAN optimization, the higher competition in EMEA, and the difficulties posed by the economic environment, Defendants took steps to create the false impression that the Company was well positioned to meet or exceed forecasts. As discussed above, at the end of reporting periods,
including 3Q 2010, Company employees were instructed to enter purchase orders that were incomplete or incorrect in order to show revenue that would then be “backed out of the system” as a credit after the reporting period ended. The purpose and effect of this “back it out” practice was to fraudulently “meet” the Company’s revenue projections. Through this practice, the Company was able to report revenues on orders that Company managers knew were incomplete or incorrect. Further, this practice allowed Defendants to make the false and misleading statements portraying Blue Coat’s European sales as “strong” at the end of 3Q 2010.

90. This scheme directly contradicted the revenue recognition protocols that Blue Coat represented were in place during the Class Period. For instance, according to Blue Coat’s SEC filings during the Class Period, Blue Coat claims only to recognize revenue when “persuasive evidence of an arrangement exists; delivery or performance has occurred; the sales price is fixed or determinable; and collection is probable.” According to those same SEC filings, persuasive evidence of an arrangement required “customer purchase orders and, in certain instances, sales contracts or agreements.” By recording revenue with incomplete or incorrect orders, Blue Coat was violating its own standard and protocol.

91. Had Blue Coat not engaged in these revenue falsifying practices, the truth about the weak demand and weak sales in Europe largely caused by the Company’s failed WAN optimization initiative would have come out no later than 2Q 2010 as the Company would have failed to meet its projections no later than 2Q 2010. Therefore, the Defendants’ 3Q 2010 statements about the success of the Company’s WAN optimization sales and Blue Coat’s “strong” quarter are false and misleading.

92. Defendants’ positive statements regarding Blue Coat’s 3Q 2010 financial performance caused the Company’s stock price to rise steadily over the next two months. Valued at $28.53 per share on February 23, 2010, the stock price climbed to $33.52 on March 23, 2010, and up to $35.47 on April 23, 2010.
Financial Analysts Absorb Defendants’ False and Misleading Statements, Which Informed Their Analyses and Reports to Investors

93. Financial analysts readily absorbed the false and misleading information Defendants provided in connection with the 2Q 2010 and 3Q 2010 financial results and regurgitated it to investors, who then used it as a basis to purchase the Company’s shares.

94. For instance, on November 24, 2009, in light of Blue Coat’s positive statements made in connection with its 2Q 2010 results, Auriga Research Limited reiterated its “Buy” rating and raised its price target to $32 per share, up from $28.

95. On the day following Blue Coat’s February 23, 2010 announcement of its 3Q 2010 financial results, Piper Jaffray issued an analyst report raising its price target to $35 per share, up from $32. This report, dated February 24, 2010 and parroting information conveyed publicly by Defendants, noted that revenues in EMEA had increased 12.5% quarter over quarter and 15.1% year over year, “with strong demand in the UK, France and Spain.”

96. A report by ThinkEquity published on February 24, 2010, also processing and analyzing information conveyed by Defendants regarding the Company’s financial position, noted that Blue Coat’s revenue and earnings per share (“EPS”) guidance for 4Q 2010 – which were both ahead of expectations – “look reasonable” in light of, among other things, “solid pipeline growth.”

97. These February 24, 2010 analyst reports, which reflected financial information transmitted directly by the Company and the Individual Defendants, caused the price of Blue Coat shares to be further artificially inflated. Blue Coat’s stock rose $0.46 per share on that date, and climbed up to $32.70 per share by March 9, 2010.

98. Similarly, in a report dated March 10, 2010, Wedbush increased its price target for Blue Coat shares from $34 per share up to $36, while maintaining its “Outperform” rating. Importantly, this highly positive research report came after Wedbush analysts were privy to presentations by Blue Coat management at a Management Access Conference in New York. Thus, Wedbush’s positive analysis was based on direct representations by Company management, as well as the financial reporting by Defendants for 3Q 2010.
99. Likewise, after attending a dinner with Defendant Brooks, analysts at ThinkEquity reiterated its “Buy” rating and increased its price target from $35 per share to $39 per share in a report published on March 15, 2010. Observing that management “was positive and portrayed confidence in the fundamental outlook and competitive positioning,” and in light of “solid pipeline growth,” the report opined that Defendants’ fourth quarter 2010 guidance “look reasonable.” In terms of WAN optimization, ThinkEquity found that the Company “maintained its leadership position in the WAN optimization market through the calendar year of 2009…. Research forecasts that the WAN optimization appliance market will grow by 28 percent over the next three years… and we believe Blue Coat is well positioned for this potential opportunity.” (Emphasis added.)

100. Following ThinkEquity’s highly positive analyst report on March 15, 2010, which was written after direct communications with Defendant Brooks, Blue Coat’s stock rose $0.70 per share to close at $32.16 on March 15, up from $31.46 on the prior trading day. The market continued to absorb the positive news on the March 16, 2010, as Blue Coat’s stock price continued its upward trend to close at $32.26 per share.

101. Piper Jaffray issued another highly positive research report on March 18, 2010, stating that “[w]e continue to highlight Blue Coat as our top small cap pick for 2010” due in part to “strong sector demand.” Piper Jaffray raised its Blue Coat price target to $38 per share, up from $35. Importantly, Defendants’ statements regarding the strength of the Company’s business were taken to heart, as the Piper Jaffray report stated that “[w]e are raising our estimates on Blue Coat given our belief that the demand environment is tracking above expectations....” (Emphasis added.)

