

WEBSENSE INC

FORM 10-Q/A (Amended Quarterly Report)

Filed 10/29/09 for the Period Ending 03/31/09

Address	10240 SORRENTO VALLEY RD SAN DIEGO, CA 92121
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

**FORM 10-Q/A
(Amendment No. 1)**

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

For the quarterly period ended March 31, 2009

OR

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

For the Transition Period from _____ to _____

Commission File Number 000-30093

Websense, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

51-0380839
(I.R.S. Employer Identification No.)

**10240 Sorrento Valley Road
San Diego, California 92121
858-320-8000**

(Address of principal executive offices, zip code and telephone number, including area code)

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

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

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller reporting company
(Do not check if a smaller reporting company)

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

The number of shares outstanding of the registrant's Common Stock, \$.01 par value, as of April 30, 2009 was 44,272,393.

EXPLANATORY NOTE

On September 14, 2009, the audit committee of the board of directors of Websense, Inc. (the “Company,” sometimes referred to as “we”, “us” or “our”), upon the identification by and recommendation of management, concluded that the previously issued financial statements contained in our annual reports on Form 10-K for the years ended December 31, 2007 and 2008, and our quarterly reports on Form 10-Q for the quarters ended March 31, 2008, June 30, 2008, September 30, 2008, March 31, 2009 and June 30, 2009 should no longer be relied upon because of errors in those financial statements, and that we would restate these financial statements to make the necessary accounting corrections.

This Amendment No. 1 on Form 10-Q/A to the Company’s Quarterly Report on Form 10-Q for the quarter ended March 31, 2009 includes restated unaudited consolidated financial statements as of and for the quarters ended March 31, 2008 and 2009. In addition, we are concurrently filing a Form 10-K/A to amend and restate our consolidated financial statements for the annual periods in fiscal years 2007 through 2008 (including restated financial information as of and for the interim periods contained therein), and a Form 10-Q/A to amend and restate our consolidated financial statements for the quarterly periods ended June 30, 2008 and 2009.

The restatement principally relates to an error in the method of recognizing royalty revenue relating to contracts with original equipment manufacturer (“OEM”) customers, who embed our software in their products for resale and provide services in the form of updates that primarily consist of database updates to our Web filtering products. All of these contracts were acquired in connection with the acquisition of SurfControl plc (“SurfControl”) in October 2007. The restated consolidated financial statements also include other adjustments that were identified but not previously recorded, as it had been determined that they were not material, either individually or in the aggregate. While none of these other adjustments were individually material, they are being made as part of the restatement process. See Note 2 to the Company’s unaudited consolidated financial statements included in “Part I Financial Information — Item 1.” of this report for additional information. Management determined whether the amounts involved were material under Staff Accounting Bulletin No. 99, *Materiality* (“SAB 99”), and Staff Accounting Bulletin No. 108, *Considering Effects of Prior Misstatements When Quantifying Misstatements in Current Year Financial Statements* (“SAB 108”), for one or more periods. Management determined that the adjustments necessary to properly state revenues were material for the years ended December 31, 2008 and 2007, the interim periods within fiscal 2008, the fourth quarter of 2007 and the first and second quarters of 2009. Accordingly, management recommended to the Audit Committee that a restatement was required.

In connection with the restatement, management has assessed the effectiveness of our disclosure controls and procedures and has included revised disclosure in this Form 10-Q/A under Item 4 of Part I, “Controls and Procedures.” Management identified material weaknesses in the Company’s internal control over financial reporting with respect to our misapplication of U.S. generally accepted accounting principles on revenue recognition of our OEM contracts which were acquired in connection with the acquisition of SurfControl in October 2007 and our error in our computation of our income tax benefit for the year ended December 31, 2008, as described in our Form 10-K/A for the year ended December 31, 2008, under Item 9A of Part II in “Management’s Report on Internal Control over Financial Reporting (Restated).” Solely as a result of these material weaknesses, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective at a reasonable assurance level as of December 31, 2008 and through the date of this filing. As of the date of this Form 10-Q/A, we have adopted a revenue recognition methodology that management believes complies with the requirements of U.S. generally accepted accounting principles and we have corrected our computational mistake on our fiscal 2008 income tax benefit. Management has taken and is taking steps, as described in Item 4 of Part I in “Management’s Remediation Initiatives,” to remediate the material weakness in our internal control over financial reporting. We believe that, as a result of management’s in-depth review of its accounting processes, the utilization of external resources and the additional procedures management has implemented, there are no material inaccuracies or omissions of material fact in this Form 10-Q/A and, to the best of our knowledge, we believe that the consolidated financial statements in this Form 10-Q/A fairly present in all material aspects the financial condition, results of operations and cash flows of the Company in conformity with U.S. generally accepted accounting principles.

The Company has amended and restated in its entirety each item of the Original Form 10-Q filed with the Securities and Exchange Commission (“SEC”) on May 7, 2009 (the “Original Filing Date”) that required a change to reflect this restatement and to include certain additional information. These items include Items 1, 2 and 4 of Part I and Item 1A of Part II. The Company has supplemented Item 6 of Part II to include current certifications of our Chief Executive Officer and Chief Financial Officer pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act of 2002, included as Exhibits 31 and 32 to this Amendment. No other information included in the original Form 10-Q is amended hereby.

Pursuant to Rule 12b-15 under the Securities Exchange Act of 1934, as amended, this Amendment contains only the items and exhibits to the Original Form 10-Q that are being amended and restated, and those unaffected items or exhibits are not included herein. Except as stated above, this Amendment speaks only as of the Original Filing Date, and this filing has not been updated to reflect any events occurring after the Original Filing Date or to modify or update disclosure affected by other subsequent events. In particular, forward-looking statements included in this Amendment represent management’s views as of the Original Filing Date. Such forward-looking statements should not be assumed to be accurate as of any future date. This Amendment should be read in conjunction with the Company’s other filings made with the SEC subsequent to the Original Filing Date, together with any amendments to those filings.

As previously disclosed in the Company’s Form 8-K filed on September 15, 2009, the Company’s unaudited quarterly consolidated financial statements and the Company’s audited consolidated financial statements previously included in the original Form 10-Q filed on May 7, 2009, should not be relied upon.

Table of Contents

**Websense, Inc.
Form 10-Q/A
(Amendment No. 1)
For the Quarterly Period Ended March 31, 2009**

TABLE OF CONTENTS

	<u>Page</u>
Part I. Financial Information	
Item 1. Consolidated Financial Statements (Unaudited)	
Consolidated Balance Sheets as of March 31, 2009 (as restated) and December 31, 2008	4
Consolidated Statements of Operations for the three months ended March 31, 2009 and 2008 (as restated)	5
Consolidated Statement of Stockholders' Equity for the three months ended March 31, 2009 (as restated)	6
Consolidated Statements of Cash Flows for the three months ended March 31, 2009 and 2008 (as restated)	7
Notes to Consolidated Financial Statements	8
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	22
Item 4. Controls and Procedures	32
Part II. Other Information	
Item 1A. Risk Factors	34
Item 6. Exhibits	47
Signatures	48

Table of Contents

Part I – Financial Information

Item 1. Consolidated Financial Statements (Unaudited)

Websense, Inc.
Consolidated Balance Sheets
(Unaudited and in thousands)

	March 31, 2009 (Unaudited) (As Restated) (See Note 2)	December 31, 2008
Assets		
Current assets:		
Cash and cash equivalents	\$ 74,182	\$ 64,096
Cash and cash equivalents – restricted	1,774	2,500
Accounts receivable, net	48,651	82,099
Prepaid income taxes	10,909	10,927
Current portion of deferred income taxes	34,529	34,198
Other current assets	9,149	9,029
Total current assets	179,194	202,849
Cash and cash equivalents – restricted, less current portion	42	215
Property and equipment, net	15,338	14,312
Intangible assets, net	96,657	106,493
Goodwill	372,624	372,624
Deferred income taxes, less current portion	27,274	24,237
Deposits and other assets	3,421	3,933
Total assets	<u>\$ 694,550</u>	<u>\$ 724,663</u>
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 3,607	\$ 2,719
Accrued compensation and related benefits	16,401	19,129
Other accrued expenses	26,472	27,946
Current portion of income taxes payable	11,022	7,135
Current portion of senior secured term loan	7,418	4,112
Current portion of deferred tax liability	685	1,053
Current portion of deferred revenue	217,267	223,944
Total current liabilities	282,872	286,038
Other long term liabilities	2,006	2,616
Income taxes payable, less current portion	10,432	10,098
Senior secured term loan, less current portion	102,582	120,888
Deferred tax liability, less current portion	8,840	10,523
Deferred revenue, less current portion	113,966	117,840
Total liabilities	520,698	548,003
Stockholders' equity:		
Common stock	523	522
Additional paid-in capital	305,608	300,050
Treasury stock, at cost	(167,427)	(159,842)
Retained earnings	38,026	39,113
Accumulated other comprehensive loss	(2,878)	(3,183)
Total stockholders' equity	173,852	176,660
Total liabilities and stockholders' equity	<u>\$ 694,550</u>	<u>\$ 724,663</u>

See accompanying notes.

Table of Contents

Websense, Inc.
Consolidated Statements of Operations
(Unaudited) (in thousands, except per share amounts)

	Three Months Ended	
	March 31, 2009	March 31, 2008
	(As Restated) (See Note 2)	(As Restated) (See Note 2)
Revenue	\$ 77,567	\$ 65,120
Cost of revenues:		
Cost of revenues	8,575	8,807
Amortization of acquired technology	3,256	3,072
Total cost of revenues	11,831	11,879
Gross margin	65,736	53,241
Operating expenses:		
Selling and marketing	39,893	42,916
Research and development	12,846	13,503
General and administrative	11,161	12,868
Total operating expenses	63,900	69,287
Income (loss) from operations	1,836	(16,046)
Interest expense	(2,212)	(4,432)
Other income (expense), net	357	(79)
Loss before income taxes	(19)	(20,557)
Provision (benefit) for income taxes	1,068	(13,856)
Net loss	<u>\$ (1,087)</u>	<u>\$ (6,701)</u>
Net loss per share:		
Basic and diluted net loss per share	<u>\$ (0.02)</u>	<u>\$ (0.15)</u>
Weighted average shares – basic and diluted	<u>44,825</u>	<u>45,395</u>

See accompanying notes.

Websense, Inc.
Consolidated Statement of Stockholders' Equity
(Unaudited and in thousands)

	Common stock		Additional paid-in capital (As Restated) (See Note 2)	Treasury stock	Retained earnings (As Restated) (See Note 2)	Accumulated other comprehensive loss	Total stockholders' equity (As Restated) (See Note 2)
	Shares	Amount					
Balance at December 31, 2008	45,048	\$ 522	\$ 300,050	\$(159,842)	\$ 39,113	\$ (3,183)	\$ 176,660
Issuance of common stock upon exercise of options	11	—	26	—	—	—	26
Issuance of common stock from restricted stock units, net	32	1	—	(85)	—	—	(84)
Share-based compensation expense (as restated – See Note 2)	—	—	6,157	—	—	—	6,157
Tax shortfall from stock option exercises	—	—	(625)	—	—	—	(625)
Purchase of treasury stock	(649)	—	—	(7,500)	—	—	(7,500)
Other comprehensive loss:							
Net loss (as restated – See Note 2)	—	—	—	—	(1,087)	—	(1,087)
Net change in unrealized gain on derivative contracts, net of tax	—	—	—	—	—	305	305
Comprehensive loss (as restated – See Note 2)							(782)
Balance at March 31, 2009 (as restated – See Note 2)	<u>44,442</u>	<u>\$ 523</u>	<u>\$ 305,608</u>	<u>\$(167,427)</u>	<u>\$ 38,026</u>	<u>\$ (2,878)</u>	<u>\$ 173,852</u>

See accompanying notes.

Table of Contents

Websense, Inc. Consolidated Statements of Cash Flows (Unaudited and in thousands)

	Three Months Ended	
	March 31, 2009 (As Restated) (See Note 2)	March 31, 2008 (As Restated) (See Note 2)
Operating activities:		
Net loss	\$ (1,087)	\$ (6,701)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	12,904	16,064
Share-based compensation	6,157	6,247
Deferred income taxes	(5,676)	(19,050)
Unrealized (gain) loss on foreign exchange	(436)	640
Tax shortfall from stock option exercises	625	—
Changes in operating assets and liabilities:		
Accounts receivable	33,775	28,916
Other assets	(574)	112
Accounts payable	1,187	(3,073)
Accrued compensation and related benefits	(2,841)	(7,826)
Other liabilities	(998)	(2,448)
Deferred revenue	(10,550)	3,555
Income taxes payable	3,692	2,473
Net cash provided by operating activities	<u>36,178</u>	<u>18,909</u>
Investing activities:		
Change in restricted cash and cash equivalents	913	(1,240)
Purchase of property and equipment	(3,402)	(2,388)
Purchase of intangible assets	—	(375)
Cash refunded from PortAuthority acquisition	—	147
Cash received from sale of CyberPatrol assets	—	1,400
Purchases of marketable securities	—	(20,160)
Maturities of marketable securities	—	39,323
Net cash (used in) provided by investing activities	<u>(2,489)</u>	<u>16,707</u>
Financing activities:		
Principal payments on senior secured term loan	(15,000)	(30,000)
Proceeds from exercise of stock options	26	224
Tax shortfall from stock option exercises	(625)	—
Purchase of treasury stock	(7,027)	(2,797)
Net cash used in financing activities	<u>(22,626)</u>	<u>(32,573)</u>
Effect of exchange rate changes on cash and cash equivalents	(977)	391
Increase in cash and cash equivalents	10,086	3,434
Cash and cash equivalents at beginning of period	64,096	66,090
Cash and cash equivalents at end of period	<u>\$ 74,182</u>	<u>\$ 69,524</u>
Supplemental disclosures of cash flow information:		
Income taxes paid	\$ 3,021	\$ 1,105
Interest paid	\$ 1,773	\$ 3,391
Increase in other accrued expenses for purchase of treasury stock	\$ 473	\$ 2,201

See accompanying notes.

Websense, Inc.

Notes To Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with United States generally accepted accounting principles (“GAAP”) for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain information or footnote disclosures normally included in complete financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the statements include all adjustments necessary, which are of a normal and recurring nature other than the normal recurring adjustments associated with the restatement adjustments described in Note 2, for the fair presentation of our financial position and results of operations for the interim periods presented.

These financial statements should be read in conjunction with the audited consolidated financial statements and notes for the fiscal year ended December 31, 2008, included in Websense, Inc.’s (“Websense” or the “Company”) Amendment No. 1 to Annual Report on Form 10-K/A filed with the Securities and Exchange Commission. Operating results for the three months ended March 31, 2009 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending December 31, 2009. The balance sheet at December 31, 2008 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. Certain prior period amounts have been reclassified to conform to the current period presentation.

2. Restatement of Previously Reported Consolidated Financial Statements

The Company has restated its historical consolidated financial statements as of March 31, 2009 and for the three months ended March 31, 2009 and 2008, included in this report.

The determination to restate these consolidated financial statements and quarterly consolidated financial statements was made by the Company’s Audit Committee upon management’s recommendation following the identification of errors related to the Company’s recording of royalty revenue related to OEM contracts which were acquired in connection with the acquisition of SurfControl in October 2007. The general nature and scope of the related errors and adjustments are summarized as follows:

- *Errors in the Timing of Recognition of OEM Revenue (“OEM Revenue — Timing Adjustments”)* — The Company identified errors relating to the timing of royalty revenue recognition from OEM contracts which were acquired in connection with the acquisition of SurfControl in October 2007. Since the SurfControl acquisition, the Company had been recognizing the reported royalty revenue in the same period that it billed the OEM for reported resale transactions of the Company’s products to the OEM’s end users. Because the Company has a continuing obligation to provide service in the form of software updates, technical support and database updates to the Company’s Web filtering products to the OEM during a contractual period of time, the Company has determined that the royalty revenue reported in each respective reporting period should have been recognized ratably over the then remaining contractual period of time for which it has an obligation to the OEM. These errors resulted in an overstatement of revenue of approximately \$3.4 million and \$1.9 million for the quarters ended March 31, 2009 and 2008, respectively.

