

NetApp, Inc.  
Form 10-Q  
March 05, 2012  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

(Mark One)

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

For the quarterly period ended January 27, 2012

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 000-27130

**NetApp, Inc.**

(Exact name of registrant as specified in its charter)

Edgar Filing: NetApp, Inc. - Form 10-Q

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**77-0307520**  
(IRS Employer  
Identification No.)

**495 East Java Drive,**

**Sunnyvale, California 94089**

(Address of principal executive offices, including zip code)

**(408) 822-6000**

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

**Class**  
Common Stock

**Outstanding at February 21, 2012**  
362,990,179

**Table of Contents****TABLE OF CONTENTS****PART I FINANCIAL INFORMATION**

Item 1	<u>Condensed Consolidated Financial Statements (Unaudited)</u>	3
	<u>Condensed Consolidated Balance Sheets as of January 27, 2012 and April 29, 2011</u>	3
	<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended January 27, 2012 and January 28, 2011</u>	4
	<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended January 27, 2012 and January 28, 2011</u>	5
	<u>Notes to Condensed Consolidated Financial Statements</u>	6
Item 2	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	26
Item 3	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	41
Item 4	<u>Controls and Procedures</u>	43

**PART II OTHER INFORMATION**

Item 1	<u>Legal Proceedings</u>	45
Item 1A	<u>Risk Factors</u>	45
Item 2	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	67
Item 3	<u>Defaults upon Senior Securities</u>	67
Item 4	<u>Mine Safety Disclosures</u>	67
Item 5	<u>Other Information</u>	67
Item 6	<u>Exhibits</u>	67
	<u>SIGNATURE</u>	68

**TRADEMARKS**

© Copyright 2012 NetApp, Inc. All rights reserved. No portions of this document may be reproduced without prior written consent of NetApp, Inc. NetApp, the NetApp logo, Go further, faster, DataFabric, Data ONTAP, FAServer, FilerView, FlexCache, FlexClone, FlexShare, FlexVol, MultiStore, NearStore, Network Appliance, SecureShare, SnapDrive, SnapLock, SnapManager, SnapMirror, SnapRestore, Snapshot, SnapVault, and WAFL are trademarks or registered trademarks of NetApp, Inc. in the United States and/or other countries. Windows is a registered trademark of Microsoft Corporation. UNIX is a registered trademark of The Open Group. All other brands or products are trademarks or registered trademarks of their respective holders and should be treated as such.

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements (Unaudited)****NETAPP, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In millions)****(Unaudited)**

	<b>January 27, 2012</b>	<b>April 29, 2011</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 2,420.9	\$ 2,757.3
Short-term investments	2,445.2	2,417.4
Accounts receivable, net of allowance of \$0.4 million and \$0.5 million at January 27, 2012 and April 29, 2011, respectively	685.4	742.6
Inventories	153.8	108.5
Other current assets	462.4	339.4
Total current assets	6,167.7	6,365.2
Property and equipment, net	1,081.8	911.6
Goodwill	905.2	760.3
Other intangible assets, net	257.5	53.0
Other non-current assets	409.4	408.7
<b>Total assets</b>	<b>\$ 8,821.6</b>	<b>\$ 8,498.8</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 220.2	\$ 232.8
Accrued compensation and related benefits	269.2	437.2
Other current liabilities	358.8	325.8
1.75% Convertible Senior Notes Due 2013	0.0	1,150.4
Short-term deferred revenue	1,309.3	1,226.6
Total current liabilities	2,157.5	3,372.8
1.75% Convertible Senior Notes Due 2013	1,188.8	0.0
Other long-term liabilities	197.3	192.9
Long-term deferred revenue	1,236.5	1,088.3
Total liabilities	4,780.1	4,654.0
Commitments and contingencies (Note 15)		
1.75% Convertible Senior Notes Due 2013	0.0	114.6
Stockholders' equity:		
Common stock (466.3 and 473.3 shares issued at January 27, 2012 and April 29, 2011, respectively)	0.5	0.5
Additional paid-in capital	4,339.2	3,970.3
Treasury stock, at cost (104.3 shares at January 27, 2012 and April 29, 2011)	(2,927.4)	(2,927.4)

Edgar Filing: NetApp, Inc. - Form 10-Q

Retained earnings	2,624.6	2,674.0
Accumulated other comprehensive income	4.6	12.8
Total stockholders' equity	4,041.5	3,730.2
<b>Total liabilities and stockholders' equity</b>	<b>\$ 8,821.6</b>	<b>\$ 8,498.8</b>