102. Defendants allowed the market to hold false perceptions about the Company’s prospects even after 4Q 2010 and FY 2010 had ended on April 30, 2010, although before those results were announced. On May 3, 2010, Wells Fargo initiated coverage of Blue Coat with an “Outperform” rating and an expected valuation range of $37-$39 per share. In this research report, Wells Fargo emphasized the Company’s positioning in the WAN optimization market:
Importantly, we believe Blue Coat is well positioned to maintain a leadership position in the WAN optimization space given the company’s unique ability to offer application optimization with security (Secure Web Gateway) and visibility (Application Performance Monitoring), which the company refers to as its Application Delivery Networking (ADN) strategy. We think this is likely to resonate with many customers and creates a differentiated sales tool that can drive share. Not to be overlooked, we see a significant opportunity for Blue Coat to cross sell WAN optimization to its Secure Gateway Customers.

(Emphasis added.) This report was based on information that Defendants proliferated to the market.

103. On May 24, 2010, in advance of the Company’s 4Q 2010 and FY 2010 reporting, Wells Fargo published a report in which it reiterated its “Outperform” rating for Blue Coat and placed a valuation range of $37-$39 per share on Blue Coat shares. Wells Fargo expected 4Q 2010 results “in-line to slightly above the high-end of guidance” and 1Q 2011 “outlook in line with our above cons ests [consensus estimates].”

104. Wedbush also published a report on May 24, 2010, in which it maintained its “Outperform” rating “given our expectations for continued margin expansion, a new product cycle and general signs of stabilization in the spending environment.” Noting “the key issue for investors will be guidance and any signs of negative impact from Europe,” the Wedbush report stated “EMEA and APAC reported healthy demand, despite market concerns about the European macro environment.” The report concluded that it expected 4Q 2010 results to “slightly exceed the high-end of guidance.”

THE TRUTH BEGINS TO EMERGE

105. After the close of trading on May 27, 2010, the Company issued a release announcing its financial results for 4Q and FY 2010, for the period ended April 30, 2010. Not until then did Defendants finally reveal the weakness in the Company’s European operations and the impact that it would have on Blue Coat’s sales and earnings going forward. Specifically, Defendants said Blue Coat expected revenues of between $121 million to $126 million and GAAP net income of $0.21 to $0.26 per diluted share for 1Q 2011. Based on Defendants’ prior bullish statements, analysts had expected revenues of $131.8 million.
Following the May 27th 4Q 2010 earnings announcement and downgraded 1Q 2011 outlook, Defendants held a conference call with analysts and investors to discuss Blue Coat’s earnings and business. With regard to the Company’s sales across different markets, Defendant Brooks conceded that the Company’s European sales had significantly underperformed throughout the 4Q 2010:

On a geographic basis in Q4, net revenue in the Americas was $58.3 million and represented 44% of revenue. Net revenue in EMEA was $47.9 million and represented 36% of total revenue, and net revenue in Asia Pac was $26.3 million and represented 20% of total revenue.

Net revenue in EMEA declined 5% sequentially, and product revenue declined 9%. This trend was not in line with our expected performance in EMEA. We believe that the softness we experienced in EMEA was due to recent uncertainty of E.U. economic environment. We saw sequential product revenue declines in a majority of the countries in Europe.

In Q4, we had four deals in the quarter whose total value is greater than $1 million. All of which were in North America.

* * * *

Jess Lubert, Analyst, Wells Fargo Securities, LLC: Can you discuss where within Europe you saw the most softening. Were there any areas of relative strength? And perhaps can you discuss how conversations have been proceeding during the first couple of weeks of May? Are things continuing to soften or have they stabilized to a lower level than you would have previously anticipated?

Gordon Brooks: Jess, this is Gordie. Over the last couple of quarters when I first started we had talked about Europe in late calendar year and early calendar year about certain countries in Europe, certain - I remember Brian had talked at various conferences about, well you really have to get down to the country level to understand what's going on. I think one of the changes we saw here was that, as we said, every country had a similar dynamic with the exception, I believe, of one or two, where we had seen stability in France and Germany in our fiscal Q2 and Q3. We did not see - we saw declines in France, Germany, the rest of southern Europe, the Middle East as well as flattening in the UK. I think we called out in Q3 we had quite a robust business in the UK, which seemed to be odd given their dynamics, but we had seen a flattening in decline in the Q4 as well there. So really throughout each of the regions which was a change from what we'd seen over the contour of the last year.

(Emphasis added.)

Defendants Brooks and NeSmith addressed questions regarding the Company’s poor outlook, and again emphasized the weakness in the Company’s European sales:
Anthony Carbone, Analyst, Auriga, USA LLC: I guess I'll start with the question that I'm sure is going to be the theme of the line in questioning and that is the guidance. And certainly, while I think we all understand the macro situation going on with Europe, a lot of the April quarter, in fact, all of the April quarter companies that have recently reported have cited no material weakness in their EMEA business. So given your guidance and if I look at the five-year seasonality of both America and Asia-Pacific, you're implying a product revenue guidance of down 13% sequentially and on EMEA, down 20% sequentially. So I guess if you could provide us a little bit more detail of what it is about your business or is there exchange rate risk, are you more exposed to the pigs, for lack of a better word? Is there something about your business that's different than say Network Appliance or HP, which just recently reported and suggested that they weren't seeing any weakness?

Gordon Brooks: This is Gordie. Let me talk a little bit about the trends that we saw in April that caused us concern as far as just what we had seen in pipeline the way deals had gotten - it looked like a year ago when deals were stuck in third parties, the type of closure rates that we were expecting as well as the weakness that we saw across, as we said, almost every country in Europe. So those trends I think are what's driving our overall concern as far as just from a specific standpoint of our business and the trends that we see and the transactions that we encountered in Europe. I think from a macro standpoint for the overall product revenue, we have not seen a sequential decline in product revenue. Last year there was a small sequential rise in product revenue from quarter-to-quarter, going from Q4 to Q1. This year we did expect a sequential decline, so there would have been or at least in my expectation, there would have been that anyway across the geographies. So I think that - again, this concern of ours in the circumstances in April added on to making that even more significant than we would normally have expected. I'll let Brian talk about at least if there are any circumstances regarding our businesses that might be different ultimately.