Table of Contents

- Other Non-Material Items (“Other Adjustments”)** — The Company identified other errors that were not material, individually or in the aggregate, to its financial statements taken as a whole. However, because the Company is restating its financial statements for the effects of the items noted above, the Company revised its previously reported financial statements to correct all identified errors, including those that were not material. These items resulted in a net (overstatement) understatement of pre-tax income of \$(265,000) and \$12,000 for the quarters ended March 31, 2009 and 2008, respectively and supplemental details are as follows:

Description	Under- (Over-) statement of pre-tax income	
	Three Months Ended	Three Months Ended
	March 31, 2009	March 31, 2008
Correction of preacquisition deferred revenue	\$ —	\$ 75
Correction of foreign currency gain/loss	—	30
Share-based compensation adjustment related to modification in Employee Stock Purchase Plan (ESPP)	(13)	(80)
Correction of revenue for a contract with a grace period	(42)	—
Correction of accrued expenses	(210)	(13)
Total	<u>\$ (265)</u>	<u>\$ 12</u>

The Company is also restating its income tax provisions for the historical periods described above to reflect the tax impact of the above adjustments to pre-tax income as well as some other tax provision errors. The Company’s assessment of its annual effective tax rate has been adjusted to reflect the above adjustments resulting in a revised annual effective tax rate. The income tax adjustments are summarized below:

Description	Increase (Decrease) to	Increase (Decrease) to
	Income Tax Provision for	Income Tax Benefit for
	Three Months Ended	Three Months Ended
	March 31, 2009	March 31, 2008
Impact of OEM revenue – timing adjustment	\$ (1,318)	\$ (767)
Reverse valuation allowance for OEM revenue adjustment	—	(453)
Impact of California law change on deferred taxes	372	—
Transfer pricing adjustment	146	—
Interim tax provision accounting adjustment	(6,044)	(43)
Interperiod reclassification of tax on share-based compensation	—	(558)
Interperiod reclassification of tax exempt interest benefit	—	358
Total	<u>\$ (6,844)</u>	<u>\$ (1,463)</u>

Table of Contents

The following tables present the adjustments due to the restatements of the Company's previously issued consolidated balance sheet as of March 31, 2009, consolidated statements of operations and consolidated statements of cash flows for the three months ended March 31, 2009 and 2008:

	Consolidated Balance Sheet March 31, 2009		
	Previously Reported	Adjustments	As Restated
	(Unaudited and in thousands)		
Assets			
Current assets:			
Cash and cash equivalents	\$ 74,396	\$ (214)	\$ 74,182
Cash and cash equivalents – restricted	1,774	—	1,774
Accounts receivable, net	48,583	68	48,651
Prepaid income taxes	3,706	7,203	10,909
Current portion of deferred income taxes	33,066	1,463	34,529
Other current assets	9,149	—	9,149
Total current assets	<u>170,674</u>	<u>8,520</u>	<u>179,194</u>
Cash and cash equivalents – restricted, less current portion	—	42	42
Property and equipment, net	15,338	—	15,338
Intangible assets, net	96,657	—	96,657
Goodwill	374,410	(1,786)	372,624
Deferred income taxes, less current portion	23,203	4,071	27,274
Deposits and other assets	3,421	—	3,421
Total assets	<u>\$ 683,703</u>	<u>\$ 10,847</u>	<u>\$ 694,550</u>
Liabilities and stockholders' equity			
Current liabilities:			
Accounts payable	\$ 3,607	—	\$ 3,607
Accrued compensation and related benefits	16,305	96	16,401
Other accrued expenses	26,808	(336)	26,472
Current portion of income taxes payable	17,647	(6,625)	11,022
Current portion of senior secured term loan	7,418	—	7,418
Current portion of deferred tax liability	685	—	685
Current portion of deferred revenue	212,974	4,293	217,267
Total current liabilities	<u>285,444</u>	<u>(2,572)</u>	<u>282,872</u>
Other long term liabilities	2,007	(1)	2,006
Income taxes payable, less current portion	10,211	221	10,432
Senior secured term loan, less current portion	102,582	—	102,582
Deferred tax liability, less current portion	8,840	—	8,840
Deferred revenue, less current portion	105,826	8,140	113,966
Total liabilities	<u>514,910</u>	<u>5,788</u>	<u>520,698</u>
Stockholders' equity:			
Common stock	523	—	523
Additional paid-in capital	305,202	406	305,608
Treasury stock, at cost	(167,427)	—	(167,427)
Retained earnings	33,642	4,384	38,026
Accumulated other comprehensive loss	(3,147)	269	(2,878)
Total stockholders' equity	<u>168,793</u>	<u>5,059</u>	<u>173,852</u>
Total liabilities and stockholders' equity	<u>\$ 683,703</u>	<u>\$ 10,847</u>	<u>\$ 694,550</u>

Table of Contents

Consolidated Statement of Operations						
Three Months Ended March 31, 2009						
	<u>Previously</u>	<u>OEM Revenue –</u>	<u>Other</u>	<u>Income Tax</u>	<u>As</u>	
	<u>Reported</u>	<u>Timing Adjustments</u>	<u>Adjustments</u>	<u>Adjustments</u>	<u>Restated</u>	
		<small>(Unaudited) (In thousands, except per share amounts)</small>				
Revenue	\$ 80,980	\$ (3,371)	\$ (42)	\$ —	\$77,567	
Cost of revenues:						
Cost of revenues	8,575	—	—	—	8,575	
Amortization of acquired technology	3,256	—	—	—	3,256	
Total cost of revenues	<u>11,831</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>11,831</u>	
Gross margin	69,149	(3,371)	(42)	—	65,736	
Operating expenses:						
Selling and marketing	39,832	—	61	—	39,893	
Research and development	12,843	—	3	—	12,846	
General and administrative	11,002	—	159	—	11,161	
Total operating expenses	<u>63,677</u>	<u>—</u>	<u>223</u>	<u>—</u>	<u>63,900</u>	
Income (loss) from operations	5,472	(3,371)	(265)	—	1,836	
Interest expense	(2,212)	—	—	—	(2,212)	
Other income, net	357	—	—	—	357	
Income (loss) before income taxes	3,617	(3,371)	(265)	—	(19)	
Provision (benefit) for income taxes	7,912	—	—	(6,844)	1,068	
Net (loss) income	<u>\$ (4,295)</u>	<u>\$ (3,371)</u>	<u>\$ (265)</u>	<u>\$ 6,844</u>	<u>\$ (1,087)</u>	
Net (loss) income per share:						
Basic and diluted net (loss) income per share	<u>\$ (0.10)</u>				<u>\$ (0.02)</u>	
Weighted average shares – basic and diluted	<u>44,825</u>				<u>44,825</u>	

Table of Contents

Consolidated Statement of Cash Flows			
Three Months Ended March 31, 2009			
Previously			
	<u>Reported</u>	<u>Adjustments</u>	<u>As Restated</u>
	(Unaudited and in thousands)		
Operating activities:			
Net (loss) income	\$ (4,295)	\$ 3,208	\$ (1,087)
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Depreciation and amortization	12,904	—	12,904
Share-based compensation	6,144	13	6,157
Deferred income taxes	(4,360)	(1,316)	(5,676)
Unrealized gain on foreign exchange	(436)	—	(436)
Tax shortfall from stock option exercises	625	—	625
Changes in operating assets and liabilities:			
Accounts receivable	33,775	—	33,775
Other assets	(574)	—	(574)
Accounts payable	1,187	—	1,187
Accrued compensation and related benefits	(2,895)	54	(2,841)
Other liabilities	(1,154)	156	(998)
Deferred revenue	(13,963)	3,413	(10,550)
Income taxes payable	9,220	(5,528)	3,692
Net cash provided by operating activities	<u>36,178</u>	<u>—</u>	<u>36,178</u>
Investing activities:			
Change in restricted cash and cash equivalents	913	—	913
Purchase of property and equipment	(3,402)	—	(3,402)
Net cash used in investing activities	<u>(2,489)</u>	<u>—</u>	<u>(2,489)</u>
Financing activities:			
Principal payments on senior secured term loan	(15,000)	—	(15,000)
Proceeds from exercise of stock options	26	—	26
Tax shortfall from stock option exercises	(625)	—	(625)
Purchase of treasury stock	(7,027)	—	(7,027)
Net cash used in financing activities	<u>(22,626)</u>	<u>—</u>	<u>(22,626)</u>
Effect of exchange rate changes on cash and cash equivalents	(977)	—	(977)
Increase in cash and cash equivalents	10,086	—	10,086
Cash and cash equivalents at beginning of period	64,310	(214)	64,096
Cash and cash equivalents at end of period	<u>\$ 74,396</u>	<u>\$ (214)</u>	<u>\$ 74,182</u>
Supplemental disclosures of cash flow information:			
Income taxes paid	\$ 2,649	\$ 372	\$ 3,021
Interest paid	\$ 1,773	\$ —	\$ 1,773
Increase in other accrued expenses for purchase of treasury stock	\$ 473	\$ —	\$ 473

Table of Contents

Consolidated Statement of Operations Three Months Ended March 31, 2008

	Previously <u>Reported</u>	OEM Revenue – <u>Timing Adjustments</u> (Unaudited) (In thousands, except per share amounts)	Other <u>Adjustments</u>	Income Tax <u>Adjustments</u>	<u>As Restated</u>
Revenues	\$ 66,984	\$ (1,939)	\$ 75	\$ —	\$ 65,120
Cost of revenues:					
Cost of revenues	8,867	—	(60)	—	8,807
Amortization of acquired technology	3,072	—	—	—	3,072
Total cost of revenues	11,939	—	(60)	—	11,879
Gross margin	55,045	(1,939)	135	—	53,241
Operating expenses:					
Selling and marketing	42,821	—	95	—	42,916
Research and development	13,460	—	43	—	13,503
General and administrative	12,853	—	15	—	12,868
Total operating expenses	69,134	—	153	—	69,287
Loss from operations	(14,089)	(1,939)	(18)	—	(16,046)
Interest expense	(4,432)	—	—	—	(4,432)
Other (expense) income, net	(109)	—	30	—	(79)
(Loss) income before income taxes	(18,630)	(1,939)	12	—	(20,557)
Benefit for income taxes	(12,393)	—	—	(1,463)	(13,856)
Net (loss) income	<u>\$ (6,237)</u>	<u>\$ (1,939)</u>	<u>\$ 12</u>	<u>\$ 1,463</u>	<u>\$ (6,701)</u>
Net loss per share:					
Basic and diluted net loss per share	<u>\$ (0.14)</u>				<u>\$ (0.15)</u>
Weighted average shares – basic and diluted	<u>45,395</u>				<u>45,395</u>

Table of Contents

Consolidated Statement of Cash Flows			
Three Months Ended March 31, 2008			
	Previously		
	Reported	Adjustments	As Restated
	(Unaudited and in thousands)		
Operating activities:			
Net loss	\$ (6,237)	\$ (464)	\$ (6,701)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	16,064	—	16,064
Share-based compensation	6,168	79	6,247
Deferred income taxes	(18,241)	(809)	(19,050)
Unrealized loss (gain) on foreign exchange	670	(30)	640
Changes in operating assets and liabilities:			
Accounts receivable	28,916	—	28,916
Other assets	112	—	112
Accounts payable	(3,073)	—	(3,073)
Accrued compensation and related benefits	(7,826)	—	(7,826)
Other liabilities	(2,462)	14	(2,448)
Deferred revenue	1,691	1,864	3,555
Income taxes payable	3,127	(654)	2,473
Net cash provided by operating activities	<u>18,909</u>	<u>—</u>	<u>18,909</u>
Investing activities:			
Change in restricted cash and cash equivalents	—	(1,240)	(1,240)
Purchase of property and equipment	(2,388)	—	(2,388)
Cash paid for purchased technology (intangible asset)	(375)	—	(375)
Cash refunded from acquisition of PortAuthority	147	—	147
Cash received from sale of CyberPatrol assets	1,400	—	1,400
Purchases of marketable securities	(20,160)	—	(20,160)
Maturities of marketable securities	39,323	—	39,323
Net cash provided by (used in) investing activities	<u>17,947</u>	<u>(1,240)</u>	<u>16,707</u>
Financing activities:			
Principal payments on senior secured term loan	(30,000)	—	(30,000)
Proceeds from exercise of stock options	224	—	224
Purchase of treasury stock	(2,797)	—	(2,797)
Net cash used in financing activities	<u>(32,573)</u>	<u>—</u>	<u>(32,573)</u>
Effect of exchange rate changes on cash and cash equivalents	371	20	391
Increase in cash and cash equivalents	4,654	(1,220)	3,434
Cash and cash equivalents at beginning of period	66,383	(293)	66,090
Cash and cash equivalents at end of period	<u>\$ 71,037</u>	<u>\$ (1,513)</u>	<u>\$ 69,524</u>
Supplemental disclosures of cash flow information:			
Income taxes paid	\$ 773	\$ 332	\$ 1,105
Interest paid	\$ 3,391	\$ —	\$ 3,391
Increase in other accrued expenses for purchase of treasury stock	\$ 2,201	\$ —	\$ 2,201

Table of Contents

3. Net Income (Loss) Per Share

Websense computes net income (loss) per share (“EPS”) as permitted by the Financial Accounting Standards Board (“FASB”) with Statement of Financial Accounting Standards (“SFAS”) No. 128, *Earnings Per Share* (“SFAS 128”). Under the provisions of SFAS 128, basic EPS is computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted EPS is computed by dividing the net income for the period by the weighted average number of common and common equivalent shares outstanding during the period. Common equivalent shares consist of dilutive stock options and restricted stock units. Dilutive stock options and dilutive restricted stock units are calculated based on the average share price for each fiscal period using the treasury stock method. In accordance with SFAS 128, if, however, the Company reports a net loss, the diluted EPS is computed in the same manner as the basic EPS.

As the Company reported a net loss for the three months ended March 31, 2009 and 2008, basic and diluted EPS were the same. Potentially dilutive securities totaling approximately 10,372,000 and 8,272,000 shares for the three months ended March 31, 2009 and 2008, respectively, were excluded from the diluted EPS calculation because of their anti-dilutive effect.

4. Comprehensive Loss

The components of comprehensive loss, as required to be reported by SFAS No. 130, *Reporting Comprehensive Income*, were as follows (in thousands):

	Three Months Ended	
	March 31, 2009 (As Restated)	March 31, 2008 (As Restated)
Net loss	\$ (1,087)	\$ (6,701)
Net change in unrealized gain (loss) on derivative contracts, net of tax of \$(243) and \$723, respectively	305	(1,084)
Translation adjustment	—	(476)
Comprehensive loss	<u>\$ (782)</u>	<u>\$ (8,261)</u>

The accumulated derivative gain (loss), net of tax, on the Company’s derivative contracts included in “Accumulated other comprehensive loss” were as follows (in thousands):

	Three Months Ended	
	March 31, 2009 (As Restated)	March 31, 2008 (As Restated)
Beginning balance	\$ (1,559)	\$ (998)
Net change during the period	305	(1,084)
Ending balance	<u>\$ (1,254)</u>	<u>\$ (2,082)</u>

Table of Contents

5. Acquisitions

In October 2007, the Company completed the acquisition of SurfControl, a U.K. based provider of Web and email security solutions for approximately \$460.9 million. The purchase price was allocated as follows: \$157.8 million to amortizable intangible assets, \$0.4 million to net tangible liabilities assumed and the remaining \$303.5 million to goodwill. In connection with the acquisition, the Company's management approved plans to exit certain SurfControl facilities. As of March 31, 2009, \$2.1 million of facility exit obligations remain accrued for payments in future periods as follows (in thousands):

	Balance at December 31, 2008	Cash Payments	Charged to Expense	Balance at March 31, 2009
Facility exit costs	\$ 2,243	\$ (204)	\$ 32	\$ 2,071

During the fourth quarter of 2008, the Company completed integration activities with two historic SurfControl subsidiaries that had functional currencies other than the U.S. dollar. As a result of the completion of the integration activities, the Company reassessed the functional currency designation of the subsidiaries and determined that a change in functional currency designation to the U.S. dollar was appropriate. The change in functional currency designation was made prospectively effective as of the beginning of fiscal 2009.

6. Intangible Assets

Intangible assets subject to amortization consisted of the following as of March 31, 2009 (in thousands):

	Weighted Average Life (years)	Cost	Accumulated Amortization	Net
Technology	2.2	\$ 45,278	\$ (21,062)	\$24,216
Customer relationships	5.3	129,200	(57,039)	72,161
Trade name	2.8	510	(230)	280
Total		<u>\$174,988</u>	<u>\$ (78,331)</u>	<u>\$96,657</u>

As of March 31, 2009, remaining amortization expense is expected to be as follows (in thousands):

<u>Years Ending December 31,</u>	
2009	\$29,408
2010	26,446
2011	15,511
2012	8,290
2013	5,538
Thereafter	11,464
Total	<u>\$96,657</u>

7. Senior Secured Credit Facility

In connection with the acquisition of SurfControl in October 2007, the Company entered into an amended and restated senior secured credit agreement (the "Senior Credit Agreement"). The \$225 million senior secured credit facility consists of a five year \$210 million senior secured term loan and a \$15 million revolving credit facility. The senior secured term loan was fully funded on October 11, 2007, and the revolving line of credit remains unused. At March 31, 2009, the outstanding balance under the senior secured term loan was \$110 million as a result of the Company making optional prepayments totaling \$15 million in the three months ended March 31, 2009. The senior secured credit facility is secured by substantially all of the assets of the Company, including pledges of stock of some of its subsidiaries (subject to limitations in the case of foreign subsidiaries) and by secured guarantees by the Company's domestic subsidiaries. The senior secured term loan bears interest at a spread above LIBOR with the spread determined based upon the Company's total leverage ratio, as defined in the Senior Credit Agreement. Based on the total leverage ratio as of December 31, 2008, the spread on the senior secured term loan was LIBOR plus 225 basis points per annum and the fee for the

Table of Contents

unused portion of the revolving credit facility was 25 basis points per annum. The weighted average interest rate on the senior secured term loan at March 31, 2009 was 5.7%. In conjunction with the Company's optional \$20 million prepayment on December 31, 2007, the Company amended its Senior Credit Agreement to eliminate any additional mandatory payments until September 30, 2009. The Senior Credit Agreement contains financial covenants, including a consolidated leverage ratio and a consolidated interest coverage ratio, as well as affirmative and negative covenants. Among the negative covenants are restrictions on our ability to borrow money, including restrictions on (a) the incurrence of more than \$15 million of new debt, including capital leases (subject to certain exceptions), (b) the incurrence of more than \$7.5 million in letters of credit, (c) the incurrence of more than \$50 to \$75 million of new debt, depending on our leverage ratio, to finance future acquisitions or (d) the assumption of more than \$15 million of new debt in connection with acquisitions. In connection with the restatements of its financial statements as described in Note 2, the Company does not believe that these restatements of its financial statements resulted in any material non-compliance with the covenants or representations and warranties in its Senior Credit Agreement.