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****NETAPP, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(In millions, except per share amounts)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
<b>Revenues:</b>				
Product	\$ 1,062.7	\$ 844.3	\$ 3,044.6	\$ 2,406.6
Software entitlements and maintenance	203.5	182.7	599.7	533.6
Service	299.3	262.6	886.4	754.1
<b>Net revenues</b>	<b>1,565.5</b>	<b>1,289.6</b>	<b>4,530.7</b>	<b>3,694.3</b>
<b>Cost of revenues:</b>				
Cost of product	517.8	328.4	1,415.9	962.9
Cost of software entitlements and maintenance	6.2	4.0	17.1	10.9
Cost of service	133.0	111.0	379.3	320.0
<b>Total cost of revenues</b>	<b>657.0</b>	<b>443.4</b>	<b>1,812.3</b>	<b>1,293.8</b>
<b>Gross profit</b>	<b>908.5</b>	<b>846.2</b>	<b>2,718.4</b>	<b>2,400.5</b>
<b>Operating expenses:</b>				
Sales and marketing	477.0	397.4	1,385.9	1,134.4
Research and development	208.3	166.0	606.6	472.1
General and administrative	63.2	61.9	193.4	182.3
Restructuring and other charges	0.0	(0.7)	0.0	(0.6)
Acquisition-related expense	3.5	0.6	7.4	0.9
<b>Total operating expenses</b>	<b>752.0</b>	<b>625.2</b>	<b>2,193.3</b>	<b>1,789.1</b>
<b>Income from operations</b>	<b>156.5</b>	<b>221.0</b>	<b>525.1</b>	<b>611.4</b>
<b>Other expense, net:</b>				
Interest income	8.7	10.3	27.6	29.6
Interest expense	(18.9)	(19.0)	(54.7)	(56.2)
Other income (expense), net	0.6	0.4	(0.1)	1.2
<b>Total other expense, net</b>	<b>(9.6)</b>	<b>(8.3)</b>	<b>(27.2)</b>	<b>(25.4)</b>
<b>Income before income taxes</b>	<b>146.9</b>	<b>212.7</b>	<b>497.9</b>	<b>586.0</b>
Provision for income taxes	27.3	26.3	73.2	73.5
<b>Net income</b>	<b>\$ 119.6</b>	<b>\$ 186.4</b>	<b>\$ 424.7</b>	<b>\$ 512.5</b>
<b>Net income per share:</b>				
Basic	\$ 0.33	\$ 0.51	\$ 1.17	\$ 1.43

Edgar Filing: NetApp, Inc. - Form 10-Q

Diluted	\$ 0.32	\$ 0.46	\$ 1.10	\$ 1.31
<b>Shares used in net income per share calculations:</b>				
Basic	360.3	364.8	364.0	358.8
Diluted	373.7	406.2	385.1	390.7

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****NETAPP, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In millions)****(Unaudited)**

	<b>Nine Months Ended</b>	
	<b>January 27, 2012</b>	<b>January 28, 2011</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 424.7	\$ 512.5
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	210.5	123.3
Stock-based compensation	197.8	127.0
Accretion of discount and issuance costs on notes	38.7	39.2
Deferred income taxes	(64.0)	(40.4)
Tax benefit from stock-based compensation	74.7	74.9
Excess tax benefit from stock-based compensation	(80.7)	(63.3)
Other non-cash items, net	(7.9)	14.2
Changes in assets and liabilities, net of acquisitions of businesses:		
Accounts receivable	55.8	(77.5)
Inventories	(8.8)	18.8
Other operating assets	(49.2)	31.7
Accounts payable	(10.4)	(2.3)
Accrued compensation and other current liabilities	(160.5)	(40.6)
Deferred revenue	234.5	151.5
Other operating liabilities	24.8	18.5
Net cash provided by operating activities	880.0	887.5
<b>Cash flows from investing activities:</b>		
Purchases of investments	(1,718.9)	(2,190.4)
Redemptions of investments	1,697.7	1,354.9
Purchases of property and equipment	(282.9)	(149.8)
Acquisitions of businesses, net of cash acquired	(480.0)	(74.9)
Other investing activities, net	0.0	0.8
Net cash used in investing activities	(784.1)	(1,059.4)
<b>Cash flows from financing activities:</b>		
Issuance of common stock	101.0	312.0
Repurchase and retirement of common stock	(600.0)	0.0
Excess tax benefit from stock-based compensation	80.7	63.3
Other financing activities, net	3.1	0.4
Net cash provided by (used in) financing activities	(415.2)	375.7
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>(17.1)</b>	<b>10.6</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(336.4)</b>	<b>214.4</b>
<b>Cash and cash equivalents:</b>		
Beginning of period	2,757.3	1,705.0



Edgar Filing: NetApp, Inc. - Form 10-Q

End of period	\$ 2,420.9	\$ 1,919.4
---------------	------------	------------

See accompanying notes to condensed consolidated financial statements.

---

**Table of Contents**

**NETAPP, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. The Company**

Headquartered in Sunnyvale, California, NetApp, Inc. ( we , us , or the Company ) is a supplier of enterprise storage and data management software and hardware products and services. Our solutions help global enterprises meet major information technology challenges such as managing storage growth, assuring secure and timely information access, protecting data and controlling costs by providing innovative solutions that simplify the complexity associated with managing corporate data.

**2. Condensed Consolidated Financial Statements**

*Fiscal Year* Our fiscal year is reported on a 52- or 53-week year ending on the last Friday in April. The first, second and third quarters of fiscal 2012 and 2011 were each 13-week periods.

*Basis of Presentation* The accompanying unaudited condensed consolidated financial statements have been prepared by the Company, and reflect all adjustments, consisting only of normal recurring adjustments that are, in the opinion of management, necessary for the fair presentation of our financial position, results of operations, and cash flows for the interim periods presented. The statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these statements do not include all information and footnotes required by GAAP for annual consolidated financial statements, and should be read in conjunction with our audited consolidated financial statements as of and for the fiscal year ended April 29, 2011 contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on June 23, 2011. The results of operations for the three and nine months ended January 27, 2012 are not necessarily indicative of the operating results to be expected for the full fiscal year or future operating periods.

*Financial Statements Presentation* Certain prior period amounts have been reclassified in the accompanying condensed consolidated financial statements to conform to current year presentation.