Brian NeSmith: Yes, I mean not very difficult to contrast us to NetApp or to HP just in the great variety of businesses they're in in a very different area. One thing that we know as a matter of course is that in general the average size of the customer in Europe is a bit smaller than it is in North America. I don't know whether that was a driver in it. We do know that when we look at the pipeline, we look at the expected forecast, as we did the roll up from our field sales function, that they were seeing softness throughout Europe. And given what we saw at the end of the quarter, especially in the last month, is business that we expected to close and even in Europe for Q4 that didn't, and so we just as a result adjusted our closure rates and looking at the numbers and that equates to obviously seeing the numbers move down. I'm a little hard-pressed to give you anything specific because I'm not sure I'm qualified to tell you what drives HP and NetApp's business as a contrast to ours. I just know that's what we see.

Daniel Ives - FBR Capital Markets & Co.: And just walk through the quarter, okay. So, if I just think about the month, like is it - is March normal not that it's always back end loaded, but where did it start? Like
just walk us through from your perspective? Like where did things start to weaken?

Brian NeSmith: Yeah, I think a couple of things to contrast. We had talked in Q3 about seasonality within the quarter that we generally see a 20, 30, 50 type of dynamic month to month. And we had talked about how we had seen an acceleration into calendar year end or our December month in Q3. I would say that in Q4, the first two months of the quarter were on the normal track that we had seen and why I'd specifically called out April itself in the script is April and particularly the end of April is where we saw the significant softness. Again we have a significant amount of business that happened over the last two to three weeks of the quarter. Especially, we have that expectation in Q4 again with the annual type of dynamics of trying to close big deals and have those completed and really it was over that period of time that we saw significant change.

(Emphasis added.)

108. Defendants NeSmith and Brooks also addressed questions regarding the Company’s failure to close certain deals, particularly in Europe:

Andrew Nowinski - Piper Jaffray: So your product margins would suggest you're not seeing any kind of pricing pressure from the competition, specifically with regard to Europe, are you seeing that just all competitive deals are simply put on hold or being pushed out? Or are you also expecting an increase in pricing pressure from your competition going forward in that region?

Brian NeSmith: I'd say that, it's what I call the big D, everything is delay. We saw delays in the cycle time for purchasing, delays in items. I don't think the loss rate changed. I don't expect going into Q1 or this fiscal year for the pricing or margin picture to change in a material way especially as we look into Q1, we are forecasting margins to be consistent with what we saw in the previous quarter as well. We're not seeing a significant difference between margins in Europe as opposed to other parts of the world. So, it's not a pricing or competitive dynamic that's driving the equation.

* * * *

Jonathan Ruykhaver - ThinkEquity LLC: And when you talk about the big D, just deals getting delayed, how does that happen - does the customer tell you that they are just postponing for a quarter or for several quarters or is it something where you see the slowdown and so you just put lower close rate assumptions around those deals?

Gordon Brooks: I think there is - Jonathan, this is Gordie. Since we use distributors and value-added resellers to fulfill our products, there is a couple of indicators that we see, one is when those deals actually don't make their way through the distributor. So, that we can see that the end-user has actually completed them and same thing with value-added reseller when a project is actually not moving forward, but it's still in evaluation stage where it got to be closed before. So, I think that that level of delay
within our channel is a key indicator for us and one that we've seen before of that type of delay.

***

Alex Henderson - Citigroup: So just wanted to go through the trajectory on the seasonal swing month-to-month over the course of the quarter, the linearity of it. So you're saying that your normal linearity is 20, 30, 50. It sounds like you were 20, 30 in the first two months and then did something substantially below the 50 in the final month. Is that an accurate restatement of what you had said earlier?

Brian NeSmith: I think that's fair. I think we were tracking to what we saw as other March 31 companies in their reporting, some of which had robust maybe over performance against their guidance and it was really kind of attractive. We believe we're on through the first two months of the quarter.

Alex Henderson - Citigroup: So you haven't seen any erosion in closure rates in Europe through the end of March and it all occurred in April?

Brian NeSmith: Yeah, I don't know that - we don't necessarily track the closure rates granularly by month. We really look at the actual expected business and how much is it closed in each of those. There may have been some underlying data that we could have parsed out earlier in the period but that didn't represent itself through what we saw in the deals that were closed.

(Emphasis added.)

109. Meanwhile, Blue Coat’s peers had been reporting a steadily building rebound in tech spending, reporting robust 1Q results and bullish forward guidance. Consequently, on Blue Coat’s announcement, shares of the Company’s stock fell precipitously, dropping $7.37 per share – losing nearly 26% of its value – to close at $21.47 per share on May 28, 2010, on unusually heavy trading volume of more than 14 million shares. (Average daily volume during the Class Period was approximately $1 million shares traded.) As identified by StreetInsider.com on May 28, 2010 in a story entitled “Blue Coat Systems (BCSI) Delivers in Q4, But Softening European Demand Slams Shares,”

* * * *

At least two Wall Street firms downgraded Blue Coat today following the news. Piper Jaffray downgraded the stock from Overweight to Neutral, noting the lower guidance was related to weakening European demand. Blue Coat has an abnormally large concentration of revenues in Europe
(35-40%), and the firm fears revenue growth could be muted for the remainder of the year.

Wells Fargo downgraded Blue Coat from Outperform to Market Perform, also noting the widespread softening in the company’s European business.

Emphasis added.)

110. Indeed, a Piper Jaffray report dated May 28, 2010, in downgrading Blue Coat to “Neutral” and lowering its price target from $38 per share to $29, parroted Defendants’ statements that “Demand in EMEA collapsed at end of quarter – Blue Coat experienced a sharp fall-off in demand in Europe during the last few weeks of the quarter....”