As of March 31, 2009, future remaining minimum principal payments under the senior secured term loan will be as follows (in thousands):

<u>Years Ending December 31,</u>	
2009	\$ 3,618
2010	15,197
2011	18,237
2012	72,948
<u>Total</u>	<u>\$110,000</u>

8. Derivative Financial Instruments

The Company adopted FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133* ("SFAS 161"). The adoption of SFAS 161 had no financial impact on the Company's consolidated financial statements and only required additional financial statement disclosures. The Company applied the requirements of SFAS 161 on a prospective basis. Accordingly, disclosures related to interim periods prior to the adoption have not been presented.

The Company uses derivative financial instruments to manage foreign currency risk relating to foreign exchange rates, and to manage interest rate risk relating to the Company's variable rate senior secured term loan. The Company does not use these instruments for speculative or trading purposes. The Company's objective is to reduce the risk to earnings and cash flows associated with changes in foreign currency exchange rates and changes in interest rates. Derivative instruments are recognized as either assets or liabilities in the accompanying financial statements and are measured at fair value. Gains and losses resulting from changes in the fair values of those derivative instruments are recorded to earnings or other comprehensive income (loss) depending on the use of the derivative instrument and whether it qualifies for hedge accounting.

The Senior Credit Agreement provides that the Company must maintain hedge agreements so that at least 50% of the aggregate principal amount of the senior secured credit facility is subject to fixed interest rate protection for a period of not less than 2.5 years from the initial funding date of October 11, 2007. On the initial funding date, the Company entered into an interest rate swap agreement to pay a fixed rate of interest (4.85% per annum) and receive a floating rate interest payment (based on three month LIBOR) on an equivalent amount. The notional amount of the swap agreement was \$76 million as of March 31, 2009 and it amortizes each quarter down to \$11 million on June 30, 2010. In addition, on October 11, 2007 the Company entered into an interest rate cap agreement to limit the maximum interest rate on a portion of its senior secured term loan to 6.5% per annum. The amount of principal protected by this agreement was \$26.4 million at March 31, 2009 and increases up to \$74.3 million on June 30, 2010. Both the interest rate swap and cap expire on September 30, 2010.

During the three months ended March 31, 2009 and 2008, the Company utilized Euro foreign currency forward contracts to hedge anticipated Euro denominated net monetary assets. All such contracts entered into were designated as fair value hedges and were not required to be tested for effectiveness as hedge accounting was not elected. The losses related to the Euro contracts designated as fair value hedges are included in other income, net, in the accompanying consolidated statements of operations and amounted to approximately \$(159,000) and \$(657,000) for the three months ended March 31, 2009 and 2008, respectively. All of the Euro hedging contracts in place as of March 31, 2009 will be settled before June 30, 2009.

During the three months ended March 31, 2009, the Company utilized British Pound foreign currency forward contracts to hedge anticipated British Pound denominated net monetary assets. All such contracts entered into were designated as fair value hedges and were not required to be tested for effectiveness as hedge accounting was not elected. The gains related to the British

Table of Contents

Pound contracts designated as fair value hedges are included in other income, net, in the accompanying consolidated statements of operations and amounted to approximately \$328,000 for the three months ended March 31, 2009. There were no British Pound contracts outstanding as of March 31, 2008 and 2009.

During the three months ended March 31, 2009, the Company utilized an Australian dollar foreign currency forward contract to hedge anticipated Australian dollar denominated net monetary assets. The contract entered into was designated as a fair value hedge and was not required to be tested for effectiveness as hedge accounting was not elected. The loss related to this contract designated as a fair value hedge is included in other income, net, in the accompanying consolidated statements of operations and amounted to approximately \$(17,000) for the three months ended March 31, 2009. The Australian Dollar hedging contract in place as of March 31, 2009 will be settled before June 30, 2009. There were no Australian dollar contracts outstanding as of March 31, 2008.

During the three months ended March 31, 2009, the Company utilized Israeli Shekel zero-cost collar and forward contracts to hedge anticipated operating expenses. All such contracts entered into were designated as cash flow hedges and were considered effective as defined by SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("SFAS 133"), as amended. None of the contracts were terminated prior to settlement. Net losses of approximately \$(61,000) related to the contracts designated as cash flow hedges during the three months ended March 31, 2009 are included in the respective operating categories for which the Company hedges its Israeli Shekel expenditures. All of the Israeli Shekel hedging contracts in place as of March 31, 2009 will be settled before December 31, 2009. There were no Israeli Shekel contracts outstanding as of March 31, 2008.

Notional and fair values of the Company's foreign currency hedging positions at March 31, 2009 and 2008 are presented in the table below (in thousands):

	March 31, 2009				March 31, 2008			
	Notional Value Local Currency	Notional Value USD	Fair Value USD	Fair Value Gain (Loss) USD	Notional Value Local Currency	Notional Value USD	Fair Value USD	Fair Value Gain (Loss) USD
Euro	5,500	\$ 7,245	\$ 7,185	\$ (60)	5,200	\$7,800	\$ 7,420	\$ (380)
Australian Dollar	1,500	1,023	1,006	(17)	—	—	—	—
Israeli Shekel	11,400	2,747	2,705	(42)	—	—	—	—
Total		<u>\$11,015</u>	<u>\$ 10,896</u>	<u>\$ (119)</u>		<u>\$7,800</u>	<u>\$ 7,420</u>	<u>\$ (380)</u>

The effects of derivative instruments on the Company's financial statements were as follows as of March 31, 2009 and for the three months then ended (in thousands):

	Fair Value of Derivative Instruments	
	Balance Sheet Location	Fair Value
Interest rate cap contract designated as cash flow hedge	Other assets	\$ 1
Interest rate swap contracts designated as cash flow hedges	Other accrued expenses	(1,999)
Foreign exchange contracts designated as cash flow hedges	Other accrued expenses	(42)
Total derivatives designated as hedges		<u>\$ (2,040)</u>
Foreign currency forward contracts not designated as hedges	Other accrued expenses	\$ (77)
Total derivatives		<u>\$ (2,117)</u>

Table of Contents

Effects of Derivative Instruments on Income and Other Comprehensive Income (OCI) (in thousands):

Derivatives in SFAS 133 Cash Flow Hedging Relationships	Amount of Gain (Loss)		Amount and Location of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	
	Recognized in Accumulated OCI on Derivative (Effective Portion)	Amount and Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount and Location of Gain (Loss) Recognized in Income on Derivatives	Amount and Location of Gain (Loss) Recognized in Income on Derivatives
	Three Months Ended March 31, 2009	Three Months Ended March 31, 2009	Three Months Ended March 31, 2009	Three Months Ended March 31, 2009
Interest rate cap contract	\$ 1	\$ —	Interest expense	\$— Interest expense
Interest rate swap contracts	(1,999)	(644)	Interest expense	— Interest expense
Foreign exchange contracts	(42)	(19)	Research and development	— Research and development
Total	<u>\$ (2,040)</u>	<u>\$ (663)</u>		<u>\$—</u>

Derivatives Not Designated as Hedges	Amount and Location of Gain (Loss) Recognized in Income on Derivatives
	Three Months Ended March 31, 2009
Foreign currency forward contracts	\$152 Other income (expense), net

9. Fair Value Measurements

SFAS No. 157

SFAS No. 157, *Fair Value Measurements* (“SFAS 157”) defines fair value, establishes a framework for measuring fair value and establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value. SFAS 157 also expands financial statement disclosures about fair value measurements.

Fair Value Measurements on a Recurring Basis

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurements. The Company’s assessment of the significance of a particular input to the fair value measurements requires judgment, and may affect the valuation of the assets and liabilities being measured and their placement within the fair value hierarchy.

The following table presents the balances of assets and liabilities measured at fair value on a recurring basis as of March 31, 2009 (in thousands):

	Level 1 ⁽¹⁾	Level 2 ⁽²⁾	Level 3 ⁽³⁾	Total
Assets:				
Interest rate cap designated as cash flow hedge	\$ —	\$ 1	\$ —	\$ 1
Liabilities:				
Interest rate swaps designated as cash flow hedges	\$ —	\$ 1,999	\$ —	\$1,999
Foreign currency forward contracts not designated as hedges	—	77	—	77
Israeli Shekel contracts designated as cash flow hedges	—	42	—	42

⁽¹⁾ – quoted prices in active markets for identical assets or liabilities

⁽²⁾ – observable inputs other than quoted prices in active markets for identical assets and liabilities

⁽³⁾ – no observable pricing inputs in the market

Included in Other assets and in Other accrued expenses are derivative contracts, comprised of interest rate swaps and an interest rate cap as well as foreign currency forward contracts and zero-cost collar contracts, that are valued using models based on readily observable market parameters for all substantial terms of the Company’s derivative contracts and thus are classified within Level 2.

Table of Contents

Fair Value Measurements on a Nonrecurring Basis

During the quarter ended March 31, 2009, the Company did not re-measure any nonfinancial assets and liabilities measured at fair value on a nonrecurring basis (e.g., goodwill, intangible assets, property and equipment and nonfinancial assets and liabilities initially measured at fair value in a business combination).

10. Stockholders' Equity

Share-Based Compensation

Employee Stock Plans

The following table summarizes the Company's restricted stock unit activity since December 31, 2008:

	Number of Shares
Balance at December 31, 2008	335,687
Granted	722,000
Vested	(39,333)
Cancelled	(44,780)
Balance at March 31, 2009	<u>973,574</u>

The following table summarizes the Company's stock option activity since December 31, 2008:

	Number of Shares	Weighted Average Exercise Price
Balance at December 31, 2008	10,431,100	\$ 22.08
Granted	431,259	12.93
Exercised	(11,100)	2.38
Cancelled	(526,436)	20.69
Balance at March 31, 2009	<u>10,324,823</u>	21.79

The results of operations for the three months ended March 31, 2009 and 2008 include share-based compensation expense in the following expense categories of the consolidated statements of operations (in thousands):

	Three Months Ended	
	March 31, 2009 (As Restated)	March 31, 2008 (As Restated)
Share-based compensation in:		
Cost of revenues	\$ 300	\$ 367
Total share-based compensation in cost of revenues	300	367
Selling and marketing	1,920	2,360
Research and development	1,098	1,145
General and administrative	2,839	2,375
Total share-based compensation in operating expenses	<u>5,857</u>	<u>5,880</u>
Total share-based compensation	<u>\$ 6,157</u>	<u>\$ 6,247</u>

Table of Contents

The Company used the following assumptions to estimate the fair value of the stock options granted:

	Three Months Ended	
	March 31,	March 31,
	2009	2008
Average expected life (years)	3.0	3.1
Average expected volatility factor	44.9%	34.8%
Average risk-free interest rate	1.4%	2.3%
Average expected dividend yield	—	—

Treasury Stock

The Company repurchased shares of its common stock during the first three months of 2009 as follows:

	Average Price	
	Shares	Per Share
Shares repurchased through December 31, 2008	9,249,109	\$ 20.59
Shares repurchased during the three months ended March 31, 2009	649,478	\$ 11.53
Total shares repurchased through March 31, 2009	<u>9,898,587</u>	<u>\$ 20.00</u>

The remaining number of shares authorized for repurchase under the Company's stock repurchase program as of March 31, 2009 was 2,101,413 shares. Under the terms of the Senior Credit Agreement, the Company is restricted from repurchasing its common stock for an aggregate purchase price that exceeds the sum of \$25 million plus 50% of the aggregate amount of its consolidated net income, as defined in the Senior Credit Agreement, during the period from the effective date of the facility through the most recent quarter end for which quarterly financial statements have been filed. As of March 31, 2009, \$26.5 million remained authorized for repurchase under the Company's Senior Credit Agreement.

11. Tax Matters

For the three months ended March 31, 2009 the Company recognized an income tax expense of \$1.1 million which represented an effective tax rate of approximately (5,600%). The effective tax rate for the three months ended March 31, 2009 is expressed as a negative rate because the Company recorded tax expense in the quarterly period while in a forecasted book loss position for the year. The effective tax rate variance from the statutory rate was primarily related to non-deductible items, including share-based payments, an increase in the valuation allowance related to net operating losses of one of the Company's subsidiaries in the United Kingdom and foreign withholding taxes, which offset the benefit of income taxed at lower rates in foreign jurisdictions and the favorable impact on deferred tax amounts resulting from a California law change.

In accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"), the Company had approximately \$9.1 million of total gross unrecognized tax benefits at March 31, 2009. Included in this balance are \$6.2 million of unrecognized tax benefits that, if recognized, would reduce the Company's annual effective tax rate. Estimated interest and penalties related to the underpayment of income taxes are classified as a component of provision for income taxes in the consolidated statements of operations. The Company accrued potential penalties and interest of \$0.1 million related to these unrecognized tax benefits during the three months ended March 31, 2009, and in total, as of March 31, 2009, the Company has recorded a liability for potential penalties and interest of \$1.4 million.

The Company and its subsidiaries file tax returns which are routinely examined by tax authorities in the U.S. and in various state and foreign jurisdictions. The Company is currently under examination by the respective tax authorities for tax years 2005 to 2007 in the United States, for 2002 to 2005 in the United Kingdom and for 2005 to 2007 in France. The Company has various other on-going audits in various stages of completion. In general, the tax years 2005 through 2008 could be subject to examination by U.S. federal and most state tax authorities. In significant foreign jurisdictions, tax years 2002 through 2008 could be subject to examination by the respective tax authorities.

Due to the potential resolution of federal, state and foreign tax examinations, and the expiration of various statutes of limitations, it is reasonably possible that the Company's gross unrecognized tax benefits balance may change within the next twelve months by a range of zero to \$2.5 million.

Table of Contents

12. Litigation

The Company is involved in various legal actions in the normal course of business. Based on current information, including consultation with the Company's attorneys, the Company believes that it has adequately reserved for any ultimate liability that may result from these actions such that any liability would not materially affect the Company's consolidated financial position, results of operations or cash flows. The Company's evaluation of the likely impact of these actions could change in the future and unfavorable outcomes and/or defense costs, depending upon the amount and timing, could have a material adverse effect on the Company's results of operations or cash flows in a future period.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the financial statements and related notes contained elsewhere in this report. See "Risk Factors" under Part II, Item 1A below regarding certain factors known to us that could cause reported financial information not to be necessarily indicative of future results.

Forward-Looking Statements

This report on Form 10-Q/A may contain "forward-looking statements" within the meaning of the federal securities laws made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements, which represent our expectations or beliefs concerning various future events, may contain words such as "may," "will," "expects," "anticipates," "intends," "plans," "believes," "estimates" or other words indicating future results. Such statements may include but are not limited to statements concerning the following:

- anticipated trends in revenue;
- plans, strategies and objectives of management for future operations;
- growth opportunities in domestic and international markets;
- new and enhanced reliance on channels of distribution;
- customer acceptance and satisfaction with our products, services and fee structures;
- changes in domestic and international market conditions;
- risks associated with fluctuations in foreign currency exchange rates;
- the impact of macro-economic conditions on our customers;
- expected trends in operating and other expenses;
- anticipated cash and intentions regarding usage of cash, including risks related to the required use of cash for debt servicing;
- risks related to compliance with the covenants in our senior secured credit facility;
- risks associated with integrating acquired businesses and launching new product offerings;
- changes in effective tax rates;
- risks related to changes in accounting interpretations;
- anticipated product enhancements or releases;
- the volatile and competitive nature of the Internet and security industries; and
- the success of our brand development efforts.

These forward-looking statements are subject to risks and uncertainties, including those risks and uncertainties described herein under Part II, Item 1A "Risk Factors," that could cause actual results to differ materially from those anticipated as of the date of this report. We assume no obligation to update any forward-looking statements to reflect events or circumstances arising after the date of this report.

Table of Contents

Overview

Restatement of Previously Reported Consolidated Financial Information

The accompanying Management's Discussion and Analysis of Financial Condition and Results of Operations gives effect to certain restatement adjustments made to the previously reported consolidated financial statements for the year ended December 31, 2008 and consolidated financial statements for the quarterly periods ended March 31, 2009 and 2008. See Note 2 to the consolidated financial statements in "Part I Financial Information — Item 1." of this report for additional information.