**3. Significant Accounting Policies**

There have been no significant changes in our significant accounting policies as of and for the nine months ended January 27, 2012, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended April 29, 2011.

*Accounting Standards Recently Adopted*

*Revenue Recognition*

In October 2009, the Financial Accounting Standards Board (FASB) amended the accounting standards for revenue recognition to exclude tangible products containing software components and non-software components that function together to deliver the tangible product s essential functionality from the scope of the software revenue recognition guidance. Concurrently, the FASB also amended the accounting standards for multiple deliverable revenue arrangements to:

provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the arrangement consideration should be allocated among its elements;

require an entity to allocate revenue in an arrangement that has separate units of accounting using best estimated selling prices (BESP) of deliverables if a vendor does not have vendor-specific objective evidence (VSOE) of fair value or third-party evidence of selling price (TPE); and

eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method to the separate units of accounting.

We elected to early adopt these standards in the fourth quarter of fiscal 2011, and the standards were applied retrospectively from the beginning of fiscal 2011 for new and materially modified revenue arrangements originating after April 30, 2010. Previously reported quarterly results have been adjusted to reflect the adoption of these standards and differ from the originally reported results.

---

**Table of Contents**

The majority of our products are hardware systems containing software components that function together to provide the essential functionality of the product. Therefore, our hardware systems and software components essential to the functionality of the hardware systems are considered non-software deliverables and therefore are not subject to industry-specific software revenue recognition guidance.

Our product revenues also include revenues from the sale of non-essential software products. Non-essential software products may operate on our hardware systems, but are not considered essential to the functionality of the hardware. Non-essential software sales generally include a perpetual license to our software. Non-essential software sales continue to be subject to the industry-specific software revenue recognition guidance. For arrangements within the scope of the new guidance, a deliverable constitutes a separate unit of accounting when it has standalone value and there are no customer-negotiated refunds or return rights for the delivered elements.

For transactions entered into or materially modified after April 30, 2010, we recognize revenue in accordance with the new accounting standards when applicable. Certain arrangements with multiple deliverables may continue to have software deliverables that are subject to the existing software revenue recognition guidance along with non-software deliverables that are subject to the new standards. The revenue for these multiple element arrangements is allocated to the software deliverables and the non-software deliverables as a group based on the relative selling prices of all of the deliverables in the arrangement using the selling price hierarchy set forth in the standards.

For our non-software deliverables, we recognize revenue based on the new standards and allocate the arrangement consideration based on the relative selling price of the deliverables. For our non-software deliverables, we use BESP as our selling price. For our software entitlements and support services, we generally use VSOE as our selling price. When we are unable to establish selling prices using VSOE for our software entitlements and support services, we use BESP in our allocation of arrangement consideration.

VSOE of fair value for elements of an arrangement is based upon the normal pricing and discounting practices for those services when sold separately. In determining VSOE, we require that a substantial majority of the selling prices for an element fall within a reasonably narrow pricing range, generally evidenced by a substantial majority of such historical stand-alone transactions falling within a reasonably narrow range. In addition, we consider major service type, customer classifications, and other variables in determining VSOE.

When VSOE cannot be established, we attempt to establish the selling price of each element based on TPE. TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, our go-to-market strategy differs from that of our peers and our offerings contain a significant level of differentiation such that the comparable pricing of products with similar functionality cannot be obtained. Furthermore, we are unable to reliably determine what similar competitor products' selling prices are on a stand-alone basis. Therefore, we typically are not able to determine TPE for our products or services.

When we are unable to establish the selling price of our non-software deliverables using VSOE or TPE, we use our BESP in our allocation of arrangement consideration. The objective of BESP is to determine the price at which we would transact a sale if the product or service were sold on a stand-alone basis. BESP is determined for a product or service by considering multiple factors, including, but not limited to, cost of products, gross margin objectives, historical pricing practices, customer classes and distribution channels. In determining BESP, we require that the majority of the selling prices fall within a reasonable pricing range, generally evidenced by a majority of such historical transactions falling within a reasonable range.

We regularly review VSOE, TPE, and BESP and maintain internal controls over the establishment and updates of these estimates.

For sales of software deliverables after April 30, 2010 and for all transactions entered into prior to the first quarter of fiscal year 2011, we recognize revenue based on software revenue recognition guidance. Under the software revenue recognition guidance, we use the residual method to recognize revenue when a multiple element arrangement includes one or more elements to be delivered at a future date and VSOE of fair value of all undelivered elements exists. In the majority of our contracts, the only element that remains undelivered at the time of delivery of the product is software entitlements and maintenance (SEM) and/or service. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the contract fee is recognized as product revenues. If evidence of the fair value of one or more undelivered elements does not exist, all revenue is generally deferred until the earlier of when delivery of those elements occurs or when fair value can be established. In instances where the only undelivered element without fair value is SEM, the entire arrangement is recognized ratably over the maintenance period.

**Table of Contents***Recent Accounting Standards Not Yet Effective*

In May 2011, the FASB issued new guidance for fair value measurements to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between GAAP and International Financial Reporting Standards. The guidance changes certain fair value measurement principles and enhances the disclosure requirements, particularly for level 3 fair value measurements. The guidance is effective for us prospectively beginning in our fourth quarter of fiscal 2012. There will be no impact to our results of operations, financial position and cash flows as the guidance relates only to financial statement presentation.