111. On the same day, ThinkEquity issued a research report that contained observations similar to those in the Piper Jaffray report:

During the conference call yesterday, the company reported that trends in the first two months of the quarter were stable and even slightly ahead of expectations; however, the month of April saw rapidly evolving economic conditions in EMEA, which led to deals getting put on hold and closure rates dropping. This “softness” led to a sequential decline of 5% in total revenue and 9% in product revenue in that region.

112. Also on May 28, 2010, in downgrading Blue Coat to “Market Perform” and lowering its valuation range estimate to $25-$27 per share (down from $37-$39), Wells Fargo stated that: “Blue Coat noted that its European business began to deteriorate in April and that weakness was widespread across the region.”

COMPANY EXECUTIVES’ ACUTE AWARENESS OF THE WRONGDOING

113. As noted above, Defendants conceded by May 27, 2010 that the Company’s European sales had significantly underperformed throughout 4Q 2010, admitting that “[n]et revenue in EMEA declined 5% sequentially, and product revenue declined 9%.” They noted that this trend was not in line with the Company’s “expected performance in EMEA” and that “[w]e believe that the softness we experienced in EMEA was due to recent uncertainty of E.U. economic environment. We saw sequential product revenue declines in a majority of the countries in Europe.” Defendant Brooks also noted that the Company had seen “declines in France, Germany, the rest of southern Europe, the Middle East as well as flattening in the UK . .
and that this "was a change from what we'd seen over the contour of the last year." In truth, it was not, as numerous confidential witnesses have stated.

114. Defendant NeSmith chalked up this "unexpected" decline to the Company's pipeline:

We do know that when we look at the pipeline, we look at the expected forecast, as we did the roll up from our field sales function, that they were seeing softness throughout Europe. And given what we saw at the end of the quarter, especially in the last month, is business that we expected to close and even in Europe for Q4 that didn't, and so we just as a result adjusted our closure rates and looking at the numbers and that equates to obviously seeing the numbers move down.

115. These end of the Class Period admissions by Defendants were not, in fact, news internally, and certainly not to NeSmith and Brooks. As CW6 put it: "[f]or [senior executives] to turn around and say the performance was not quite as good as we expected" was not believable.

116. In reality, Defendants knew that Blue Coat's European business began to deteriorate much earlier than April 2010. As former Blue Coat employees have abundantly stated, the weakness in Europe developed no later than 2009, in the wake of the Company's acquisition of Packeteer and shift in strategy from its core security products to WAN optimization. The Company's senior management, including Defendants herein, were made aware of this softening in Europe prior to April 2010, as they were provided real time forecast information on a day-to-day basis throughout the Class Period. Yet they proceeded to hide the truth from the public.

117. According to CW1, a former Blue Coat order administration specialist, director of order management Scott Hashiguchi received revenue forecasts and reports including from EMEA. Armed with this information, Hashiguchi then attended revenue meetings with the Company's upper management, including CEO Brian NeSmith and CFO Gordon Brooks.

118. CW6, the UK-based technical consultant and systems engineer, explained that he was under pressure to update the sales information on salesforce.com daily. Indeed, his failure to do so "infuriated [his] manager because, supposedly, everyone up the chain was looking at
this data every day.” (Emphasis added.) According to CW6, it would have been impossible for senior executives to be unaware of weaknesses in Europe in 2Q 2010 and 3Q 2010.

119. Indeed, CW6’s supervisor, Graham Henderson, specifically advised him that management “was reviewing all accounts at all stages and the money deemed to be coming in from specific accounts, so that they were forecasting on a daily and weekly basis.” CW6 explained that the “information in salesforce.com was key to the business.”

120. According to CW4, a former Blue Coat financial systems manager, beginning in 2009, management felt the Company was “falling behind the market” and was worried about losing market share in EMEA. Internally, Blue Coat employees believed in 2009 that the Company’s growth forecasts were too high and that the forecasts should have been more conservative.

121. By late summer 2009, the economic situation in Europe had made business uncertain such that forecasting was difficult to accomplish with any accuracy – a fact which directly contradicts Defendants’ optimistic statements throughout the Class Period. As CW2, a former accounting policy manager, stated: “I don’t recall [company executives] saying EMEA sales were strong.... I don’t recall them saying their forecasts showed EMEA would be strong or that they had projections that EMEA would be strong.” In fact, by that point, the economic situation in Europe was deteriorating so rapidly that “it became hard to accurately forecast.”

122. According to CW2, the Company’s EMEA sales “weren’t robust” in September 2009. At this time, approximately 40 percent of the Company’s revenues came from EMEA, and as such, “there was a lot of concern about making numbers.”

123. In early 2010, CW4 was asked by the Company’s Chief Information Officer Jim Haar to analyze “how much future revenue [could] be generated” from renewals or contracts approaching maturity. According to CW4, the Company’s management was concerned that “a lot of customers were not going to renew.”

124. According to CW5, a former Vice-President of Marketing for the Americas, she was hired into the Company’s marketing department that was “obliterated” in early calendar
year 2010 due to layoffs and resignations – hardly the sign of a “strong” company with “continued growth.”

125. Similarly, CW4 reported that turnover was high in the R & D and sales departments. CW4 explained that, “R & D was fundamental to create and get product out there.” Yet, R & D “was reorganizing about two times a year.” According to CW4, the sales department “drives sales,” so with turnover being high, sales execution was difficult.