Company Overview

We are a leading provider of solutions for Web filtering and Web security, data loss prevention ("DLP"), and email security. Our products and services prevent malicious applications and inappropriate content from accessing the network and prevent critical business data from improperly leaving the network, allowing organizations to provide a secure and productive computing environment for employees, business partners and customers. Our portfolio of Web filtering, Web security, DLP and email anti-spam and messaging security software allows organizations to:

- prevent access to undesirable and dangerous elements on the Web, such as Web sites that contain inappropriate content or sites that download viruses, spyware, keyloggers, and an ever-increasing variety of malicious code, including Web sites with dynamic or user-generated content (Web 2.0 sites);
- identify and remove malicious applications from incoming Web traffic;
- prevent the unauthorized use and loss of sensitive data, such as customer or employee information;
- filter "spam" out of incoming email traffic;
- filter viruses and other malicious attachments from email and instant messages;
- manage the use of non-Web Internet traffic, such as peer-to-peer communications and instant messaging;
- protect from spam and malware embedded in Web-based user-generated content; and
- control misuse of an organization's valuable computing resources, including unauthorized downloading of high-bandwidth content and sites that employees can otherwise access to utilize hacking tools.

Since we commenced operations in 1994, Websense has evolved from a reseller of computer security products to a leading provider of content security software solutions, including Web security, DLP, email and messaging security solutions. Our first Web filtering software product was released in 1996 and prevented access to inappropriate Web content. Since then, we have focused on adapting our Web filtering capabilities to address changing Internet use patterns and the growing incidence of Web-based criminal activity. Our current solutions share our Threatseeker™ security intelligence and offer integrated policy enforcement options to protect against Web and email attacks and prevent the inappropriate or malicious transmission of data. Additionally, our Web Security Gateway ("WSG") product provides real time classification of dynamic end user generated content embedded in Web 2.0 Web sites, providing organizations with the same management options available with traditional static content Web sites. In April 2009, we launched a new appliance platform, our V10000 appliance, which offers our customers another alternative for implementing our software products by providing centralized management of Web security, proxy and cache, and application controls to manage and secure our customers in Web 2.0 environments. We expect the availability of the V10000 appliance to help generate additional new and upgraded subscriptions to our software, particularly our WSG product.

During the three months ended March 31, 2009, we derived approximately 51% of our revenue from international sales, compared with approximately 41% for the three months ended March 31, 2008, with the United Kingdom comprising approximately 16% and 12% of our total revenue for the three months ended March 31, 2009 and 2008, respectively. We believe international markets continue to represent a significant growth opportunity and we are continuing to expand our international operations, particularly in selected countries in the European, Asia/Pacific, Latin American and Australian markets.

We distribute our products through a global network of distributors and value-added resellers to leverage our internal sales and marketing resources. Sales through indirect channels currently account for more than 90% of our revenue. We utilize a two-tier distribution strategy in North America to sell our products, with an objective of increasing the number of value-added resellers selling our products and further extending our reach into the small and medium sized business market segment. Our distribution strategy outside North America also relies on a multi-tiered system of distributors and value-added resellers.

Table of Contents

As described elsewhere in this report, we recognize revenue from subscriptions to our products on a daily straight-line basis over the term of the subscription agreement, commencing on the first day of the subscription term. In accordance with the accounting rules for software revenue recognition, we recognize revenue associated with OEM contracts ratably over the contractual period for which we are obligated to provide post contract customer support. We recognize the operating expenses related to these sales as they are incurred. These operating expenses include sales commissions, which are based on the total amount of the subscription contract, and are fully expensed in the period the subscription term begins. We expect to sell our appliances pre-loaded with our software on a subscription basis and to recognize revenue from the appliance and the software on a daily straight line basis over the term of the subscription.

Operating expenses for 2009 have declined compared with 2008 primarily as a result of the substantial completion of the SurfControl integration activities during 2008, a reduction in amortization of intangibles and the favorable impact of a stronger U.S. dollar. However, certain of our operating expenses are expected to increase in absolute dollars on a comparative quarter over quarter basis due to continued product research and development and investments in administrative infrastructure (such as headcount, facilities, equipment and software) to support subscription sales that we will recognize as revenue in subsequent periods.

In October 2007, we completed our acquisition of SurfControl. As a result of expenses related to the combination and certain purchase accounting adjustments, we incurred operating losses under GAAP from the fourth quarter of 2007 through the fourth quarter of 2008. Similar to Websense, SurfControl sold products primarily under subscriptions whereby revenues were initially recorded as deferred revenue and recognized ratably over the term of the agreement. Under GAAP purchase accounting, we wrote off \$101.1 million of SurfControl's deferred revenue, leaving a balance of \$19.7 million as the fair value of the obligation. This adjustment reflects the fair value of the post-contract technical support services that will be recognized daily in accordance with our revenue recognition policy. In connection with the acquisition, we incurred restructuring costs primarily in connection with reducing SurfControl headcount and eliminating redundant facilities. We also incurred the expenses of managing the SurfControl operations as well as recording the amortization of the acquired intangibles. Given the average remaining term of the SurfControl subscriptions we acquired and the elimination of many of the non-recurring acquisition related expenses, we currently expect to report income from operations for fiscal 2009. Our ability to retain SurfControl customers when their existing product subscriptions expire and maintain our overall pricing levels for our products will impact our results of operations and the timing of our return to profitability.

Critical Accounting Policies and Estimates

Critical accounting policies are those that may have a material impact on our financial statements and also require management to exercise significant judgment due to a high degree of uncertainty at the time the estimate is made. Our senior management has discussed the development and selection of our accounting policies, related accounting estimates and disclosures with the Audit Committee of our Board of Directors. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition. When a purchase decision is made for our products, including our new appliance product, customers enter into a subscription agreement, which is generally 12, 24 or 36 months in duration and for a fixed number of users. Other services such as upgrades/enhancements and standard post-contract technical support services are sold together with our product subscription and provided throughout the subscription term. We recognize revenue on a daily straight-line basis, including our new appliance product revenue, commencing on the date the term of the subscription begins, and continuing over the term of the subscription agreement, provided the fee is fixed or determinable, persuasive evidence of an arrangement exists and collectability is reasonably assured. Upon entering into a subscription arrangement for a fixed or determinable fee, we electronically deliver access codes to users and then promptly invoice customers for the full amount of their subscriptions. Payment is due for the full term of the subscription, generally within 30 to 60 days of the invoice. We record amounts billed to customers in excess of recognizable revenue as deferred revenue on our balance sheet. When we enter into a subscription agreement that is denominated and paid in a currency other than U.S. dollars, we record the subscription billing and deferred revenue in U.S. dollars based upon the currency exchange rate in effect on the last day of the previous month before the subscription agreement is effective. Changes in currency rates relative to the U.S. dollar may have a significant impact on the revenue that we will recognize under contracts that are denominated in currencies other than U.S. dollars.

Table of Contents

For our OEM contracts, we grant our OEM customers the right to incorporate our web filtering products into their products for resale to end users. The OEM customer pays us a royalty fee for each resale of a subscription to our product to an end user over a specified period of time. In accordance with the accounting rules for software revenue recognition, we recognize revenue associated with the OEM contracts ratably over the contractual period for which we are obligated to provide our services. The timing of the OEM revenue recognition will vary for each OEM depending on the information available, such as underlying end user subscription periods, to determine the contractual obligation period.

We record distributor marketing payments and channel rebates as an offset to revenue. We recognize distributor marketing payments as an offset to revenue as the marketing service is provided. We recognize channel rebates as an offset to revenue on a straight-line basis over the term of the subscription agreement.

Acquisitions, Goodwill and Other Intangible Assets. We account for acquired businesses using the purchase method of accounting in accordance with SFAS No. 141(R), *Business Combinations*, which requires that the assets acquired and liabilities assumed be recorded at the date of acquisition at their respective fair values. Any excess of the purchase price over the estimated fair values of net assets acquired is recorded as goodwill. The fair value of intangible assets, including acquired technology and customer relationships, is based on significant judgments made by management. The valuations and useful life assumptions are based on information available near the acquisition date and are based on expectations and assumptions that are considered reasonable by management. The judgments made in determining estimated fair values assigned to assets acquired and liabilities assumed, as well as asset lives, can materially impact our results of operations.

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, we review goodwill that has an indefinite useful life for impairment at least annually in our fourth fiscal quarter, or more frequently if an event occurs indicating the potential for impairment. We amortize the cost of identified intangible assets using amortization methods that reflect the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up. In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"), we review intangible assets that have finite useful lives when an event occurs indicating the potential for impairment. We review for impairment by facts or circumstances, either external or internal, indicating that we may not recover the carrying value of the asset. We measure impairment losses related to long-lived assets based on the amount by which the carrying amounts of these assets exceed their fair values. We measure fair value under SFAS 144, which is generally based on the estimated future cash flows. Our analysis is based on available information and on assumptions and projections that we consider to be reasonable and supportable. If necessary, we perform subsequent calculations to measure the amount of the impairment loss based on the excess of the carrying value over the fair value of the impaired assets.

Share-Based Compensation. We account for share-based compensation in accordance with the provisions of SFAS No. 123(R), *Share-Based Payment* ("SFAS 123R") and Staff Accounting Bulletin No. 107 ("SAB 107") requiring the measurement and recognition of all share-based compensation under the fair value method. Share-based compensation expense related to stock options is recorded based on the fair value of the award on its grant date which we estimate using the Black-Scholes valuation model in accordance with the provisions prescribed under SFAS 123R and SAB 107. Share-based compensation expense related to restricted stock unit awards is calculated based on the market price of our common stock on the date of grant.

At March 31, 2009, there was \$55.2 million of total unrecognized compensation costs related to share-based compensation arrangements granted under all equity compensation plans (excluding tax effects). The total unrecognized compensation costs will be adjusted for estimated forfeitures as well as for future changes in estimated forfeitures. We expect to recognize those costs over a weighted average period of approximately 2.5 years.

We estimate the fair value of options granted using the Black-Scholes option valuation model and the assumptions described below. We estimate the expected term of options granted based on the history of grants and exercises in our options database. We estimate the volatility of our common stock at the date of grant based on both the historical volatility as well as the implied volatility of publicly traded options on our common stock, consistent with SFAS 123R and SAB 107. We base the risk-free interest rate that is used in the Black-Scholes option valuation model on the implied yield in effect at the time of option grant on U.S. Treasury zero-coupon issues with equivalent remaining terms. We have never paid any cash dividends on our common stock and do not anticipate paying any cash dividends in the foreseeable future. Consequently, we use an expected dividend yield of zero in the Black-Scholes option valuation model. We amortize the fair value ratably over the vesting period of the awards, which is typically four years. We use historical data to estimate pre-vesting option forfeitures and record share-based expense only for those awards that are expected to vest. We may elect to use different assumptions under the Black-Scholes option valuation model in the future or select a different option valuation model altogether, which could materially affect our results of operations in the future.

Table of Contents

We determine the fair value of share-based payment awards on the date of grant using an option-pricing model that is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include, but are not limited to our expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors. Option-pricing models were developed for use in estimating the value of traded options that have no vesting or hedging restrictions and are fully transferable. Because our employee stock options have certain characteristics that are significantly different from traded options, and because changes in the subjective assumptions can materially affect the estimated value, in management's opinion the existing valuation models may not provide an accurate measure of the fair value of our employee stock options. Although the fair value of employee stock options is determined in accordance with SFAS 123R and SAB 107 using an option-pricing model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction.

Income Tax Provision and Uncertain Tax Positions. We are subject to income taxes in the U.S. and numerous foreign jurisdictions. Significant judgment is required in evaluating our tax positions and determining our provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. We establish reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes will be due. These reserves for tax contingencies are established when we believe that certain positions might be challenged despite our belief that our tax return positions are consistent with prevailing law and practice. We adjust these reserves in light of changing facts and circumstances, such as the outcome of tax audits. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate.

Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* ("SFAS 109"), requires that deferred tax assets be evaluated for future realization and reduced by a valuation allowance to the extent we believe a portion will not be realized. We consider many factors when assessing the likelihood of future realization of our deferred tax assets, including our recent cumulative earnings experience and expectations of future taxable income by taxing jurisdiction, the carry-forward periods available to us for tax reporting purposes, and other relevant factors.

We account for uncertainty in income taxes in accordance with the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which require periodic adjustments and which may not accurately anticipate actual outcomes.

Allowance for Doubtful Accounts and Other Loss Contingencies. We maintain an allowance for doubtful accounts for estimated losses resulting from the inability or unwillingness of our customers to pay their invoices. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Other loss contingencies are recorded as liabilities when it is probable that a liability has been incurred and the amount of the loss is reasonably estimable. Contingent liabilities are often resolved over long time periods. Estimating probable losses requires significant judgment by management based on the facts and circumstances of each matter.

Table of Contents

Results of Operations

Three months ended March 31, 2009 compared with the three months ended March 31, 2008

The following table summarizes our operating results as a percentage of total revenue for each of the periods shown.

	Three Months Ended	
	March 31, 2009 (As Restated)	March 31, 2008 (As Restated)
Revenue	100%	100%
Cost of revenues:		
Cost of revenues	11	13
Amortization of acquired technology	4	5
Total cost of revenues	15	18
Gross margin	85	82
Operating expenses:		
Selling and marketing	52	65
Research and development	17	21
General and administrative	14	20
Total operating expenses	83	106
Income (loss) from operations	2	(24)
Interest expense	(2)	(7)
Other income, net	—	—
Income (loss) before income taxes	—	(31)
Provision (benefit) for income taxes	1	(21)
Net loss	(1)%	(10)%

Revenue

Revenue increased to \$77.6 million in the first quarter of 2009 from \$65.1 million in the first quarter of 2008. The increase was primarily a result of additional customer seats in new, renewed and upgraded subscriptions (including an increase of \$8.8 million from new or renewed SurfControl seat subscriptions and an increase of \$0.9 million from SurfControl OEM revenue on a quarter over quarter basis) from the first quarter of 2008 to the first quarter of 2009. Revenue from DLP products increased by 60% from the first quarter of 2008 to the first quarter of 2009. The number of product seats under subscription increased from 42.4 million as of March 31, 2008 to 44.4 million as of March 31, 2009. Revenue from products sold in the United States accounted for \$37.9 million or 49% of first quarter 2009 revenue compared to \$38.6 million or 59% in the first quarter of 2008. Revenue from products sold internationally accounted for \$39.7 million or 51% of first quarter 2009 revenue compared to \$26.5 million or 41% in the first quarter of 2008. We had current deferred revenue of \$217.3 million as of March 31, 2009, compared to \$195.5 million as of March 31, 2008. For the remainder of 2009, we expect our revenue to increase over 2008 revenue levels due to the amount of current deferred revenue that will be recognized as revenue during 2009, subscriptions that are scheduled for renewal that are expected to be renewed and expected new business for which some revenue will be recognized during 2009. Our revenue in 2009 may be impacted by the duration of contracts for renewal and new subscriptions, the timing of sales of renewal and new subscriptions, the average annual contract value and per seat price, and currency exchange rates impacting new and renewal subscriptions in international markets.

Table of Contents

Cost of Revenues

Cost of revenues. Cost of revenues consists of the costs of content review, technical support and infrastructure costs associated with maintaining our databases and costs associated with providing our hosted security services. Cost of revenues decreased to \$8.6 million in the first quarter of 2009 from \$8.8 million in the first quarter of 2008. The \$0.2 million decrease was primarily due to decreased temporary personnel costs in our technical support and database groups in 2009 from 2008 as we substantially completed the SurfControl integration during 2008. Our full-time employee headcount in cost of revenue departments increased from an average of 217 employees during the first quarter of 2008 to an average of 241 employees during the first quarter of 2009. We allocate the costs for human resources, employee benefits, payroll taxes, information technology, facilities and fixed asset depreciation to each of our functional areas based on headcount data. As a percentage of revenue, cost of revenues decreased to 11% from 13% during the first quarter of 2009 compared to 2008. We expect cost of revenue will increase in absolute dollars due to the higher headcount for the remainder of 2009 but as a percentage of revenue will remain approximately the same as compared to 2008. We expect cost of revenues to increase to support the growth and maintenance of our databases and costs associated with providing our hosted security services as well as the technical support needs of our customers.

Amortization of acquired technology. Amortization of acquired technology, which primarily relates to the developed technology acquired from the PortAuthority and SurfControl acquisitions in 2007, was \$3.3 million in the first quarter of 2009 compared to \$3.1 million in the first quarter of 2008. The increase of \$0.2 million in amortization of acquired technology from the first quarter of 2008 to the first quarter of 2009 was primarily due to the acquisition of additional acquired technology in the second half of 2008. As of March 31, 2009, the acquired technology is being amortized over a remaining weighted average period of 2.2 years. We expect to incur \$9.6 million in amortization expense of acquired technology during the remainder of 2009 and that 2009 levels will be slightly higher than 2008 in absolute dollars.

Gross Margin

Gross margin increased to \$65.7 million in the first quarter of 2009 from \$53.2 million in the first quarter of 2008. As a percentage of revenue, gross margin increased to 85% in the first quarter of 2009 from 82% in the first quarter of 2008 due to increased revenue while cost of revenue remained relatively flat as described in the preceding Cost of Revenues section. We expect that gross margin as a percentage of revenue will remain in excess of 80% for the remainder of 2009.