In June 2011, as modified in December 2011, the FASB issued new guidance on the presentation of comprehensive income. Specifically, the new guidance requires an entity to present components of net income and other comprehensive income in one continuous statement, referred to as the statement of comprehensive income, or in two separate, but consecutive statements. The new guidance eliminates the current option to report other comprehensive income and its components in the statement of stockholders' equity. The specific requirement to present items that are reclassified from accumulated other comprehensive income to net income separately within their respective components of net income and other comprehensive income has been deferred. While the new guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income under current accounting guidance. This new guidance is effective for us beginning in our first quarter of fiscal 2013 and is required to be applied retrospectively. There will be no impact to our results of operations, financial position and cash flows as the guidance relates only to financial statement presentation.

In September 2011, the FASB issued a revised accounting standard intended to simplify how an entity tests goodwill for impairment. The revised standard will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. An entity will no longer be required to calculate the fair value of a reporting unit unless it determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. This guidance is effective for us beginning in our first quarter of fiscal 2013. We do not expect this guidance to have a material impact on our consolidated financial statements.

In December 2011, the FASB issued new guidance that will require us to disclose information about offsetting arrangements associated with financial and derivative instruments to enable users of our financial statements to understand the effect of those arrangements on our financial position. This guidance is effective for us beginning in our first quarter of fiscal 2014 and is required to be applied retrospectively. We are currently evaluating the impact of adoption on our consolidated financial statements.

*Use of Estimates*

The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Such estimates include, but are not limited to, revenue recognition, reserve and allowances; inventory valuation and purchase order accruals; valuation of goodwill and intangibles; restructuring reserves; product warranties; employee benefits; stock-based compensation; loss contingencies; investment impairments; income taxes, and fair value measurements. Actual results could differ materially from those estimates.

**4. Statements of Cash Flows**

Non-cash investing and financing activities and supplemental cash flow information are as follows (in millions):

	Nine Months Ended	
	January 27, 2012	January 28, 2011
<b>Non-cash Investing and Financing Activities:</b>		
Reclassification of equity component of convertible debt	\$ 114.6	\$ 0.0
Acquisition of property and equipment on account	\$ 37.4	\$ 7.8
Acquisition of property and equipment through long-term financing	\$ 3.0	\$ 12.6
Options assumed from acquired business	\$ 0.0	\$ 3.3
<b>Supplemental Cash Flow Information:</b>		
Income taxes paid, net of refunds	\$ 39.3	\$ 23.4
Interest paid (net of capitalized interest of \$1.3 million and \$0.0 million, respectively)	\$ 21.3	\$ 22.6



**Table of Contents****5. Business Combinations*****Fiscal 2012 Acquisition***

On May 6, 2011, we completed the acquisition of certain assets related to the Engenio external storage systems business (Engenio) of LSI Corporation (LSI). We paid LSI \$480.0 million in cash and also assumed certain liabilities related to Engenio. During the three years following the acquisition, LSI will pay us a total of \$13.0 million to service certain LSI customer warranties. This acquisition enables us to address growing customer requirements in the areas of high bandwidth and intensive analytics workloads such as video, including full-motion video capture and digital video surveillance, as well as high-performance computing applications, such as genomics sequencing and scientific research.

The purchase price was allocated to Engenio's net tangible and intangible assets as of the date of acquisition based on various fair value estimates and analyses, including work performed by third-party valuation specialists.

The following are the preliminary estimated fair value of assets acquired and liabilities assumed as of the closing date (in millions):

Current assets	\$ 49.8
Property and equipment	33.3
Identified intangible assets	272.1
Goodwill	143.7
Other assets	9.3
Total assets acquired	508.2
Current liabilities	(20.9)
Other liabilities	(7.3)
Total purchase price	\$ 480.0

Adjustments may be made to the allocation of the purchase price during the measurement period to reflect adjustments related to facts existing at the time of the acquisition.

As this was an asset acquisition, United States (U.S.) goodwill is deductible for income tax purposes. The goodwill is comprised of expected synergies in utilizing Engenio's technology in our products and channels (and vice versa), reduction in future combined research and development expenses, and intangible assets, such as acquired workforce, that do not qualify for separate recognition.

The identified intangible assets as of the date of acquisition, which are amortized on a straight-line basis over their estimated useful lives, consisted of the following (in millions, except useful life):

	Estimated Fair Value	Useful Life (Years)
Developed technology	\$ 216.0	5
Customer contracts/relationships	45.0	2
Trademarks and trade names	7.0	2
Order backlog	2.5	0
Covenant not to compete	1.6	3
Total identified intangible assets	\$ 272.1	

Our consolidated net revenues for the three and nine months ended January 27, 2012 included \$178.3 million and \$517.8 million, respectively, attributable to Engenio since the acquisition. Due to continued integration of the combined businesses since the date of acquisition, it is impracticable to determine the earnings contributed by Engenio.

## Edgar Filing: NetApp, Inc. - Form 10-Q

The following unaudited pro forma condensed combined financial information gives effect to the acquisition of Engenio as if it were consummated on May 1, 2010 (the beginning of the comparable prior annual reporting period). Due to historically differing fiscal year ends of the Company and Engenio, the unaudited pro forma condensed combined financial information for the three and nine months ended January 28, 2011 is based on historical results of the Company for the three and nine months ended January 28, 2011 and the historical results of Engenio for the three and nine months ended December 31, 2010.