126. Immediately upon joining the company, CW5 noticed that the Company did not have appropriate systems in place to drive the pipeline. According to CW5, the sales and marketing departments were a “mess” with “no flow, documentation or accountability” which had a negative impact on the pipeline. One of CW5’s “biggest concerns was that there was a huge break between leads that were being generated and leads that were being followed up on.” According to CW5, in order to set revenue expectations, “you have to know whether you have deals in the working. If you don’t have deals working today, which take six [to] nine months to close, how are you going to close those deals in the future? But everyone was just always focused on the current quarter.” CW5 explained that it was her understanding that “this is how [the Company] had always done it.”

127. According to CW3, the Company was “not necessarily firing on all cylinders” during the Class Period, failing to sign up “appropriate channel partners for its new products” and failing to take competitors “as seriously as they should have been [taken].”

128. According to CW3, 30 to 40 percent of Blue Coat’s business came in during the last two or three weeks of each quarter. CW3 explained, “[i]f at Week 10 [of the quarter] the sales that were anticipated are not [likely to close in the quarter], we will try to keep costs down.” CW3 recalled receiving notices to keep costs down towards the ends of 2Q 2010 and 3Q 2010.

129. CW6 reported that during the Class Period, it was very clear “business was falling off.” According to CW6, “[f]or [senior executives] to turn around and say the performance was not quite as good as we expected” was not believable.

130. According to CW2, all EMEA forecasts “flowed up” to the CFO.
131. According to CW4, “[e]very forecast [period], there were specific meetings to
look at the revenue lines ... the top line vs. the gross margins and ... the expenses, which would
drive the bottom line.” These meetings helped executives determine margins and expected
growth. There were several meetings of this nature during each reporting period. CW4
explained, “[i]n general, they did a monthly forecast, and they looked very closely at the end of
quarters.” According to CW4, every top level employee (CEO, CFO, CIO, etc.), received a
copy of the revenue forecast reports. The meetings were run by CEO Brian NeSmith.

132. CW7 described the forecasting process as “very transparent” for senior
management who would have known what was forecasted, what was in the pipeline and what
projects needed work in order to close as all information was “rolled up” the line to senior
executives. According to CW7, the Company’s senior management “would have known
exactly what was going on.”

133. Further, although the Company in its 4Q 2010 earnings announcement attributed
the “softness [it] experienced in EMEA ... to recent uncertainty of E. U. economic
environment,” according to CW2, that uncertainty in Europe was present during the summer of
2009 when the worldwide financial crisis “was at its height” and EMEA sales “weren’t robust.”
Thus, contrary to what Defendants attempted to sell to the public as the reason for its shortfall,
the “uncertainty” in Europe was hardly a new development in May 2010.

FRAUDULENTLY “MEETING” PROJECTIONS

134. Aware of the weakening demand for its products, the higher competition in
EMEA, and the difficulties posed by the economic environment, Defendants took steps to create
the false impression that the Company was well positioned to meet or exceed forecasts. One
way in which this was accomplished was by falsifying sales – and hence, revenues.

135. At the end of reporting periods, Company employees were instructed to enter
purchase orders that were incomplete or incorrect in order to show revenue that would then be
“backed out of the system” as a credit after the reporting period ended. The purpose and effect
of this “back it out” practice was to fraudulently “meet” the Company’s revenue projections.
Through this practice, the Company was able to report revenues on orders that Company managers knew were incomplete or incorrect.

136. Specifically, in situations where orders had not yet come in before the midnight reporting deadline, Company employees, including CW1, working right up to the midnight deadline, were instructed by the director of order management, Scott Hashiguchi, to “go ahead and book it.” According to CW1, “[t]hen we had to back it out or credit the order after the close of the reporting period, which wasn’t legal.”

137. For instance, just before the reporting deadline in November 2009, CW1 was instructed to input a $1.5 million order from a U.S. insurance company knowing that the order was incorrect. CW1 was told to “back it out [of the Company’s system] the following day [after the reporting deadline.]”

138. The “back it out” procedure was used for purchase orders from all regions, including EMEA. According to CW1, up until she stopped processing EMEA purchase orders in early 2008, a significant percentage – approximately 20-25% – of the orders that she handled for EMEA “weren’t clean” or legitimate. While CW1 processed orders in the Asia-Pacific (“APAC”) and Americas regions after early 2008, she observed that this practice continued, up through and including 2Q 2010.

139. CW5 reported that during her employment she heard from other Blue Coat employees that the Company engaged in a “channel-stuffing scheme” operated by the Company’s vice president of worldwide channel sales Jim Harold. Through this scheme, which CW5 had heard “was happening and had been happening,” product was shipped to a channel partner’s warehouse so that it could be booked as revenue during a specific period. (Emphasis added.) After the close of the period, the product would then be returned by the channel partner and credited. CW5 described this practice as a “revenue-recognition numbers game.” She explained that the Company was “stuffing the pipeline and then allowing huge returns.”

140. CW5 had heard that Jim Harold had engaged in this “channel-stuffing scheme” at another company prior to his employment at Blue Coat. The purpose and effect of this
scheme, similar to the "back it out" procedure reported by CW1, was to fraudulently "meet" the company's revenue projections.

141. Defendants employed these fraudulent practices to allow the Company to "meet" projections. Without these illicit methods, given the pipeline problems and poor closure rates in Europe in large part caused by the Company's shift in focus from selling security products to selling WAN optimization products, the Company would not have met its projections made during the Class Period and the public would have discovered the truth prior to May 27, 2010.

GAAP VIOLATIONS

142. Generally Accepted Accounting Principles – GAAP – consists of the rules, conventions and practices recognized and employed by the accounting profession for the preparation of financial statements. Statements of Financial Accounting Standards ("SFAS") are promulgated by the profession's Financial Accounting Standards Board ("FASB"). Other authoritative pronouncements include Statements of Position of the American Institute of Certified Public Accountants ("SOP") and Staff Accounting Bulletins ("SABs"), which represent the views of the SEC staff regarding certain accounting and reporting matters and have the weight of GAAP for public companies' financial statements.