Operating Expenses

Selling and marketing . Selling and marketing expenses consist primarily of salaries, commissions and benefits related to personnel engaged in selling, marketing and customer support functions, including costs related to public relations, advertising, promotions and travel, amortization of acquired customer relationships as well as allocated costs. Selling and marketing expenses do not include payments to channel partners for marketing services and rebates. Selling and marketing expenses decreased to \$39.9 million, or 52% of revenue, in the first quarter of 2009, from \$42.9 million, or 65% of revenue, in the first quarter of 2008. The \$3.0 million decrease was primarily due to a reduction in the amortization of acquired intangibles (customer relationships) of approximately \$2.8 million and due to improvements in the U.S. currency rates relative to the foreign currencies in which certain of our international expenses were incurred. As of March 31, 2009, the acquired customer relationships intangible assets are being amortized over a remaining weighted average period of approximately 5.3 years. Even though our headcount in sales and marketing increased from an average of 531 employees during the first quarter of 2008 to 580 employees for the first quarter of 2009, our personnel costs were only marginally higher by \$0.3 million due to the improvement in the currency exchange rates as approximately one-half of our sales and marketing personnel are based in international locations whose local currencies were weaker as compared to the U.S. dollar. We expect overall selling and marketing expenses to decrease in absolute dollars and as a percentage of revenue for the remainder of 2009 as compared to 2008 primarily due to a reduction of amortization of acquired intangibles from the SurfControl acquisition due to the accelerated nature of the amortization and the elimination of the non-recurring acquisition related expenses associated with PortAuthority and SurfControl, partially offset by having additional sales and marketing personnel to support our expanding selling and marketing efforts worldwide and increased sales resulting in higher overall sales commission expenses. We also expect that selling and marketing expenses as a percentage of revenue will decrease in 2009 compared to 2008 due to the expected increase in revenue. We expect amortization of acquired intangibles of \$19.8 million for the remainder of 2009 as a result of the amortization of acquired intangibles from the SurfControl and PortAuthority acquisitions.

Table of Contents

Research and development. Research and development expenses consist primarily of salaries and benefits for software developers and allocated costs. Research and development expenses decreased to \$12.8 million, or 17% of revenue, in the first quarter of 2009 from \$13.5 million, or 21% of revenue, in the first quarter of 2008. The decrease of \$0.7 million in research and development expenses was primarily due to a reduction in contractor services relating to our DLP product and a reduction in allocated costs relating to the substantial completion of SurfControl integration activities during 2008. Our headcount increased in research and development from an average of 339 employees for the first quarter of 2008 to 385 employees for the first quarter of 2009. We expect research and development expenses to increase in absolute dollars for the remainder of 2009 as compared to 2008 due to having an expanded base of product offerings and the hiring of personnel to support our continued enhancements and new products. We are managing the increase in our absolute research and development expenses by operating research and development facilities in multiple international locations, including a facility in Beijing, China, that have lower costs than our operations in the United States. During the first quarter of 2009, we relocated our research and development facility in Sydney, Australia to our Beijing, China facility. We also have research and development facilities in Ra'anana, Israel, Los Gatos and San Diego, California and Reading, England. While we expect research and development expenses to increase in absolute dollars for the remainder of 2009, we expect that research and development expenses as a percentage of revenue will decrease in 2009 compared to 2008 due to the expected increase in revenue.

General and administrative . General and administrative expenses consist primarily of salaries, benefits and related expenses for our executive, finance and administrative personnel, third party professional service fees and allocated costs. General and administrative expenses decreased to \$11.2 million, or 14% of revenue, in the first quarter of 2009 from \$12.9 million, or 20% of revenue, in the first quarter of 2008. The \$1.7 million decrease in general and administrative expenses was primarily due to a reduction in allocated costs, personnel costs and professional service fees primarily related to a reduction in SurfControl integration activities in 2009 compared to 2008. Our headcount increased in general and administrative departments from an average of 108 employees during the first quarter of 2008 to 121 employees for the first quarter of 2009. We expect general and administrative expenses to increase in absolute dollars due to the higher headcount but decline as a percentage of revenue for the remainder of 2009 as compared to 2008 due to the expected increase in revenue.

Interest Expense

Interest expense decreased to \$2.2 million in the first quarter of 2009 from \$4.4 million in the first quarter of 2008. The decrease was primarily due to a lower average outstanding loan balance on our senior secured term loan of \$118 million during the first quarter of 2009 compared to an average loan balance of \$175 million during the first quarter of 2008. In addition, the marginal interest rates were lower in the first quarter of 2009 compared to 2008. Included in the interest expense for the first quarter of 2009 and 2008 is \$0.4 million and \$1.0 million, respectively, of amortization of deferred financing fees that were capitalized as part of the senior secured credit facility. We made prepayments on the senior secured term loan totaling \$15 million and \$30 million during the first quarter of 2009 and 2008, respectively. As a result of reductions in the LIBOR interest rate and improvements in our leverage ratio, our weighted average interest rate decreased from 6.5% at March 31, 2008 to 5.7% at March 31, 2009. The amount of interest expense will fluctuate due to changes in the outstanding principal balance, changes in LIBOR and changes in our applicable spread to LIBOR based upon improvements in our leverage ratio in accordance with our senior secured credit facility agreement. Interest expense should decline in the remaining quarters of 2009 as compared to 2008 due to the lower outstanding principal amount and the expected lower marginal interest rate on the non-fixed rate component of our senior secured credit facility.

Other Income (Expense), Net

Other income (expense), net increased to a net other income of \$0.4 million in the first quarter of 2009 from net other expense of \$0.1 million in the first quarter of 2008. The increase was due primarily to foreign exchange related gains of \$0.3 million in the first quarter of 2009 compared to losses of \$0.7 million in the first quarter of 2008 due to favorable movements in the foreign exchange rates during the first quarter of 2009, partially offset by reduced interest income of \$0.5 million as a result of lower interest rates realized on our balances of cash and cash equivalents. Due to a lower interest rate environment, we expect our net other income for the remainder of 2009 will be less than 2008 levels.

Provision for Income Taxes

For the three months ended March 31, 2009 we recognized an income tax expense of \$1.1 million compared to an income tax benefit of \$13.9 million for the three months ended March 31, 2008. The effective tax rates reflect a tax expense of approximately (5,600%) for the three months ended March 31, 2009 and a tax benefit of 67.4% for the three months ended March 31, 2008. The effective tax rate for the three months ended March 31, 2009 is expressed as a negative rate because we recorded tax expense in the quarterly period while in a forecasted book loss position for the year. For the first quarter of 2009, the effective tax rate variance from the statutory rate was primarily related to non-deductible items, including share-based payments, an increase in the valuation allowance related to net operating losses of one

Table of Contents

of our subsidiaries in the United Kingdom and foreign withholding taxes, which offset the benefit of income taxed at lower rates in foreign jurisdictions and the favorable impact on deferred tax amounts resulting from a California law change. For the first quarter of 2008, the effective tax rate variance from the statutory rate was primarily attributed to the release of a valuation allowance, a favorable state tax ruling and income taxed at lower rates in certain foreign jurisdictions, which offset the expense of withholding taxes and non-deductible share-based compensation.

Our effective tax rate may change in future periods due to differences in the composition of taxable income between domestic and international operations along with the potential changes or interpretations in tax rules and legislation, or corresponding accounting rules.

In accordance with the provisions of SFAS 109, we assess, on a quarterly basis, the realizability of our deferred income tax assets. Realization of deferred income tax assets is dependent upon taxable income in prior carryback years, estimates of future taxable income, tax planning strategies and reversals of existing taxable temporary differences. Based on our assessment of these items during the first quarter of 2009, it is more likely than not, subject to valuation allowances established, that we will be able to fully realize our deferred tax assets except as it relates to the potential tax deduction for stock based compensation that would result based on the current fair value of our common stock pursuant to SFAS123R.

Liquidity and Capital Resources

As of March 31, 2009, we had cash and cash equivalents (including restricted cash and cash equivalents) of \$76.0 million and retained earnings of \$38.0 million. During the first three months of 2009, we used our cash and cash equivalents primarily to pay down \$15 million on our senior secured term loan as optional prepayments and for stock repurchases of approximately \$7.0 million. Of the \$7.5 million stock repurchases recorded during the first quarter, \$7.0 million was paid during the quarter and the remaining \$0.5 million was paid in April 2009.

Net cash provided by operating activities was \$36.2 million in the first three months of 2009 compared with \$18.9 million in the first three months of 2008. The increase in cash provided by operating activities was primarily a result of our increasing cash collections by approximately \$3.6 million in the first quarter of 2009, decreasing cash expenses by approximately \$3.8 million primarily due to the elimination of many of the SurfControl integration activities, as well as a decrease of settlement of liabilities of approximately \$10.7 million in the first quarter of 2009 compared to the first quarter of 2008 which included many non-recurring SurfControl related obligations and a litigation settlement. Our operating cash flow is significantly influenced by new and renewal subscriptions, accounts receivable collections and cash expenses. A decrease in sales of new and/or renewal subscriptions or accounts receivable collections, or an increase in our cash expenses, would negatively impact our operating cash flow.

Net cash used in investing activities was \$2.5 million in the first three months of 2009 compared with net cash provided by investing activities of \$16.7 million in the first three months of 2008. The \$19.2 million change in net cash used in investing activities was primarily due to \$19.2 million of net increases in maturities over purchases of marketable securities in the first quarter of 2008 for which we discontinued investing in marketable securities in early 2008 due to our use of excess cash to prepay our senior secured term loan and to repurchase our stock.

Net cash used in financing activities was \$22.6 million in the first three months of 2009 compared with \$32.6 million in the first three months of 2008. The \$10 million decrease of net cash used in financing activities was primarily due to a decrease in optional principal prepayments of \$15 million on our senior secured term loan offset by an increase in stock repurchases of \$4.2 million in the first three months of 2009 compared to the first three months of 2008.

In connection with the acquisition of SurfControl in October 2007, we entered into the Senior Credit Agreement. The \$225 million senior secured credit facility consists of a five year \$210 million senior secured term loan and a \$15 million revolving credit facility. The senior secured term loan was fully funded on October 11, 2007, and the revolving line of credit remains unused. At March 31, 2009, the outstanding balance under our senior secured term loan was \$110 million as a result of making optional prepayments totaling \$15 million during the first quarter of 2009. In conjunction with our optional \$20 million prepayment on December 31, 2007, we amended our Senior Credit Agreement to eliminate any additional mandatory payments until September 30, 2009. The senior secured credit facility is secured by substantially all of our assets, including pledges of stock of some of our subsidiaries (subject to limitations in the case of foreign subsidiaries) and by secured guarantees by our domestic subsidiaries. The senior secured term loan bears interest at a spread above LIBOR with the spread determined based upon our total leverage ratio, as defined in the Senior Credit Agreement. Based on the total leverage ratio as of December 31, 2008, the spread on the senior secured term loan was LIBOR plus 225 basis points per annum and the fee for the unused portion of the revolving credit facility was 25 basis points per annum. The weighted average interest rate on the senior secured term loan at March 31, 2009 was 5.7%. The Senior Credit

Table of Contents

Agreement contains financial covenants, including a consolidated leverage ratio and a consolidated interest coverage ratio, as well as affirmative and negative covenants. Among the negative covenants are restrictions on our ability to borrow money, including restrictions on (a) the incurrence of more than \$15 million of new debt, including capital leases (subject to certain exceptions), (b) the incurrence of more than \$7.5 million in letters of credit, (c) the incurrence of more than \$50 to \$75 million of new debt, depending on our leverage ratio, to finance future acquisitions or (d) the assumption of more than \$15 million of new debt in connection with acquisitions. On September 15, 2009, we announced that our previously issued financial statements contained in our annual reports on Form 10-K for the years ended December 31, 2007 and 2008, and our quarterly reports on Form 10-Q for the quarters ended March 31, 2008, June 30, 2008, September 30, 2008, March 31, 2009 and June 30, 2009 should no longer be relied upon because of errors in these financial statements. We subsequently restated our financial statements for these periods. We do not believe that these restatements of our financial statements resulted in any material non-compliance by us with the covenants or representations and warranties in our Senior Credit Agreement. While we have confirmed our compliance to our lenders and we have not received any notifications from our lenders to the contrary, there can be no assurance that our lenders will not take a different position from ours, seek to modify the interest rate or other terms of the Senior Credit Agreement, or pursue an acceleration of our obligations under the Senior Credit Agreement.

The Senior Credit Agreement provides that we must maintain hedge agreements so that at least 50% of the aggregate principal amount of the senior secured credit facility is subject to fixed interest rate protection for a period of not less than 2.5 years from the initial funding date of October 11, 2007. On the initial funding date, we entered into an interest rate swap agreement to pay a fixed rate of interest (4.85% per annum) and receive a floating rate interest payment (based on three month LIBOR) on an equivalent amount. The notional amount of the swap agreement was \$76 million as of March 31, 2009 and it amortizes each quarter down to \$11 million on June 30, 2010. In addition, on October 11, 2007 we entered into an interest rate cap agreement to limit the maximum interest rate on a portion of our senior secured term loan to 6.5% per annum. The amount of principal protected by this agreement was \$26.4 million at March 31, 2009 and increases up to \$74.3 million on June 30, 2010. Both the interest rate swap and cap expire on September 30, 2010.

Obligations and commitments. The following table summarizes our contractual payment obligations and commitments as of March 31, 2009 (in thousands):

	Payment Obligation by Year						Total
	2009	2010	2011	2012	2013	Thereafter	
Senior credit agreement:							
Scheduled principal payments	\$ 3,618	\$15,197	\$18,237	\$72,948	\$ —	\$ —	\$110,000
Estimated interest and fees	4,422	4,079	3,003	1,668	—	—	13,172
Operating leases	4,943	5,796	4,692	4,477	4,358	1,189	25,455
Facility exit obligation	1,846	—	—	—	—	—	1,846
Software licenses	439	97	—	—	—	—	536
Total	\$15,268	\$25,169	\$25,932	\$79,093	\$4,358	\$ 1,189	\$151,009

Obligations under our Senior Credit Agreement represent the future minimum principal debt payments due under the senior secured term loan. Estimated interest and fees represent interest and fees expected to be incurred under the Senior Credit Agreement based on known rates as of March 31, 2009 (see Note 7 to the financial statements).

We lease our facilities under operating lease agreements that expire at various dates through 2015. Approximately one-half of our operating lease commitments are related to our corporate headquarters lease, which extends through December 2013 and has escalating rent payments from 2009 to 2013.

The facility exit obligation represents the lease termination fee pursuant to a lease termination agreement executed in April 2009 for a facility acquired from SurfControl that has been vacated.

Software license obligations represent purchase commitments for software licenses made in the ordinary course of business.

In addition, due to the uncertainty with respect to the timing of future cash flows associated with our unrecognized tax benefits at March 31, 2009, we are unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authorities. Therefore, \$9.1 million of unrecognized tax benefits have been excluded from the contractual payment obligations table above.

Table of Contents

In 2003, we announced that our Board of Directors authorized a stock repurchase program of up to 4 million shares of our common stock. In 2005, we announced that our Board of Directors increased the size of the stock repurchase program by an additional 4 million shares, for a total program size of up to 8 million shares. In 2006, we announced that our Board of Directors increased the size of the stock repurchase program by an additional 4 million shares, for a total program size of up to 12 million shares. Repurchases may be made from time to time on the open market at prevailing market prices or in privately negotiated transactions. In January 2008, we adopted a 10b5-1 plan that provides for quarterly purchases of our common stock in open market transactions. Depending on market conditions and other factors, purchases by our agent under this program may be commenced or suspended at any time, or from time to time, without prior notice to us. During the three months ended March 31, 2009, we repurchased 649,478 shares of our common stock for an aggregate of approximately \$7.5 million at an average price of \$11.53 per share. As of March 31, 2009, we have repurchased a total of 9,898,587 shares of our common stock under this program, for an aggregate of \$197.9 million at an average price of \$20.00 per share. Under the terms of the Senior Credit Agreement, we are restricted from repurchasing our common stock for an aggregate purchase price that exceeds the sum of \$25 million plus 50% of the aggregate amount of our consolidated net income, as defined in our Senior Credit Agreement, during the period from the effective date of the facility through the most recent quarter end for which we have filed quarterly financial statements. As of March 31, 2009, we can repurchase up to \$26.5 million of our common stock under our Senior Credit Agreement. We intend to repurchase shares during the remainder of 2009.

We believe that our cash and cash equivalents balances, revolving credit balances and our ongoing cash flow from operations will be sufficient to satisfy our cash requirements, including our capital expenditures, debt repayment obligations and stock repurchases, if any, for at least the next 12 months. During the first three months of 2009, we made voluntary prepayments on our senior secured term loan of \$15 million and repurchased approximately \$7.5 million of our common stock. Our cash requirements may increase for reasons we do not currently foresee or we may make acquisitions as part of our growth strategy that increase our cash requirements. We may elect to raise funds for these purposes or to reduce our cost of capital through capital markets transactions or debt or private equity transactions as appropriate. We intend to continue to invest our cash in excess of current operating and capital requirements in interest-bearing, investment-grade securities.