**Table of Contents**

The unaudited pro forma condensed combined financial information is presented for informational purposes only, is not intended to represent or be indicative of the results of operations of the Company that would have been reported had the acquisition occurred on May 1, 2010 and should not be taken as representative of future condensed consolidated results of operations of the combined company (in millions):

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Net revenues	\$ 1,565.5	\$ 1,486.6	\$ 4,539.3	\$ 4,240.5
Net income	\$ 119.6	\$ 142.8	\$ 431.3	\$ 459.0

A nonrecurring adjustment of \$5.6 million has been reflected in the unaudited pro forma condensed combined information with the effect of increasing net income for the nine months ended January 27, 2012 and decreasing net income for the nine months ended January 28, 2011 to present the impact on cost of revenues from the step-up in inventory as if the acquisition occurred on May 1, 2010.

Acquisition-related expense included in our condensed consolidated statements of operations was:

	Three Months Ended	Nine Months Ended
	January 27, 2012	January 27, 2012
Acquisition-related expense	\$ 3.5	\$ 7.4

For the nine months ended January 27, 2012, acquisition-related expense consisted of due diligence and legal charges of \$0.7 million directly related to the acquisition of Engenio and \$6.7 million of integration charges related to the combined business.

**Fiscal 2011 Acquisitions**

During fiscal 2011, we acquired two privately held companies, Akorri Networks, Inc. (Akorri), and Bycast Inc. (Bycast). Akorri, headquartered in Massachusetts, is a provider of data center management software focused on performance and capacity analytics for virtualized, shared information technology infrastructures. The Akorri acquisition extends our offering by adding performance capacity analytics to provide customers greater visibility across the entire IT stack, resulting in further improvement in IT efficiency and flexibility through functions that help control, automate, and analyze their shared IT infrastructure. Bycast, headquartered in Vancouver, Canada, develops and sells software designed to manage petabyte-scale, globally distributed repositories of images, video and records for enterprises and service providers. The Bycast acquisition extends our position in unified storage by adding an object-based storage software offering, which simplifies the task of large-scale storage and improves the ability to search and locate data objects.

The following table summarizes the purchase price components and equity interests acquired as of January 27, 2012 (in millions):

	Akorri January 31, 2011	Bycast May 13, 2010
Acquisition dates		
Percentage of equity interest acquired	100%	100%
Total purchase price	\$ 62.3	\$ 83.8
Cash component of purchase price	\$ 62.3	\$ 80.5
Fair value of vested options assumed	\$ 0.0	\$ 3.3
Purchase price held in escrow to secure obligations of acquired entity	\$ 7.9	\$ 0.0

## Edgar Filing: NetApp, Inc. - Form 10-Q

In the three months ended January 27, 2012, the escrow period for the Bycast acquisition expired and the remaining purchase price of \$13.1 million was released to the former shareholders. Subject to any claims for indemnity, the escrow funds for Akorri will be released in July 2012.

A summary of the purchase price allocation as of the respective acquisition dates is as follows (in millions):

	<b>Akorri</b>	<b>Bycast</b>
Cash	\$ 0.7	\$ 5.7
Identified intangible assets	22.0	23.6
Goodwill	23.3	56.0
Deferred income taxes	9.9	(3.9)
Other assets, net	6.4	2.4
Total purchase price	\$ 62.3	\$ 83.8

**Table of Contents**

In the three and nine months ended January 27, 2012, an adjustment of \$1.2 million was recorded to the value of Akorri goodwill related to an adjustment to deferred income taxes.

Goodwill related to the Akorri and Bycast acquisitions is not deductible for income tax purposes.

The results of operations of Akorri and Bycast are included in our condensed consolidated statements of operations from their respective acquisition dates. Pro forma results of operations have not been presented because the acquisitions were not material to our results of operations.

**6. Goodwill and Other Intangible Assets, Net**

Goodwill and other intangible assets, net are summarized as follows (in millions):

<b>Goodwill:</b>	
April 29, 2011	\$ 760.3
Additions	143.7
Adjustments	1.2
January 27, 2012	\$ 905.2

	January 27, 2012			April 29, 2011		
	Gross Carrying Amount	Accumulated Amortization	Other Intangible Assets, Net	Gross Carrying Amount	Accumulated Amortization	Other Intangible Assets, Net
<b>Other Intangible Assets, Net:</b>						
Developed technology	\$ 282.1	\$ (65.0)	\$ 217.1	\$ 66.1	\$ (23.2)	\$ 42.9
Customer contracts/relationships	59.5	(26.5)	33.0	12.0	(4.6)	7.4
Trademarks and trade names	14.7	(8.7)	6.0	7.7	(5.5)	2.2
Covenants not to compete	2.2	(0.8)	1.4	0.6	(0.1)	0.5
Total other intangible assets	\$ 358.5	\$ (101.0)	\$ 257.5	\$ 86.4	\$ (33.4)	\$ 53.0

Amortization expense for other intangible assets is summarized below (in millions):

	Three Months Ended		Nine Months Ended		Statements of Operations Classifications
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011	
Developed technology	\$ 14.0	\$ 2.5	\$ 41.9	\$ 10.2	Cost of product revenues
Customer contracts/relationships	6.4	0.6	21.8	2.2	Sales and marketing
Trademarks and trade names	1.0	0.3	3.3	0.9	Sales and marketing
Covenants not to compete	0.2	0.0	0.6	0.0	Sales and marketing/Research and development
	\$ 21.6	\$ 3.4	\$ 67.6	\$ 13.3	