143. Financial statements filed in any documents with the SEC are required by Regulation S-X (17 C.F.R. 210.4-01(a)(1)) to conform to U.S. GAAP. Regulation S-X further provides that financial statements filed with the SEC that are not prepared in compliance with GAAP are presumed to be misleading and inaccurate. Regulation S-K provides direction on the form and content of information, other than financial statements, included in registration statements and other periodic filings with the SEC.

144. The GAAP provisions violated by Defendants, as discussed herein, were not new or untested provisions of GAAP and did not involve complex accounting issues. Additionally, Defendants committed these GAAP violations repeatedly.

145. As set forth in Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Concepts ("SFAC") No. 1, one of the fundamental objectives of financial
Financial reporting should provide information about an enterprise’s financial performance during a period. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investments and credit decisions reflect investors’ and creditors’ expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of enterprise performance.

146. Due to the accounting improprieties alleged herein, including the manipulation of sales data and improperly recognizing revenue so as to meet quarterly sales and revenue projections and targets, Blue Coat presented its financial results and statements in a manner that violated GAAP, including violation of the following fundamental accounting principles:

a. The principle that interim financial reporting should be based upon the same accounting principles and practices used to prepare annual financial statements (APB No. 28);

b. The principle that financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions (Financial Accounting Standards Board Statement of Financial Accounting Concepts “FASCON” No. 1);

c. The principle that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources and effects of transactions, events and circumstances that change resources and claims to those resources (FASCON No. 1);

d. The principle that financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it. To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for
The principle that financial reporting should provide information about an enterprise's financial performance during a period. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' expectations about future enterprise performance, those expectations are commonly based, at least in part, on an evaluation of an enterprise's past performance (FASCON No. 1);

The principle that financial reporting should be reliable in that it represents what it purports to represent. That information should be reliable as well as relevant is a notion that is central to accounting (FASCON No. 2);

The principle of completeness, which means that nothing is left out of the information that may be necessary to insure that it validly represents underlying events and conditions (FASCON No. 2); and

The principle that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered. The best way to avoid injury to investors is to try to ensure that what is reported represents what it purports to represent (FASCON No. 2).

SCIENTER ALLEGATIONS

As alleged herein, Defendants acted with scienter in that Defendants knew that the public documents and statements issued or disseminated in the name of the Company were materially false and misleading; knew that such statements or documents would be issued or disseminated to the investing public; and knowingly and substantially participated or acquiesced in the issuance or dissemination of such statements or documents as primary violations of the federal securities laws. As set forth elsewhere herein in detail, Defendants, by virtue of their
receipt of information reflecting the true facts regarding Blue Coat, their control over, and/or
receipt and/or modification of Blue Coat's allegedly materially misleading misstatements and/or
their associations with the Company, which made them privy to confidential proprietary
information concerning Blue Coat, participated in the fraudulent scheme alleged herein.

**Defendants' Knowledge of the Wrongful Conduct and the Flow of Information**

148. As described herein, the flow of information within the Company, from the sales
levels in all regions straight up to senior management, was open and direct at all relevant times.
As such, members of senior management – including the Individual Defendants – were aware
on a constant basis of the sales and pipeline issues facing the Company, including the
manipulation of the sales data.

149. According to CW6, a former technical consultant and systems engineer based in
the United Kingdom, Blue Coat internally used the sales tracking application on the website
"salesforce.com" as the means of conveying sales information for use in forecasting "up the
chain" to all senior level executives. Salesforce.com, according to its website, is a tool that
conveys information in real time to "accurately forecast future sales." This former Blue Coat
employee explained that, "[t]hey [senior level executives] were well aware of what was going
on. They had to see what was in the pipeline. We were always told to report everything – who
we were seeing, what the projects were, the value of deals … [Chief Executive Officer Brian
NeSmith was]…clued up and knew what he was doing."

150. CW6 explained that he was under pressure to update the sales information on
salesforce.com on a daily basis because "everyone up the chain was looking at this data every
day." As such, according to CW6, it would have been impossible for senior executives to be
unaware of weaknesses in Europe in 2Q 2010 and 3Q 2010 – well before they were publicly
disclosed.

151. Moreover, CW6's supervisor, Graham Henderson, specifically advised him that
management “was reviewing all accounts at all stages and the money deemed to be coming in
from specific accounts, so that they were forecasting on a daily and weekly basis.”
152. According to CW1, a former Blue Coat order administration specialist, director of order management Scott Hashiguchi received revenue forecasts and reports including from EMEA. Armed with this information, Hashiguchi then attended revenue meetings with the Company’s upper management including CEO Brian NeSmith and CFO Gordon Brooks.

153. According to CW2, all EMEA forecasts “flowed up” to the CFO.

154. According to CW4, “[e]very forecast [period], there were specific meetings to look at the revenue lines ... the top line vs. the gross margins and ... the expenses, which would drive the bottom line.” These meetings helped executives determine margins and expected growth. There were several meetings of this nature during each reporting period. CW4 explained, “[i]n general, they did a monthly forecast, and they looked very closely at the end of quarters.” According to CW4, every top level employee (CEO, CFO, CIO, etc.), received a copy of the revenue forecast reports. The meetings were run by CEO Brian NeSmith.

155. CW7 described the forecasting process as “very transparent” for senior management who would have known what was forecasted, what was in the pipeline and what projects needed work in order to close as all information was “rolled up” the line to senior executives. According to CW7, the Company’s senior management “would have known exactly what was going on.” (Emphasis added.)

Insider Trading

156. Defendant Nesmith engaged in insider stock sales during the Class Period, taking advantage of his knowledge that Blue Coat’s stock was trading at artificially inflated prices because of the misrepresentations described above.