Off-Balance Sheet Arrangements

As of March 31, 2009, we did not have any material off-balance sheet arrangements.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures (Restated)

We maintain disclosure controls and procedures (as defined in Rules 13a — 15(e) and 15d — 15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) that are designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is (a) recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and (b) accumulated and communicated to management, including our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), as appropriate, to allow timely decisions regarding required disclosure.

Management, with participation by our CEO and CFO, has designed our disclosure controls and procedures to provide reasonable assurance of achieving desired objectives. As of March 31, 2009, we carried out an evaluation, under the supervision of and with the participation of our CEO and CFO, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Exchange Act). Based on the evaluation, as of March 31, 2009, our CEO and CFO originally concluded that our disclosure controls and procedures were effective.

In connection with the restatement of our financial statements for the fiscal years ended December 31, 2007 and December 31, 2008 and the quarters ended March 31, 2009 and June 30, 2009, our management, with the participation of our CEO and CFO, has reevaluated the effectiveness of our disclosure controls and procedures. Based upon that evaluation, management identified material weaknesses in our internal control over financial reporting with respect to our application of SOP 97-2 as it relates to the recognition of royalty revenue related to original equipment manufacturer (“OEM”) contracts for the years ended December 31, 2008 and 2007 and our error in our computation of our income tax benefit for the year ended December 31, 2008, as described below under “Management’s Report on Internal Control over Financial Reporting (Restated).” Solely as a result of these material weaknesses, our CEO and CFO have revised their conclusions regarding the effectiveness of our internal control over financial reporting as of December 31, 2008 and through the date of this filing. Accordingly, management now concludes that our disclosure controls and procedures were not effective at a reasonable assurance level as of December 31, 2008 and through the date of this filing.

Table of Contents

In light of the material weaknesses referred to above, the Company performed additional analyses and procedures in order to conclude that its consolidated financial statements, for the years ended December 31, 2008 and December 31, 2007 (including restated interim periods therein) and the quarter ended March 31, 2009 are fairly presented, in all material respects, in accordance with GAAP and has undertaken remediation initiatives as discussed below.

Other than as described above, during the quarter ended March 31, 2009, there was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

(b) Management's Report on Internal Control over Financial Reporting (Restated)

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Our internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company, (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the Company are being made only in accordance with authorizations of our management and directors, and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In connection with the restatement discussed in the Explanatory Note to this Form 10-Q/A and in Note 2 to our consolidated financial statements, under the direction of our CEO and CFO, management conducted a reevaluation of the effectiveness of our internal control over financial reporting as of December 31, 2008 and through the date of this filing. The framework on which such evaluation was based is contained in the report entitled "Internal Control — Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO Report"). Under Audit Standard No. 5, a material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Based on the evaluation and the criteria set forth in the COSO Report, management identified the following material weaknesses as of December 31, 2008 and through the date of this filing:

There were deficiencies in our internal controls over the application of Statement of Position No. 97-2, *Software Revenue Recognition*, as it applies to the recording of our royalty revenue pursuant to arrangements with our OEM customers. These OEM contracts were acquired in our acquisition of SurfControl in October 2007 and contain multiple elements which require us to provide services over various contractual periods. Specifically, our failure to properly review the acquired OEM contracts caused us to not detect that our method of accounting for the royalty revenue upon being invoiced was not in conformity with generally accepted accounting principles.

There were also deficiencies in our internal controls over the computation of our (benefit) provision for income taxes for the year ended December 31, 2008. Specifically, our failure to properly reconcile the separate pre-tax bases in the individual subsidiary income tax provision calculations to the consolidated pre-tax earnings, together with the incorrect treatment of a valuation allowance in the tax reconciliation, caused us to not detect that a component of previously taxed income had not been eliminated in computing the tax provision.

These material weaknesses resulted in the accounting errors which have caused us to restate our consolidated financial statements as of and for the years ended December 31, 2008 and 2007 (including interim periods therein), and our consolidated financial statements as of and for the quarterly periods ended June 30, 2009 and March 31, 2009.

Table of Contents

Based on its assessment, including consideration of the aforementioned material weaknesses, and the criteria discussed above, management has revised its conclusion relative to the effectiveness of our internal control over financial reporting as of December 31, 2008 through the date of this filing. Accordingly, management now concludes that our internal control over financial reporting was not effective at a reasonable assurance level as of December 31, 2008 and through the date of this filing.

Management's Remediation Initiatives

We have taken and are taking the following actions to remediate the material weaknesses described above. We performed a detailed review of all OEM contracts, our billing and revenue systems, and processes for recording revenue. We are in the process of implementing stronger internal controls surrounding our review of contracts with our customers, including implementing a new system for review of each OEM contract to determine the maximum period of our performance obligations under each OEM contract, which are designed to detect any material errors and misapplication of revenue recognition principles. We are also in the process of reviewing our tax provisioning process to strengthen controls in terms of separation of the provisioning and review processes together with revising and improving the tools used for tax to financial statement reconciliations prior to and during the review process.

The Audit Committee has directed management to develop and present to the Committee a plan and timetable for the implementation of the remediation measures described above (to the extent not already implemented), and the Committee intends to monitor such implementation. We believe that the actions described above will remediate the material weakness control deficiencies we have identified and strengthen our internal control over financial reporting. As we improve our internal control over financial reporting and implement remediation measures, we may supplement or modify the remediation measures described above.

Part II - Other Information

Item 1A. Risk Factors

You should carefully consider the following information in addition to other information in this report in evaluating our business and our prospects. The risks and uncertainties described below are those that we currently deem to be material and that we believe are specific to our company and our industry. In addition to these risks, our business may be subject to risks currently unknown to us. If any of these or other risks actually occur, our business may be adversely affected, the trading price of our common stock could decline, and you may lose all or part of your investment in Websense.

We have marked with an asterisk (*) those risk factors that reflect material changes from the risk factors included in our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission on February 27, 2009 as amended by Amendment No. 1 thereto.

*Recent volatility in the world capital markets and the financial services industry may adversely impact our business, results of operations, financial condition or liquidity.**

Recently, the world capital markets and the financial services industry have been experiencing a period of unprecedented volatility characterized by the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from governments and regulatory agencies worldwide. The recent economic crisis could cause our end user customers to choose shorter contract durations or to not renew their contracts at all, reducing our cash flow, and also could negatively affect our ability to maintain or expand the number of seats and/or product offerings to large customers upon renewal due to adverse developments within the customers' organization. Credit markets may also adversely affect our resellers through whom our distributors distribute products and limit the credit value-added resellers may extend to their customers. The volatility of currency exchange rates can also significantly affect sales of our products denominated in foreign currencies. In addition, recent events in the global financial markets may make it difficult for us to access the credit markets or to obtain financing or refinancing, if needed, on satisfactory terms or at all.

Our future success depends on our ability to sell new, renewal and upgraded Web filtering and Web security subscriptions.

Substantially all of our revenue for the quarter ended March 31, 2009 was derived from new and renewal subscriptions to our Web filtering and Web security products, and we expect that a significant majority of our sales for 2009 will continue to be derived from our Web filtering and Web security products. We expect sales of our Web Security Gateway ("WSG"), data loss prevention ("DLP") products, hosted security services, our appliance product and other products under development to comprise a relatively small portion of our overall sales in 2009. If our Web filtering and Web security products fail to meet the needs of our existing and

Table of Contents

target customers, or if they do not compare favorably in price, features and performance to competing products, our operating results and our business will be significantly impaired. If we cannot sufficiently increase our customer base with the addition of new customers, particularly in the small to medium sized business (“SMB”) segment, increase seats under subscriptions from existing customers or renew a sufficient number of SurfControl’s Web filtering customers or migrate them to our Web filtering product, we will not be able to grow our business to meet expectations.

Subscriptions for our Web filtering and security products typically have durations of 12, 24 or 36 months. Our revenue depends upon maintaining a high rate of sales of renewal subscriptions and upon adding additional seats or product offerings to existing customers. Our customers have no obligation to renew their subscriptions upon expiration, and if they renew, they may elect to renew for a shorter duration than the previous subscription period. As a result of macroeconomic conditions, our Websense and SurfControl customers may elect to renew subscriptions for shorter durations and may not add seats or product offerings due to contractions of work forces of their respective organizations. This may require increasingly costly sales efforts targeting senior management and other management personnel associated with our customers’ Internet and security infrastructure. We may not be able to maintain or continue to generate increasing revenue from existing customers.

*Our revenue is derived almost entirely from sales through indirect channels and we depend upon these channels to create demand for our products.**

Our revenue has been derived almost entirely from sales through indirect channels, including value-added resellers, distributors that sell our products to end-users, providers of managed Internet services and other resellers. Although we rely upon these indirect channels of distribution, we also depend upon our internal sales force to generate sales leads and sell products through the reseller network. Ingram Micro, one of our broad-line distributors in North America, accounted for approximately 27% of our revenue during the quarter ended March 31, 2009. Should Ingram Micro experience financial difficulties or otherwise delay or prevent our collection of accounts receivable from them, our revenue and cash flow would be adversely affected. Also, should our resellers be subject to credit limits or have financial difficulties that limit financing terms available to them, our revenue and cash flow could be significantly adversely affected. Our indirect sales model involves a number of additional risks, including:

- our resellers and distributors, including Ingram Micro, are not subject to minimum sales requirements or any obligation to market our products to their customers;
- we cannot control the level of effort our resellers and distributors expend or the extent to which any of them will be successful in marketing and selling our products;
- we cannot assure that our channel partners will market and sell our newer product offerings such as our security-oriented offerings, our WSG, our DLP offerings or our hosted security services;
- our reseller and distributor agreements are generally nonexclusive and may be terminated at any time without cause; and
- our resellers and distributors frequently market and distribute competing products and may, from time to time, place greater emphasis on the sale of these products due to pricing, promotions and other terms offered by our competitors.

Our ability to meaningfully increase the amount of our products sold through our sales channels also depends on our ability to adequately and efficiently support these channel partners with, among other things, appropriate financial incentives to encourage pre-sales investment and sales tools, such as sales training, technical training and product materials needed to support their customers and prospects. The diversity and sophistication of our product offerings have required us to focus on additional sales and technical training, and we are making increased investments in this area. Additionally, we are continually evaluating the changes to our internal ordering and partner management systems in order to effectively execute our two-tier distribution strategy. Any failure to properly and efficiently support our sales channels will result in lost sales opportunities.

*If our internal controls are not effective, current and potential stockholders could lose confidence in our financial reporting.**

Section 404 of the Sarbanes-Oxley Act of 2002 requires companies to conduct a comprehensive evaluation of their internal control over financial reporting. To comply with this statute, we are required to document and test our internal control over financial reporting; our management is required to assess and issue a report concerning our internal control over financial reporting; and our independent registered public accounting firm is required to attest to and report on management’s assessment and the effectiveness of internal control over financial reporting.

Management had previously concluded that we maintained effective internal control over financial reporting as of December 31, 2008. In connection with the restatement discussed under the heading “Restatement of Previously Reported Consolidated Financial Statements” in Note 2 to the consolidated financial statements included in “Part I — Item 1. Notes to Consolidated Financial Statements” of this report, management determined that the material weaknesses described below existed as of December 31, 2008 and through the date of this filing. Accordingly, management has now concluded that our internal control over financial reporting was not effective as of December 31, 2008 and through the date of this filing.

Table of Contents

As described in “Part I — Item 4. Controls and Procedures” of this report, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were not effective at the reasonable assurance level as of December 31, 2008 and through the date of this filing. We and our auditors have also identified material weaknesses in our internal control over financial reporting relating to our revenue recognition under OEM contracts and our computation of our income tax benefit for the year ended December 31, 2008.

We have taken and are taking actions to remediate these material weaknesses, including implementing a new system for review to determine the maximum period of our performance obligations under each OEM contract and strengthening the controls in the reconciliation and review of the computation of our income tax provision. In addition, our audit committee has directed management to develop and present a plan and timetable for the implementation of remediation measures (to the extent not already implemented), and our audit committee intends to monitor such implementation. We believe that these actions will remediate the control deficiencies we have identified and strengthen our control over financial reporting. Although we have begun the process of remediating these material weaknesses, this process will take time, and we will not be able to assert that we have remediated these material weaknesses until the procedures that we put in place have been working for a sufficient period of time for us to determine that they are effective.

Although we believe we are taking appropriate actions to remediate the control deficiencies we have identified and to strengthen our internal control over financial reporting, we cannot assure you that we will not discover other material weaknesses in the future. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in implementation, could cause us to fail to meet our periodic reporting obligations or result in material misstatements in our financial statements, and substantial costs and resources may be required to rectify these or other internal control deficiencies. If we cannot produce reliable financial reports, investors could lose confidence in our reported financial information, the market price of our common stock could decline significantly, and our business and financial condition could be harmed.

We face increasing competition from much larger software and hardware companies, which places pressure on our pricing and which could prevent us from increasing revenue or returning to profitability. In addition, as we increase our emphasis on our security-oriented products, we face competition from better-established security companies that have significantly greater resources.

The market for our products is intensely competitive and is likely to become even more so in the future. Our current principal Web filtering competitors frequently offer their products at a significantly lower price than our products, which has resulted in pricing pressures on sales of our products and potentially could result in the commoditization of products in our space. We also face current and potential competition from vendors of Internet servers, operating systems and networking hardware, many of which now, or may in the future, develop and/or bundle Web filtering or other competitive products with their current products with no price increase to these current products. Increased competition may cause price reductions or a loss of market share, either of which could have a material adverse effect on our business, results of operations and financial condition. If we are unable to maintain the current pricing on sales of our products or increase our pricing in the future, our results of operations could be negatively impacted. Even if our products provide greater functionality and are more effective than certain other competitive products, potential customers might accept this limited functionality. In addition, our own indirect sales channels may decide to develop or sell competing products instead of our products. Pricing pressures and increased competition generally could result in reduced sales, reduced margins or the failure of our products to achieve or maintain widespread market acceptance, any of which could have a material adverse effect on our business, results of operations and financial condition.

Our current principal competitors include:

- companies offering Web filtering and Web security solutions, such as Microsoft, Symantec/Message Labs, McAfee/Secure Computing, Cisco Systems, Juniper Networks, Trend Micro, Google, BrightCloud, ScanSafe, Blue Coat Systems, Aladdin, Finjan, FaceTime, St. Bernard Software, Marshal8e6, Clearswift, Sophos, Barracuda, Digital Arts and Computer Associates;
- companies integrating Web filtering into specialized security appliances, such as Blue Coat Systems, Cisco Systems, McAfee/Secure Computing, WatchGuard, Check Point Software, St. Bernard Software, Barracuda, Juniper Networks, Trend Micro, SonicWALL, Sophos, Network Box and Marshal8e6;

Table of Contents

- companies offering DLP solutions, such as Symantec, Verdasys, Vericept, EMC, McAfee/Secure Computing, IBM, Trend Micro, Proofpoint, Palisade Systems, Computer Associates, Raytheon, Intrusion, Fidelis, GTB Technologies, Workshare, Check Point Software and Code Green Networks;
- companies offering messaging security, such as McAfee/Secure Computing, Symantec/Message Labs, Google, Cisco Systems, Barracuda, SonicWALL, Trend Micro, Axway/Tumbleweed, MX Logic, Sophos, Microsoft, Proofpoint, Clearswift and BorderWare;
- companies offering on-demand email and Web security services, such as Google, Symantec/Message Labs, McAfee, MX Logic, Webroot, St. Bernard Software, Purewire, BrightCloud, Zscaler, Trend Micro and ScanSafe;
- companies offering desktop security solutions such as Check Point Software, Cisco Systems, McAfee, Microsoft, Symantec, Computer Associates, Sophos, Webroot, IBM and Trend Micro; and
- companies offering Web gateway solutions such as Microsoft, Blue Coat Systems, Cisco Systems, Trend Micro, Check Point Software, McAfee and Juniper Networks.

As we develop and market our products with an increasing security-oriented emphasis, we also face growing competition from security solutions providers. Many of our competitors within the Web security market, such as Symantec, McAfee, Trend Micro, Cisco Systems, Google and Microsoft enjoy substantial competitive advantages, including:

- greater name recognition and larger marketing budgets and resources;
- established marketing relationships and access to larger customer bases; and
- substantially greater financial, technical and other resources.

As a result, we may be unable to gain sufficient traction as a provider of Web security solutions, and our competitors may be able to respond more quickly and effectively than we can to new or emerging technologies and changes in customer requirements, or devote greater resources to the development, marketing, promotion and sale of their products than we can. Current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase the functionality and market acceptance of their products. In addition, our competitors may be able to replicate our products, make more attractive offers to existing and potential employees and strategic partners, develop new products or enhance existing products and services more quickly. Accordingly, new competitors or alliances among competitors may emerge and rapidly acquire significant market share. In addition, many of our competitors made recent acquisitions in some of our product areas, and, we expect competition to increase as a result of this industry consolidation. Through an acquisition, a competitor could bundle separate products to include functions that are currently provided primarily by our Web and data security solutions and sell the combined product at a lower cost than our stand-alone solutions. For all of the foregoing reasons, we may not be able to compete successfully against our current and future competitors.