As of January 27, 2012, future amortization expense related to identifiable intangible assets is as follows (in millions):

Edgar Filing: NetApp, Inc. - Form 10-Q

<b>Fiscal Year</b>	<b>Amount</b>
Remainder of 2012	\$ 21.4
2013	84.2
2014	52.0
2015	50.7
2016	46.9
2017	2.3
<b>Total</b>	<b>\$ 257.5</b>

**7. Balance Sheet Details**

*Cash and cash equivalents (in millions):*

	<b>January 27, 2012</b>	<b>April 29, 2011</b>
Cash	\$ 754.6	\$ 1,169.1
Cash equivalents	1,666.3	1,588.2
<b>Cash and cash equivalents</b>	<b>\$ 2,420.9</b>	<b>\$ 2,757.3</b>

**Table of Contents*****Inventories (in millions):***

	January 27, 2012	April 29, 2011
Purchased components	\$ 15.6	\$ 7.5
Work-in-process	0.0	0.1
Finished goods	138.2	100.9
Inventories	\$ 153.8	\$ 108.5

***Other current assets (in millions):***

	January 27, 2012	April 29, 2011
Deferred tax assets, net	\$ 223.2	\$ 145.7
Prepaid expenses and other current assets	231.1	188.4
Short-term restricted cash	8.1	5.3
Other current assets	\$ 462.4	\$ 339.4

***Property and equipment, net (in millions):***

	January 27, 2012	April 29, 2011
Land	\$ 206.1	\$ 204.7
Buildings and building improvements	417.3	406.2
Leasehold improvements	92.8	79.3
Computer, production, engineering and other equipment	603.1	475.5
Software	360.0	270.4
Furniture and fixtures	70.5	61.5
Construction-in-progress	107.7	91.9
	1,857.5	1,589.5
Accumulated depreciation and amortization	(775.7)	(677.9)
Property and equipment, net	\$ 1,081.8	\$ 911.6

Software includes capitalized internal-use software development costs. The net book value of computer software is as follows (in millions):

	January 27, 2012	April 29, 2011
Computer software	\$ 154.0	\$ 88.3

***Other non-current assets (in millions):***

Edgar Filing: NetApp, Inc. - Form 10-Q

	January 27, 2012	April 29, 2011
Auction rate securities	\$ 51.0	\$ 65.1
Restricted cash	2.4	2.8
Deferred tax assets, net	183.9	213.2
Other assets	172.1	127.6
<b>Other non-current assets</b>	<b>\$ 409.4</b>	<b>\$ 408.7</b>

*Short-term and long-term deferred revenue (in millions):*

	January 27, 2012	April 29, 2011
Product	\$ 32.8	\$ 106.2
SEM and service	2,513.0	2,208.7
<b>Total</b>	<b>\$ 2,545.8</b>	<b>\$ 2,314.9</b>
Reported as:		
Short-term	\$ 1,309.3	\$ 1,226.6
Long-term	1,236.5	1,088.3
<b>Total</b>	<b>\$ 2,545.8</b>	<b>\$ 2,314.9</b>

**Table of Contents****8. Financial Instruments and Fair Value**

The accounting guidance for fair value measurements provides a framework for measuring fair value on either a recurring or nonrecurring basis whereby the inputs used in valuation techniques are assigned a hierarchical level. The following are the three levels of inputs to measure fair value:

*Level 1:* Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

*Level 2:* Inputs that reflect quoted prices for identical assets or liabilities in less active markets; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

*Level 3:* Unobservable inputs that reflect our own assumptions incorporated in valuation techniques used to measure fair value. These assumptions are required to be consistent with market participant assumptions that are reasonably available.

We consider an active market to be one in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an on-going basis, and consider an inactive market to be one in which there are infrequent or few transactions for the asset or liability, the prices are not current, or price quotations vary substantially either over time or among market makers. Where appropriate, our own or the counterparty's non-performance risk is considered in measuring the fair values of liabilities and assets, respectively.

**Investments**

The following is a summary of our investments as of January 27, 2012 and April 29, 2011, respectively (in millions):

	January 27, 2012				April 29, 2011			
	Cost or Amortized Cost	Gross Unrealized		Estimated Fair Value	Cost or Amortized Cost	Gross Unrealized		Estimated Fair Value
		Gains	Losses			Gains	Losses	
Corporate bonds	\$ 1,968.6	\$ 7.2	\$ (2.0)	\$ 1,973.8	\$ 1,643.2	\$ 10.2	\$ (0.6)	\$ 1,652.8
U.S. treasury and government debt securities	351.4	0.3	0.0	351.7	661.9	0.6	(0.7)	661.8
Commercial paper	66.2	0.0	0.0	66.2	5.0	0.0	0.0	5.0
Certificates of deposit	107.3	0.4	0.0	107.7	96.3	0.0	0.0	96.3
Money market funds	1,612.1	0.0	0.0	1,612.1	1,539.6	0.0	0.0	1,539.6
Auction rate securities	54.4	0.8	(4.2)	51.0	69.2	0.4	(4.5)	65.1
Equity funds	24.3	0.0	0.0	24.3	20.2	0.0	0.0	20.2
Private equity fund	1.0	0.0	0.0	1.0	1.3	0.0	0.0	1.3
Municipal bonds	0.0	0.0	0.0	0.0	1.5	0.0	0.0	1.5
Total debt and equity securities	\$ 4,185.3	\$ 8.7	\$ (6.2)	\$ 4,187.8	\$ 4,038.2	\$ 11.2	\$ (5.8)	\$ 4,043.6

The following table presents the contractual maturities of our debt investments as of January 27, 2012 (in millions):

	Amortized Cost	Fair Value
Due in one year or less	\$ 821.6	\$ 823.6
Due in one through five years	1,672.0	1,675.8
Due after ten years*	54.4	51.0
	\$ 2,548.0	\$ 2,550.4

\* Consists of auction rate securities which have contractual maturities of greater than 10 years.