157. Plaintiff does not rely primarily on allegations of insider sales to establish scienter. Nevertheless, NeSmith’s unusual stock sales during the Class Period augment the strong inference of scienter pleaded herein as to NeSmith. The following is a chart evidencing the large insider trading conducted by NeSmith during the Class Period:
<table>
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<tr>
<th>INSIDER</th>
<th>DATE</th>
<th>SHARES</th>
<th>PRICE</th>
<th>PROCEEDS</th>
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<tr>
<td>NeSmith Brian M</td>
<td>12/14/09</td>
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<td>3,786</td>
<td>$ 31.64</td>
<td>$ 119,789.04</td>
</tr>
</tbody>
</table>

**TOTAL**       161,002  | $4,939,145.25

158. During the Class Period, NeSmith made over $4.9 million trading Blue Coat stock, selling over 161,000 shares. By contrast, in the six months prior to the Class Period, NeSmith sold 152,000 shares for total proceeds of $2.4 million. NeSmith did not make any of the stock trades in question pursuant to an SEC Rule 10b5-1(c) stock trading plan. With one exception, a single trade in December 2009, NeSmith made no purchases or sales of Blue Coat stock between July 2009 and March 2010.

159. The timing of NeSmith's trades is suspicious. All of NeSmith's direct Class Period trades were made in March 2010, during the last fiscal quarter before the truth emerged. Purchases and sales occurred almost simultaneously, as NeSmith exercised his stock options. He disposed of 116,000 shares in this manner in a two day period in March 2010, making $3.7 million in gross proceeds.

160. NeSmith's insider trading in advance of the revelations of his and the other Defendants' misrepresentations reveals a possible motive NeSmith had in making the misrepresentations at issue and further supports the allegations of scienter against him.

**LOSS CAUSATION/ECONOMIC LOSS**

161. Defendants defrauded Lead Plaintiffs and the Class because their false and misleading statements artificially inflated the price of Blue Coat's stock. The misrepresentations about Blue Coat's expected revenue and growth in the EMEA market caused and maintained artificial inflation in Blue Coat's stock price throughout the Class Period and until the truth was revealed on May 27, 2010. When the market learned about Defendants’...
misrepresentations and fraudulent conduct, Blue Coat’s stock price plummeted as the artificial
inflation dissipated.

162. The disclosure of the truth about Blue Coat’s EMEA business took place after
the stock markets closed on May 27, 2010, with the announcement of Blue Coat’s Fourth
Quarter and Year Ended April 30, 2010 Results and with statements made by NeSmith and
Brooks during the Blue Coat Systems Fourth Quarter Results Conference Call, which also took
place on May 27, 2010.

163. Through these disclosures, Defendants revealed facts that indicate their prior
statements about Blue Coat’s strength in the EMEA market and their stated expectations for
continued revenue growth in the EMEA market had been untrue. In fact, as the May 27, 2010
disclosures revealed, contrary to prior representations, Blue Coat’s EMEA revenues declined in
the fourth quarter and were not expected to improve.

164. Consequently, on May 28, 2010, two research analysts downgraded Blue Coat
stock -- Piper Jaffray & Co. from Overweight to Neutral, and Wells Fargo Securities, LLC from
Outperform to Market Perform. Three other analysts (Wedbush Securities, Inc., Merriman
Curhan Ford & Co. (“Merriman”), and Miller Tabak + Co., LLC (“Miller”)) maintained their
recommendations but lowered their performance expectations for Blue Coat. The analysts
acknowledged that Blue Coat’s poor performance in and guidance for the EMEA market
prompted their lowered valuations. Merriman and Miller noted how anomalous Blue Coat’s
poor European performance was when competitors and other Eurocentric companies had not yet
reported any adverse effects from macroeconomic conditions in the European market.

165. The market reacted swiftly to the revelation of Defendants’ misrepresentations
and fraudulent conduct. On the next trading day after the truth emerged, May 28, 2010, the
price of Blue Coat’s common stock fell from its May 27 closing price of $28.84 to close at
$21.47 on exceptionally heavy trading volume – a loss of over 25%. The trading volume in
Blue Coat stocks on May 28, 2010 exceeded 14 million shares that day alone - over sixteen
times the average trading volume for the preceding twelve months. On June 1, 2010, the second
trading day after the revelations, Blue Coat’s stock closed at a price of $21.15, down over 26%
since the May 27 revelations. Blue Coat’s stock price did not return to its pre-revelation price levels until December 2010.

166. The artificial price inflation caused and maintained by Defendants’ misrepresentations and fraudulent conduct dissipated with these declines in Blue Coat’s stock price and caused real economic loss to investors that purchased Blue Coat stock during the Class Period.

167. The following chart, which was generated on a Bloomberg terminal using normalized pricing data, compares the movement in Blue Coat’s stock price with the movement in the stock prices of its industry peers and in the market generally, during the Class Period and through June 4, 2010 - the week following the May 27, 2010 revelations. Neither Blue Coat’s peers nor the market suffered losses as severe or abrupt as Blue Coat investors did after the revelations.

168. As a result of their purchases of Blue Coat stock during the Class Period, Lead Plaintiff and other Class members suffered economic loss, i.e. damages, under federal securities laws. As Blue Coat’s stock price declined, Lead Plaintiff and the Class suffered corresponding losses directly attributable to the market’s reaction to the disclosure of information previously
misrepresented or concealed by Defendants and to the market's adjustment of Blue Coat's stock price to reflect the newly-revealed truth about the Company's actual condition.

169. The decline in the value of Blue Coat stocks was foreseeable at the time Defendants made their misrepresentations. Defendants knowingly misrepresented the strength of Blue Coat's EMEA business which, when the truth became known, caused Blue Coat's stock price to decline.