*The covenants in our senior secured credit facility restrict our financial and operational flexibility, including our ability to complete additional acquisitions and invest in new business opportunities.**

In connection with our acquisition of SurfControl in October 2007, we entered into an amended and restated senior secured credit facility to provide financing for a substantial portion of the acquisition purchase price. Our senior secured credit facility contains covenants that restrict, among other things, our ability to borrow money, make particular types of investments, including investments in our subsidiaries, make other restricted payments, pay down subordinated debt, swap or sell assets, merge or consolidate or make acquisitions. An event of default under our senior secured credit facility could allow the lenders to declare all amounts outstanding with respect to the senior secured credit facility to be immediately due and payable. On September 15, 2009, we announced that our previously issued financial statements contained in our annual reports on Form 10-K for the years ended December 31, 2007 and 2008, and our quarterly reports on Form 10-Q for the quarters ended March 31, 2008, June 30, 2008, September 30, 2008, March 31, 2009 and June 30, 2009 should no longer be relied upon because of errors in these financial statements. We subsequently restated our financial statements for these periods. We do not believe that these restatements of our financial statements resulted in any material non-compliance by us with the covenants or representations and warranties in our Senior Credit Agreement. While we have confirmed our compliance to our lenders and we have not received any notifications from our lenders to the contrary, there can be no assurance that our lenders will not take a different position from ours, seek to modify the interest rate or other terms of the Senior Credit Agreement, or pursue an acceleration of our obligations under the Senior Credit Agreement. As collateral for the loan, we pledged substantially all of our consolidated assets and the stock of some of our subsidiaries (subject to limitations with respect to foreign subsidiaries) to secure the debt under our senior secured credit facility. If the amounts

Table of Contents

outstanding under the senior secured credit facility were accelerated, the lenders could proceed against those consolidated assets and the stock of our subsidiaries. Any event of default, therefore, could have a material adverse effect on our business. Our senior secured credit facility also requires us to maintain specified financial ratios. Our ability to meet these financial ratios can be affected by events beyond our control, and we cannot assure that we will meet those ratios.

The amount of our debt outstanding may prevent us from taking actions we would otherwise consider in our best interest.

In October 2007, we borrowed \$210 million under the senior credit agreement and \$110 million remained outstanding as of March 31, 2009. As a result, we are incurring interest expense for the amounts we borrowed under the senior secured term loan, and our income from our cash, cash equivalents and marketable securities has declined as we used a significant portion of our cash and marketable securities to fund a portion of the acquisition cost. This debt and the limitations our senior secured credit facility impose on us could have important consequences, including:

- it may be difficult for us to satisfy our obligations under the senior secured credit facility;
- we will have to use much of our cash flow for scheduled debt service rather than for potential investments;
- we may be less able to obtain other debt financing in the future;
- we could be less able to take advantage of significant business opportunities, including acquisitions or divestitures, as a result of debt covenants;
- our vulnerability to general adverse economic and industry conditions could be increased; and
- we could be at a competitive disadvantage to competitors with less debt.

*Failure of our security products, including our DLP products, hosted security solutions and our new appliance platform, to achieve more widespread market acceptance will seriously harm our business.**

Our future financial performance depends on our ability to diversify our offerings by successfully developing, introducing and gaining customer acceptance of our new products and services, particularly our security offerings. We now sell the Websense Data Security Suite, our DLP offering for the data security market, Websense Hosted Web Security and Websense Hosted Email Security, our hosted security services, and Websense Email Security, our email filtering solution. In addition, we recently released our next generation Web content gateway to address emerging Web 2.0 threats, Websense WSG, as well as our V10000 appliance pre-loaded with our software. We continue to develop and release products in accordance with our announced product roadmap. We may not be successful in achieving market acceptance of these or any new products that we develop. Moreover, our recent increased emphasis on the development, marketing and sale of our security offerings and DLP products could distract us from sales of our core Web filtering and Web security offerings, negatively impacting our overall sales. Any failure or delay in diversifying our existing offerings, or diversification at the detriment to our core Web filtering and Web security offerings, could harm our business, results of operations and financial condition and our growth.

*The launch of our V10000 appliance exposes us to risks inherent with the sale of hardware, to which we were not previously exposed as a software company.**

With the launch of our V10000 appliance, we are now selling a generally available product that is hardware-based and not solely software-based. Our V10000 appliance is manufactured by a third-party contract manufacturer, and a third party logistics company is providing logistical services, including product configuration and shipping. Our ability to deliver the V10000 appliance to our customers could be delayed if we fail to effectively manage our third party relationships or if our contract manufacturer or logistics provider experience delays, disruptions or quality control problems in manufacturing, configuring or shipping the appliance. If our third-party providers fail for any reason to manufacture and deliver the V10000 appliance with acceptable quality, in the required volumes, and in a cost-effective and timely manner, it could be costly to us, as well as disruptive to product shipments. In addition, supply disruptions or cost increases could increase our cost of goods sold and negatively impact our financial performance. Our V10000 appliance platform may also face greater obsolescence risks than our pure software products.

We have experienced declining growth rates, particularly for Web filtering sales to large enterprises in North America and Western Europe.

Our growth plans for new sales in North America and Western Europe are largely dependent on our ability to increase sales in the SMB segment and maintain our subscription base in the large enterprise market through subscription renewals and product upgrades. We need to increase sales through our two-tier distribution channel in North America and in Western Europe. We sell

Table of Contents

products specifically targeted at the SMB segment, Websense Express and Websense Hosted Security, though we cannot assure that these products will ultimately increase sales to the SMB segment. Numerous competitors target the SMB segment for Web filtering and security sales, many of whom are different competitors from our primary competitors in the large enterprise market segment. If Websense Express and Websense Hosted Security do not meet our customers' expectations in the SMB segment or if we fail to compete effectively for volume business through our two-tier distribution model, our financial results and growth will be negatively affected.

Our international operations involve risks that could increase our expenses, adversely affect our operating results and require increased time and attention of our management.

We have significant operations outside of the United States, including research and development, sales and customer support. We have engineering operations in Reading, England; Beijing, China and Ra'anana, Israel.

We plan to continue to expand our international operations, but such expansion is contingent upon the financial performance of our existing international operations as well as our identification of growth opportunities. Our international operations are subject to risks in addition to those faced by our domestic operations, including:

- difficulties associated with managing a distributed organization located on multiple continents in greatly varying time zones;
- potential loss of proprietary information due to misappropriation or laws that may be less protective of our intellectual property rights;
- requirements of foreign laws and other governmental controls, including trade and labor restrictions and related laws that reduce the flexibility of our business operations;
- political unrest, war or terrorism, particularly in areas in which we have facilities;
- difficulties in staffing, managing, and operating our international operations, including difficulties related to administering our stock plans in some foreign countries;
- difficulties in coordinating the activities of our geographically dispersed and culturally diverse operations;
- seasonal reductions in business activity in the summer months in Europe and in other periods in other countries;
- restrictions on our ability to repatriate cash from our international subsidiaries or to exchange cash in international subsidiaries into cash available for use in the United States;
- costs and delays associated with developing software in multiple languages; and
- currency exchange risks.

A significant portion of our foreign subsidiaries' operating expenses are incurred in foreign currencies so if the U.S. dollar weakens, our consolidated operating expenses would increase. Should the U.S. dollar strengthen, our products may become more expensive for our international customers with subscription contracts denominated in U.S. dollars, and as a result, our results of operations and net cash flows from international operations may be adversely affected, especially if the trend continues of international sales growing as a percentage of our total sales. Changes in currency rates also impact our future revenue under subscription contracts that are not denominated in U.S. dollars. Our revenue and deferred revenue for these currencies are recorded in U.S. dollars when the subscription is signed based upon currency exchange rates in effect on the last day of the previous month before the subscription agreement is signed. As a result, the strengthening of the U.S. dollar for current sales will not only reduce current cash flows from these sales, but will also reduce our revenue from these contracts, even if these foreign currencies should strengthen in the future.

Sales to customers outside the United States have accounted for a significant portion of our revenue, which exposes us to risks inherent in international sales.

We market and sell our products outside the United States through value-added resellers, distributors and other resellers. International sales represented 51% of our total revenue generated during the quarter ended March 31, 2009 compared with 41% of our total revenue during the quarter ended March 31, 2008. As a key component of our business strategy to generate new business sales, we intend to continue to expand our international sales, but success cannot be assured. In addition to the risks associated with our domestic sales, our international sales are subject to the following risks:

- our ability to adapt to sales and marketing practices and customer requirements in different cultures;

Table of Contents

- our ability to successfully localize software products for a significant number of international markets;
- the significant presence of some of our competitors in some international markets;
- laws and business practices favoring local competitors;
- dependence on foreign distributors and their sales channels;
- longer payment cycles for sales in foreign countries and difficulties in collecting accounts receivable;
- compliance with multiple, conflicting and changing governmental laws and regulations, including tax laws and regulations and consumer protection and privacy laws; and
- regional economic and political conditions, including adverse economic conditions in emerging markets with significant growth potential.

These factors could have a material adverse effect on our international sales. Any reduction in international sales, or our failure to further develop our international distribution channels, could have a material adverse effect on our business, results of operations and financial condition.

Some of our international revenue is denominated in U.S. dollars. In these markets, fluctuations in the value of the U.S. dollar and foreign currencies may make our products more expensive for international customers, which could harm our business. We also currently bill certain international customers in Euros, British Pounds, Australian Dollars, Chinese Renminbi and Japanese Yen. This increases our risks associated with fluctuations in currency exchange rates since we cannot be assured of receiving the same U.S. dollar equivalent as when we bill exclusively in U.S. dollars. We engage in currency hedging activities with the intent of limiting the risk of exchange rate fluctuations, but our foreign exchange hedging activities also involve inherent risks that could result in an unforeseen loss. If we fail to properly forecast rate fluctuations these activities could have a negative impact.

*We may not be able to develop acceptable new products or enhancements to our existing products at a rate required by our rapidly changing market.**

Our future success depends on our ability to develop new products or enhancements to our existing products that keep pace with rapid technological developments and that address the changing needs of our customers. Although our products are designed to operate with a variety of network hardware and software platforms, we will need to continuously modify and enhance our products to keep pace with changes in Internet-related hardware, software, communication, browser and database technologies. We may not be successful in either developing such products or introducing them to the market in a timely fashion. In addition, uncertainties about the timing and nature of new network platforms or technologies, or modifications to existing platforms or technologies could increase our research and development expenses. The failure of our products to operate effectively with the existing and future network platforms and technologies will limit or reduce the market for our products, result in customer dissatisfaction and seriously harm our business, results of operations and financial condition.

Because our products primarily manage access to URLs and executable files included in our databases, if our databases do not contain a meaningful portion of relevant content, the effectiveness of our Web filtering products will be significantly diminished. Any failure of our databases to keep pace with the rapid growth and technological change of the Internet, such as the increasing amount of multimedia content on the Internet that is not easily classified, will impair the market acceptance of our products.

We rely upon a combination of automated filtering technology and human review to categorize URLs and executable files in our proprietary databases. Our customers may not agree with our determinations that particular URLs and executable files should be included or not included in specific categories of our databases. In addition, it is possible that our filtering processes may place objectionable or security risk material in categories that are generally unrestricted by our users' Internet and computer access policies, which could result in such material not being blocked from the network. Any errors in categorization could result in customer dissatisfaction and harm our reputation. Any failure to effectively categorize and filter URLs and executable files according to our customers' expectations could impair the growth of our business. Our databases and database technologies may not be able to keep pace with the growth in the number of URLs and executable files, especially the growing amount of content utilizing foreign languages and the increasing sophistication of malicious code and the delivery mechanisms associated with spyware, phishing and other hazards associated with the Internet. The success of our dynamic Web categorization capabilities may be critical to our customers' long term acceptance of our products.

Table of Contents

We may spend significant time and money on research and development to design and develop our DLP products, our hosted security services and our content gateway products. If these products fail to achieve broad market acceptance in our target markets, we may be unable to generate significant revenue from our research and development efforts. As a result, our business, results of operations and financial condition would be adversely impacted.

If we fail to maintain adequate operations infrastructure, we may experience disruptions of our hosted services.

Any disruption to our technology infrastructure or the Internet could harm our operations and our reputation among our customers. Our technology and network infrastructure is extensive and complex, and could result in inefficiencies or operational failures. These potential inefficiencies or operational failures could diminish the quality of our products, services, and user experience, resulting in damage to our reputation and loss of current and potential subscribers, and could harm our operating results and financial condition. Any disruption to our computer systems could adversely impact the performance of our hosted service offerings, our customer service, our delivery of products or our operations and result in increased costs and lost opportunities for business.

Failure of our products to work properly or misuse of our products could impact sales, increase costs, and create risks of potential negative publicity and legal liability.

Our products are complex, are deployed in a wide variety of network environments and manage content in a dramatically changing Web 2.0 world. Our products may have errors or defects that users identify after deployment, which could harm our reputation and our business. In addition, products as complex as ours frequently contain undetected errors when first introduced or when new versions or enhancements are released. We have from time to time found errors in versions of our products, and we expect to find such errors in the future. Because customers rely on our products to manage employee behavior to protect against security risks and prevent the loss of sensitive data, any significant defects or errors in our products may result in negative publicity or legal claims. For example, an actual or perceived breach of network or computer security at one of our customers, regardless of whether the breach is attributable to our products, could adversely affect the market's perception of our security products. Moreover, parties whose Web sites or executable files are placed in security-risk categories or other categories with negative connotations may seek redress against us for falsely labeling them or for interfering with their business. The occurrence of errors could adversely affect sales of our products, divert the attention of engineering personnel from our product development efforts and cause significant customer relations or legal problems.

Our products may also be misused or abused by customers or non-customer third parties who obtain access to our products. These situations may arise where an organization uses our products in a manner that impacts their end users' or employees' privacy or where our products are misappropriated to censor private access to the Internet. Any of these situations could result in negative press coverage and negatively affect our reputation.

We face risks related to customer outsourcing to system integrators.

Some of our customers have outsourced the management of their information technology departments to large system integrators. If this trend continues, our established customer relationships could be disrupted and our products could be displaced by alternative system and network protection solutions offered by system integrators. Significant product displacements could impact our revenue and have a material adverse effect on our business.

Other vendors may include products similar to ours in their hardware or software and render our products obsolete.

In the future, vendors of hardware and of operating system software or other software may continue to enhance their products or bundle separate products to include functions that are currently provided primarily by network security software. If network security functions become standard features of computer hardware or of operating system software or other software, our products may become obsolete and unmarketable, particularly if the quality of these network security features is comparable to that of our products. Furthermore, even if the network security and/or management functions provided as standard features by hardware providers or operating systems or other software is more limited than that of our products, our customers might accept this limited functionality in lieu of purchasing additional software. Sales of our products would suffer materially if we were then unable to develop new Web filtering, security and DLP products to further enhance operating systems or other software and to replace any obsolete products.

Table of Contents

*Our worldwide income tax provisions and other tax accruals may be insufficient if any taxing authorities assume taxing positions that are contrary to our positions.**

Significant judgment is required in determining our worldwide provision for income taxes and for our accruals for state, federal and international taxes together with transaction taxes such as sales tax, VAT and GST. In the ordinary course of a global business, there are many transactions for which the ultimate tax outcome is uncertain. Some of these uncertainties arise as a consequence of intercompany arrangements to share revenue and costs. In such arrangements there are uncertainties about the amount and manner of such sharing, which could ultimately result in changes once the arrangements are reviewed by taxing authorities. Although we believe that our approach to determining the amount of such arrangements is consistent with prevailing legislative interpretation, no assurance can be given that the final tax authority review of these matters will agree with our historical income tax provisions and other tax accruals. Such differences could have a material effect on our income tax provisions or benefits, or other tax accruals, in the period in which such determination is made, and consequently, on our results of operations for such period.

From time to time, we are also audited by various state, federal and tax authorities of other countries in which we operate. Generally, the tax years 2005 through 2008 could be subject to examination by U.S. federal and most state tax authorities. In significant foreign jurisdictions, tax years 2002 through 2008 could be subject to examination by the respective tax authorities. We are currently under examination by the respective tax authorities for tax years 2005 to 2007 in the United States, for 2002 to 2005 in the United Kingdom, for 2005 to 2007 in France, and by other tax authorities in other jurisdictions. Our audits are in various stages of completion; however, no outcome for a particular audit can be determined with certainty prior to the conclusion of the audit and any appeals process. As each audit progresses and is ultimately concluded, adjustments, if any, are appropriately recorded in our financial statements from time to time in light of prevailing facts based on our and the taxing authority's respective positions on any disputed matters. We provide for potential tax exposures by accruing for uncertain tax positions based on judgment and estimates including historical audit activity. As of March 31, 2009, no liability relating to the current audit by the Internal Revenue Service is included in the accrual for uncertain tax positions. If the reserves are insufficient upon completion or during the progression of any audits, there could be an adverse impact on our financial position and results of operations. In addition, our external costs of settling any dispute with the tax authorities could be substantial and adversely impact our financial position and results of operation.

Any failure to protect our proprietary technology would negatively impact our business.

Intellectual property is critical to our success, and we rely upon patent, trademark, copyright and trade secret laws in the United States and other jurisdictions as well as confidentiality procedures and contractual provisions to protect our proprietary technology and our Websense brands. We rely on trade secrets to protect technology where we believe patent protection is not appropriate or obtainable. However, trade secrets are difficult to protect. While we require employees, collaborators and consultants to enter into confidentiality agreements, we cannot assure that these agreements will not be breached or that we will have adequate remedies for any breach. We may not be able to adequately protect our trade secrets or other proprietary information in the event of any unauthorized use or disclosure or the lawful development by others of such information.