**Table of Contents****Fair Value of Financial Instruments**

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis as of January 27, 2012 (in millions):

	Total	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets</b>				
Corporate bonds	\$ 1,973.8	\$ 0.0	\$ 1,973.8	\$ 0.0
U.S. treasuries and government debt securities	351.7	0.0	351.7	0.0
Commercial paper	66.2	0.0	66.2	0.0
Certificates of deposit	107.7	0.0	107.7	0.0
Money market funds	1,612.1	1,612.1	0.0	0.0
Auction rate securities	51.0	0.0	0.0	51.0
Equity funds	24.3	24.3	0.0	0.0
Private equity fund	1.0	0.0	0.0	1.0
Foreign currency contracts	4.5	0.0	4.5	0.0
<b>Total</b>	<b>\$ 4,192.3</b>	<b>\$ 1,636.4</b>	<b>\$ 2,503.9</b>	<b>\$ 52.0</b>
<b>Liabilities</b>				
Foreign currency contracts	\$ 3.8	\$ 0.0	\$ 3.8	\$ 0.0

Reported as (in millions):

	Total	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets</b>				
Cash equivalents	\$ 1,666.3	\$ 1,612.1	\$ 54.2	\$ 0.0
Short-term investments	2,445.2	0.0	2,445.2	0.0
Other current assets	9.8	5.3	4.5	0.0
Other non-current assets	71.0	19.0	0.0	52.0
<b>Total</b>	<b>\$ 4,192.3</b>	<b>\$ 1,636.4</b>	<b>\$ 2,503.9</b>	<b>\$ 52.0</b>
<b>Liabilities</b>				
Other current liabilities	\$ 3.8	\$ 0.0	\$ 3.8	\$ 0.0

The unrealized losses on our available-for-sale investments in corporate bonds were caused by market value declines as a result of the economic environment, as well as fluctuations in market interest rates. Because the decline in market value is attributable to changes in market conditions

## Edgar Filing: NetApp, Inc. - Form 10-Q

and not credit quality, and because we neither intend to sell nor are likely to be required to sell these investments prior to a recovery of par value, we do not consider these investments to be other-than temporarily impaired as of January 27, 2012.

The table below provides a reconciliation of the beginning and ending balance of our Level 3 auction rate securities measured at fair value on a recurring basis using significant unobservable inputs as of January 27, 2012 and January 28, 2011, respectively (in millions):

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Balance at beginning of period	\$ 56.0	\$ 66.2	\$ 65.1	\$ 69.0
Total unrealized gains (losses), net included in other comprehensive income	(0.7)	(0.5)	0.6	(1.9)
Total realized gains included in earnings	0.7	0.0	0.7	0.0
Settlements	(5.0)	(0.6)	(15.4)	(2.0)
<b>Balance at end of period</b>	<b>\$ 51.0</b>	<b>\$ 65.1</b>	<b>\$ 51.0</b>	<b>\$ 65.1</b>

All of our auction rate securities (ARSs) are classified as other non-current assets and are backed by pools of student loans guaranteed by the U.S. Department of Education. As of January 27, 2012, we recorded cumulative net temporary impairment charges of \$3.4 million in accumulated other comprehensive income (AOCI). Prior to the three months ended October 28, 2011, we estimated the fair value for each individual ARS using an income (discounted cash flow) approach that incorporates both observable and unobservable inputs to discount the expected future cash flows. Key inputs into the discounted cash flow analysis include managements' expectation of when the principal amount will be recovered either through redemption at par, a refinancing event by the issuer, and/or marketability adjustments. Beginning October 28, 2011, we included the market approach to the valuation technique in order to incorporate secondary market activity into our estimated fair value for each individual ARS. This change had no material impact on the valuation of our ARS portfolio. Based on our ability to access our cash and other short-term investments, our expected operating cash flows, and our other sources of cash, we do not intend to sell these investments prior to recovery of value. We will continue to monitor our ARS investments in light of the current debt market environment and evaluate these investments for impairment and classification.

---

**Table of Contents****9. Financing Arrangements*****1.75% Convertible Senior Notes Due 2013***

On June 10, 2008, we issued \$1,265.0 million aggregate principal amount of 1.75% Convertible Senior Notes due 2013 (the Notes). The Notes are unsecured, unsubordinated obligations of the Company, which pay interest in cash semi-annually at a rate of 1.75% per annum. The Notes will mature on June 1, 2013 unless earlier repurchased or converted in accordance with their terms prior to such date. The Notes may be converted, under the conditions specified below, based on an initial conversion rate of 31.40 shares of common stock per \$1,000 principal amount of Notes (which represents an initial effective conversion price of the Notes of \$31.85 per share), subject to adjustment as described in the indenture governing the Notes.