APPLICABILITY OF PRESUMPTION OF RELIANCE: FRAUD ON THE MARKET DOCTRINE

170. At all relevant times, the market for Blue Coat common stock was an efficient market for the following reasons, among others:

(a) Blue Coat common stock met the requirements for listing, and was listed and actively traded on the NASDAQ, a highly efficient and automated market;

(b) as a regulated issuer, Blue Coat filed periodic public reports with the SEC and the NASDAQ;

(c) Blue Coat regularly communicated with public investors via established market communication mechanisms, including regular disseminations of press releases on the national circuits of major newswire services and other wide-ranging public disclosures, such as communications with the financial press and other similar reporting services; and

(d) Blue Coat was followed by several securities analysts employed by major brokerage firms who wrote reports which were distributed to the sales force and certain customers of their respective brokerage firms. Each of these reports was publicly available and entered the public marketplace.

171. As a result of the foregoing, the market for Blue Coat common stock was open, well-developed and efficient, and promptly digested current information regarding Blue Coat from all publicly available sources and reflected such information in the prices of the stock.
172. As a result of the materially false and misleading statements and omissions
detailed herein, Blue Coat common stock traded at artificially inflated prices during the Class
Period. Plaintiff and other members of the Class purchased or otherwise acquired Blue Coat
common stock relying upon the integrity of the market price of Blue Coat common stock and
market information relating to Blue Coat, and have been damaged thereby.

NO SAFE HARBOR

173. The statutory safe harbor provided for forward-looking statements under certain
circumstances does not apply to any of the allegedly false statements pleaded in this Complaint.
Many of the specific statements pleaded herein were not identified as "forward-looking
statements" when made. To the extent there were any forward-looking statements, there were no
meaningful cautionary statements identifying important factors that could cause actual results to
differ materially from those in the purportedly forward-looking statements. Alternatively, to the
extent that the statutory safe harbor does apply to any forward-looking statements pleaded
herein, Defendants are liable for those false forward-looking statements because at the time
each of those forward-looking statements were made, the particular speaker knew that the
particular forward-looking statement was false, and/or the forward-looking statement was
authorized and/or approved by an executive officer of Blue Coat who knew that those
statements were false when made.

COUNT I

Violation of Section 10(b) of the Exchange Act and Rule 10b-5
Promulgated Thereunder Against All Defendants

174. Plaintiff repeats and realleges each and every allegation contained above as if
fully set forth herein.

175. During the Class Period, Defendants disseminated or approved the materially
false and misleading statements specified above, which they knew or deliberately disregarded
were misleading in that they contained misrepresentations and failed to disclose material facts
necessary in order to make the statements made, in light of the circumstances under which they
were made, not misleading.
176. Defendants: (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of material fact and/or omitted to state material facts necessary to make the statements not misleading; and (c) engaged in acts, practices, and a course of business which operated as a fraud and deceit upon the purchasers of the Company’s common stock during the Class Period.

177. Plaintiff and the Class have suffered damages in that, in reliance on the integrity of the market, they paid artificially inflated prices for Blue Coat common stock. Plaintiff and the Class would not have purchased Blue Coat common stock at the prices they paid, or at all, if they had been aware that the market prices had been artificially and falsely inflated by Defendants’ misleading statements.

178. As a direct and proximate result of Defendants’ wrongful conduct, Plaintiff and the other members of the Class suffered damages in connection with their purchases of Blue Coat common stock during the Class Period.

COUNT II

Violation of Section 20(a) of the Exchange Act
Against the Individual Defendants

179. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

180. The Individual Defendants acted as controlling persons of Blue Coat within the meaning of Section 20(a) of the Exchange Act as alleged herein. By reason of their positions as officers and/or directors of Blue Coat, and their ownership of Blue Coat stock, the Individual Defendants had the power and authority to cause Blue Coat to engage in the wrongful conduct complained of herein. By reason of such conduct, the Individual Defendants are liable pursuant to Section 20(a) of the Exchange Act.

PRAYER

WHEREFORE, Plaintiff prays for relief and judgment, as follows:

A. Determining that this action is a class action properly maintained pursuant to Rule 23 of the Federal Rules of Civil Procedure and Plaintiff’s counsel as Lead Counsel;
B. Awarding compensatory damages in favor of Plaintiff and the other Class members against all Defendants, jointly and severally, for all damages sustained as a result of Defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

C. Awarding Plaintiff and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

D. Such other and further relief as the Court may deem just and proper.

JURY TRIAL DEMANDED

Plaintiff hereby demands a trial by jury.

DATED: February 17, 2012

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CERTIFICATE OF SERVICE

I, Leslie R. Cuesta, hereby declare as follows:

I am employed by Berman DeValerio, One California Street, Suite 900, San Francisco, California, 94111. I am over the age of 18 years and am not a party to this action. On February 17, 2012, using the Northern District of California’s Electronic Case Filing System (“ECF”), with the ECF ID registered to Nicole Lavallee, and at her direction, I filed and served true and correct copies of the document(s) described as follows:

AMENDED COMPLAINT FOR VIOLATIONS OF THE FEDERAL SECURITIES LAWS

The ECF System is designed to automatically generate an e-mail message to all parties in the case, which constitutes service.

I further declare that on February 17, 2012, I served true and correct copies of the document(s) listed above on the following attorneys and/or parties, who are not on the list to receive e-mail notices for this case, by placing true copies thereof, enclosed in a sealed envelope, addressed as shown below, affixing proper first class postage, and depositing the envelope in the United States Mail at San Francisco, California, in accordance with Berman DeValerio’s ordinary business practices:

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I declare under penalty of perjury pursuant to the laws of the United States that the foregoing is true and correct.  

Executed at San Francisco, California, on February 17, 2012.  

Leslie R. Cuesta

[CV 11-04293 (RS)] AMENDED COMPLAINT FOR VIOLATIONS OF THE FEDERAL SEC. LAWS