We have registered our Websense and Websense Enterprise trademarks in several countries and have registrations for the Websense trademark pending in several other countries. Effective trademark protection may not be available in every country where our products are available. Furthermore, any of our trademarks may be challenged by others or invalidated through administrative process or litigation.

We currently have thirteen patents issued in the United States and 22 patents issued internationally, and we may be unable to obtain further patent protection in the future. We have other pending patent applications in the United States and in other countries. We cannot ensure that:

- we were the first to make the inventions covered by each of our pending patent applications;
- we were the first to file patent applications for these inventions;
- any of our pending patent applications are not obvious or anticipated such that they will not result in issued patents;
- others will not independently develop similar or alternative technologies or duplicate any of our technologies;
- any patents issued to us will provide us with any competitive advantages or will not be challenged by third parties;

Table of Contents

- we will develop additional proprietary technologies that are patentable; or
- the patents of others will not have a negative effect on our ability to do business.

Furthermore, legal standards relating to the validity, enforceability and scope of protection of intellectual property rights are uncertain and can change over time. Effective patent, trademark, copyright and trade secret protection may not be available to us in every country in which our products are available. The laws of some foreign countries may not be as protective of intellectual property rights as U.S. laws, and mechanisms for enforcement of intellectual property rights may be inadequate. As a result our means of protecting our proprietary technology and brands may not be adequate. Furthermore, despite our efforts, we may be unable to prevent third parties from infringing upon or misappropriating our intellectual property, including the misappropriation or misuse of the content of our proprietary databases of URLs and executable files, and our ability to police that misappropriation or infringement is uncertain, particularly in countries outside of the United States. Any such infringement or misappropriation could have a material adverse effect on our business, results of operations and financial condition.

Third parties claiming that we infringe their proprietary rights could cause us to incur significant legal expenses that reduce our operating margins and/or prevent us from selling our products.

The software and Internet industries are characterized by the existence of a large number of patents, trademarks and copyrights and by frequent litigation based on allegations of patent infringement or other violations of intellectual property rights. As we expand our product offerings in the data loss and security area where larger companies with large patent portfolios compete, the possibility of an intellectual property claim against us grows. We may receive claims that we have infringed the intellectual property rights of others, including claims regarding patents, copyrights and trademarks. Any such claim, with or without merit, could result in costly litigation and distract management from day-to-day operations. If we are not successful in defending such claims, we could be required to stop selling or redesign our products, pay monetary amounts as damages, enter into royalty or licensing arrangements, or satisfy indemnification obligations that we have with some of our customers. Such arrangements may cause operating margins to decline.

*Because we recognize revenue from subscriptions for our products ratably over the term of the subscription, downturns in sales may not be immediately reflected in our revenue.**

Substantially all of our revenue comes from the sale of subscriptions to our products, including our hosted services. Upon execution of a subscription agreement or receipt of royalty reports from OEM customers, we invoice our customers for the full term of the subscription agreement or for the period covered by the royalty report from OEM customers. We then recognize revenue from customers daily over the terms of their subscription agreements, or performance period under the OEM contract, as applicable, which, in the case of subscriptions, typically have durations of 12, 24 or 36 months. As a result, a majority of the revenue we report in each quarter is derived from deferred revenue from subscription agreements and OEM contracts entered into and paid for during previous quarters. Because of this financial model, the revenue we report in any quarter or series of quarters may mask significant downturns in sales and the market acceptance of our products, before these downturns are reflected by declining revenues.

*Acquired companies or technologies can be difficult to integrate, disrupt our business, dilute stockholder value and adversely affect our operating results.**

In October 2007 we acquired SurfControl and, as a result of the acquisition, Websense reported losses from operations under generally accepted accounting principles (“GAAP”) from the fourth quarter of 2007 through the fourth quarter of 2008 after more than five years of reporting income from operations under GAAP. Given our subscription model and the elimination of many of the non-recurring acquisition related expenses, we expect to operate at a profit under GAAP during 2009. Although we expect to continue to compete effectively for subscription renewals from the SurfControl customers when their contracts are up for renewal, we face substantial competition and may not retain as high a percentage of the SurfControl customer base as we expect, which could negatively impact our results of operations.

Acquisitions involve numerous risks, including:

- difficulties in integrating operations, technologies, services and personnel of the acquired company;
- potential loss of customers and original equipment manufacturing relationships of the acquired company;
- diversion of financial and management resources from existing operations and core businesses;

Table of Contents

- risk of entering new markets;
- potential loss of key employees of the acquired company;
- integrating personnel with diverse business and cultural backgrounds;
- preserving the development, distribution, marketing and other important relationships of the companies;
- assumption of liabilities of the acquired company, including debt and litigation;
- inability to generate sufficient revenue from newly acquired products and/or cost savings needed to offset acquisition related costs; and
- the continued use by acquired companies of accounting policies that differ from GAAP, such as policies related to the timing of revenue recognition.

Acquisitions may also cause us to:

- issue equity securities that would dilute our current stockholders' percentage ownership;
- assume certain liabilities;
- incur additional debt, such as the debt we incurred to partially fund the acquisition of SurfControl;
- make large and immediate one-time write-offs for restructuring and other related expenses;
- become subject to intellectual property or other litigation; and
- create goodwill and other intangible assets that could result in significant impairment charges and/or amortization expense.

We may acquire additional companies, services and technologies in the future as part of our efforts to expand and diversify our business. Although we review the records of companies or businesses we are interested in acquiring, even an in-depth review may not reveal existing or potential problems or permit us to become familiar enough with a business to assess fully its capabilities and deficiencies. Integration of acquired companies may disrupt or slow the momentum of the activities of our business. As a result, if we fail to properly evaluate, execute and integrate future acquisitions, our business and prospects may be seriously harmed.

Our quarterly operating results may fluctuate significantly, and these fluctuations may cause our stock price to fall.

Our quarterly operating results have varied significantly in the past, and will likely vary in the future primarily as the result of fluctuations in our billings, operating expenses and tax provisions. Although a significant portion of our revenue in any quarter comes from previously deferred revenue, a meaningful portion of our revenue in any quarter depends on the number, size and length of subscriptions to our products that are sold in that quarter. The unpredictability of quarterly fluctuations is increased by the fact that a significant portion of our quarterly sales have historically been generated during the last month of each fiscal quarter, with many of the largest enterprise customers purchasing subscriptions to our products nearer to the end of the last month of each quarter.

We expect that our operating expenses will increase in the future as we expand our selling and marketing activities, increase our research and development efforts and potentially hire additional personnel which could impact our margins. In addition, our operating expenses historically have fluctuated, and may continue to fluctuate in the future, as the result of the factors described below and elsewhere in this quarterly report:

- timing of marketing expenses for activities such as trade shows and advertising campaigns;
- quarterly variations in general and administrative expenses, such as recruiting expenses and professional services fees;
- increased research and development costs prior to new or enhanced product launches;
- timing of expenses associated with commissions paid on sales of subscriptions to our products;
- amortization of acquired intangible assets associated with our PortAuthority and SurfControl acquisitions in 2007; and

Table of Contents

- changes in currency exchange rates impacting our international operating expenses.

Consequently, our results of operations may not meet the expectations of current or potential investors. If this occurs, the price of our common stock may decline.

The market price of our common stock is likely to be highly volatile and subject to wide fluctuations.

The market price of our common stock has been and likely will continue to be highly volatile and could be subject to wide fluctuations in response to a number of factors that are beyond our control, including:

- deteriorating or fluctuating world economic conditions;
- announcements of technological innovations or new products or services by our competitors;
- demand for our products, including fluctuations in subscription renewals;
- changes in the pricing policies of our competitors; and
- changes in government regulations.

In addition, the market price of our common stock could be subject to wide fluctuations in response to:

- announcements of technological innovations or new products or services by us;
- changes in our pricing policies; and
- quarterly variations in our revenues and operating expenses.

Further, the stock market has experienced significant price and volume fluctuations that have particularly affected the market price of the stock of many Internet-related companies, and that often have been unrelated or disproportionate to the operating performance of these companies. A number of publicly traded Internet-related companies have current market prices below their initial public offering prices. Market fluctuations such as these may seriously harm the market price of our common stock. In the past, securities class action suits have been filed following periods of market volatility in the price of a company's securities. If such an action were instituted, we would incur substantial costs and a diversion of management attention and resources, which would seriously harm our business, results of operations and financial condition.

*We are dependent on our management team, and the loss of any key member of this team may prevent us from implementing our business plan in a timely manner.**

Our success depends largely upon the continued services of our executive officers and other key management personnel and our ability to recruit new personnel to executive and key management positions. As we have publicly announced, our former Chief Financial Officer, Dudley Mendenhall, resigned in March 2009 and we are in the process of recruiting a new Chief Financial Officer who would assume those duties from our current Chief Operating Officer, Douglas C. Wride, who is now also serving as our Chief Financial Officer. Upon hiring a new Chief Financial Officer, Mr. Wride will remain Chief Operating Officer. We are also substantially dependent on the continued service of our existing engineering personnel because of the complexity of our products and technologies. We do not have employment agreements with a majority of our executive officers, key management or development personnel and, therefore, they could terminate their employment with us at any time without penalty. We do not maintain key person life insurance policies on any of our employees. The loss of one or more of our key employees could seriously harm our business, results of operations and financial condition. In such an event we may be unable to recruit personnel to replace these individuals in a timely manner, or at all, on acceptable terms.

Because competition for our target employees is intense, we may not be able to attract and retain the highly skilled employees we need to support our planned growth.

To execute our growth plan, we must attract and retain highly qualified personnel. Competition for these personnel is intense, especially for engineers with high levels of experience in designing and developing software and Internet-related products. We may not be successful in attracting and retaining qualified personnel. We have from time to time in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. In order to attract and retain personnel in a competitive marketplace, we believe that we must provide a competitive compensation

Table of Contents

package, including cash and equity-based compensation. The volatility of our stock price and our results of operations may from time to time adversely affect our ability to recruit or retain employees. Many of the companies with which we compete for experienced personnel have greater resources than we have. If we fail to attract new personnel or retain and motivate our current personnel, our business and future growth prospects could be severely harmed.

Compliance with regulation of corporate governance, accounting principles and public disclosure may result in additional expenses.

Compliance with laws, regulations and standards relating to corporate governance, accounting principles and public disclosure, including the Sarbanes-Oxley Act of 2002, regulations and NASDAQ Global Select Market rules, have caused us to incur higher compliance costs and we expect to continue to incur higher compliance costs as a result of our increased global reach and obligation to ensure compliance with these laws as well as local laws in the jurisdictions where we do business. These laws, regulations and standards are subject to varying interpretations in many cases due to their lack of specificity and, as a result, their application in practice may evolve over time. Further guidance by regulatory and governing bodies can result in continuing uncertainty regarding compliance matters and higher costs related to the ongoing revisions to accounting, disclosure and governance practices. Our efforts to comply with evolving laws, regulations and standards have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, our reputation may be harmed.

If we cannot effectively manage our internal growth, our business revenues, results of operations and prospects may suffer.

If we fail to manage our internal growth in a manner that minimizes strains on our resources, we could experience disruptions in our operations that could negatively affect our revenue, billings and results of operations. We are pursuing a strategy of organic growth through implementation of two-tier distribution, international expansion, introduction of new products and expansion of our product sales to the SMB segment. Each of these initiatives requires an investment of our financial and employee resources and involves risks that may result in a lower return on our investments than we expect. These initiatives also may limit the opportunities we pursue or investments we would otherwise make, which may in turn impact our prospects.

*It may be difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders.**

Some provisions of our certificate of incorporation and bylaws, as well as some provisions of Delaware law, may discourage, delay or prevent third parties from acquiring us, even if doing so would be beneficial to our stockholders. For example, our certificate of incorporation provides that stockholders may not fill board vacancies, call stockholder meetings or act by written consent. Our bylaws further provide that advance written notice is required prior to stockholder proposals. Each of these provisions makes it more difficult for stockholders to obtain control of our board or initiate actions that are opposed by the then current board. Additionally, we have authorized preferred stock that is undesignated, making it possible for the board to issue up to 5,000,000 shares of preferred stock with voting or other rights and preferences that could impede the success of any attempted change of control. Delaware law also could make it more difficult for a third party to acquire us. Section 203 of the Delaware General Corporation Law has an anti-takeover effect with respect to transactions not approved in advance by our board, including discouraging attempts that might result in a premium over the market price of the shares of common stock held by our stockholders.

Our senior secured credit facility also accelerates and becomes payable in full upon a change of control, which is defined generally as a person or group acquiring 35% of our voting securities or a proxy contest that results in changing a majority of our Board of Directors. These consequences may discourage third parties from attempting to acquire us.

We do not intend to pay dividends.

We have not declared or paid any cash dividends on our common stock since we have been a publicly traded company. We currently intend to retain any future cash flows from operations to fund growth, pay down our senior secured term loan and repurchase shares of our common stock, and therefore do not expect to pay any cash dividends in the foreseeable future. Moreover, we are not permitted to pay cash dividends under the terms of our senior secured credit facility.

Table of Contents

Item 6. Exhibits

Exhibits

- 3.1(1) Amended and Restated Certificate of Incorporation.
- 3.2(2) Amended and Restated Bylaws.
- 4.1(3) Specimen Stock Certificate of Websense, Inc.
- 10.1(4) CEO Bonus Plan.
- 10.2(4) President Bonus Plan.
- 10.3(4) SVP Bonus Plan.
- 10.4(5) Distribution Agreement by and between Websense, Inc. and Ingram Micro Inc., dated August 3, 2006.
- 31.1 Certification of Principal Executive Officer pursuant to Exchange Act Rules 13a-14(a) or 15d-14(a).
- 31.2 Certification of Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) or 15d-14(a).
- 32.1 Certification of Principal Executive Officer pursuant to Exchange Act Rules 13a-14(b) or 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).
- 32.2 Certification of Principal Financial Officer pursuant to Exchange Act Rules 13a-14(b) or 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).

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- (1) Filed as an Exhibit to our Registration Statement on Form S-1/A (No 333-95619) filed on March 3, 2000.
 - (2) Filed as an Exhibit to our Current Report on Form 8-K (No 000-30093) filed on March 12, 2009.
 - (3) Filed as an Exhibit to our Registration Statement on Form S-1/A (No 333-95619) filed on March 23, 2000.
 - (4) Filed as an Exhibit to our Current Report on Form 8-K (No 000-30093) filed on January 27, 2009.
 - (5) Filed as an Exhibit to our Quarterly Report on Form 10-Q (No 000-30093) filed on May 7, 2009.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WEBSENSE, INC.

Date: October 28, 2009

By: /s/ GENE HODGES

Gene Hodges
Chief Executive Officer

Date: October 28, 2009

By: /s/ ARTHUR S. LOCKE III

Arthur S. Locke III
Chief Financial Officer

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CERTIFICATION

I, Gene Hodges, certify that:

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

Date: October 28, 2009

By: /s/ GENE HODGES

Gene Hodges
Chief Executive Officer

CERTIFICATION

I, Arthur S. Locke III, certify that:

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

Date: October 28, 2009

By: /s/ ARTHUR S. LOCKE III

Arthur S. Locke III
Chief Financial Officer

CERTIFICATION

Gene Hodges, Chief Executive Officer of Websense, Inc., hereby certifies pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, (the "Exchange Act") and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. § 1350) that, to the best of his knowledge:

1. The Quarterly Report on Form 10-Q/A of Websense, Inc. for the quarterly period ended March 31, 2009 (the "Quarterly Report") fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act.
2. The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of Websense, Inc. for the period covered by the Quarterly Report.

Dated: October 28, 2009

By: /s/ GENE HODGES

Gene Hodges

Chief Executive Officer

* A signed original of this written statement has been provided to Websense, Inc. and will be retained by Websense, Inc. and furnished to the Securities and Exchange Commission or its staff upon request. This written statement accompanies the Quarterly Report to which it relates, is not deemed filed with the Securities and Exchange Commission, and is not incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Exchange Act, irrespective of any general incorporation language contained in such filing.

CERTIFICATION

Arthur S. Locke III, Chief Financial Officer of Websense, Inc., hereby certifies pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, (the "Exchange Act") and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. § 1350) that, to the best of his knowledge:

1. The Quarterly Report on Form 10-Q/A of Websense, Inc. for the quarterly period ended March 31, 2009 (the "Quarterly Report") fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act.
2. The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of Websense, Inc. for the period covered by the Quarterly Report.

Dated: October 28, 2009

By: /s/ ARTHUR S. LOCKE III

Arthur S. Locke III
Chief Financial Officer

- * A signed original of this written statement has been provided to Websense, Inc. and will be retained by Websense, Inc. and furnished to the Securities and Exchange Commission or its staff upon request. This written statement accompanies the Quarterly Report to which it relates, is not deemed filed with the Securities and Exchange Commission, and is not incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Exchange Act, irrespective of any general incorporation language contained in such filing.