The Notes are not redeemable by us prior to the maturity date. In the event of a fundamental change (as defined in the indenture for the Notes), holders of the Notes may require us to repurchase all or a portion of their Notes at a repurchase price equal to 100% of the principal amount of the Notes plus accrued and unpaid interest, if any, to, but excluding, the fundamental change repurchase date.

The holders of the Notes may convert their Notes until the close of business on the scheduled trading day immediately preceding the maturity date if any of the following conditions are met: (1) during the five business day period after any five consecutive trading day period (the measurement period) in which the trading price of the Notes for each day in the measurement period was less than 98% of an amount equal to (i) the last reported sale price of our common stock multiplied by (ii) the conversion rate for the Notes on each such day; (2) during any calendar quarter (and only during such calendar quarter) if the last reported sale price of our common stock for 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the applicable conversion price in effect for the Notes on the last trading day of such immediately preceding calendar quarter; or (3) upon the occurrence of specified corporate transactions set forth in the indenture for the Notes. On or after March 1, 2013, until the scheduled trading day immediately preceding the maturity date, holders of the Notes may convert their Notes regardless of the foregoing conditions. Upon conversion, a holder will receive cash in an amount equal to the lesser of the conversion value and the principal amount of the Notes, and any shares of our common stock for any conversion value in excess of the principal amount of the Notes, if any. Holders of the Notes who convert their Notes in connection with a fundamental change will, under certain circumstances, be entitled to a make-whole premium in the form of an increase in the conversion rate.

Our common stock price did not exceed the conversion threshold price of \$41.41 per share set forth for the Notes for at least 20 trading days during the 30 consecutive trading days ended December 31, 2011. Accordingly, as of January 27, 2012, the Notes were not convertible at the option of the holder and, therefore, the carrying value of the Notes was classified as long-term debt and the difference between the principal amount and the carrying value of the Notes is reflected as equity on our condensed consolidated balance sheet as of that date.

Our common stock price exceeded the conversion threshold for the Notes for at least 20 trading days during the 30 consecutive trading days ended March 31, 2011. Accordingly, as of April 29, 2011, the Notes were convertible at the option of the holder and, therefore, the carrying value of the Notes was classified as short-term debt. Since the Notes were convertible at the option of the holder and the principal amount would have been required to be paid in cash, the difference between the principal amount and the carrying value of the Notes was reflected as convertible debt in mezzanine on our condensed consolidated balance sheet as of April 29, 2011.

The determination of whether or not the Notes are convertible must continue to be performed quarterly. Consequently, the Notes may be convertible in future quarters, and therefore may be classified as short-term debt, if the conversion thresholds are met in such quarters. Additionally, since the Notes would be convertible at the option of the holder and the principal amount would be required to be paid in cash, the difference between the principal amount and the carrying value of the Notes would be reflected as convertible debt in mezzanine on our condensed consolidated balance sheets.

Upon conversion of any Notes, we deliver cash up to the principal amount of the Notes and, with respect to any excess conversion value greater than the principal amount of the Notes, shares of our common stock. As of January 27, 2012, shares issued related to the Notes were minimal. Based on the closing price of our common stock of \$37.28 on January 27, 2012, the if-converted value of our Notes exceeded their principal amount by approximately \$215.6 million.

**Table of Contents**

The following table reflects the carrying value of the Notes (in millions):

	January 27, 2012	April 29, 2011
1.75% Convertible Senior Notes Due 2013	\$ 1,265.0	\$ 1,265.0
Less: Unamortized discount	(76.2)	(114.6)
<b>Net carrying amount of Notes</b>	<b>\$ 1,188.8</b>	<b>\$ 1,150.4</b>

We capitalize interest on facility assets under construction and on significant software development projects. The following table presents the amount of interest expense recognized related to the Notes (in millions):

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Contractual coupon interest expense	\$ 5.5	\$ 5.5	\$ 16.5	\$ 16.5
Amortization of debt discount	13.0	12.2	38.4	36.1
Amortization of debt issuance costs	1.1	1.1	3.3	3.1
Less capitalized interest	(0.9)	0.0	(4.3)	0.0
<b>Total interest expense related to Notes</b>	<b>\$ 18.7</b>	<b>\$ 18.8</b>	<b>\$ 53.9</b>	<b>\$ 55.7</b>

The following table reflects the remaining debt discount and issuance costs as of January 27, 2012 (in millions):

Remaining debt discount	\$ 76.2
Remaining issuance costs	6.6
Remaining life of the Notes (years)	1.3

**Note Hedges and Warrants**

Concurrent with the issuance of the Notes, we purchased Note hedges and sold warrants. The separate Note hedge and warrant transactions are structured to reduce the potential future economic dilution associated with the conversion of the Notes.

**Note Hedges:** As of January 27, 2012 and April 29, 2011, we had arrangements with counterparties to buy up to approximately 31.8 million shares, subject to anti-dilution adjustments, of our common stock at a price of \$31.85 per share, subject to adjustment. The Note hedge transactions will expire at the earlier of (1) the last day on which any Notes remain outstanding or (2) the scheduled trading day immediately preceding the maturity date of the Notes. Upon exercise of the Note hedges, we have the option to receive cash or shares of our common stock equal to the difference between the then market price and the strike price of the hedges.

**Warrants:** As of January 27, 2012 and April 29, 2011, we had outstanding warrants for others to acquire, subject to anti-dilution adjustments, 39.7 million shares of our common stock at an exercise price of \$41.28 per share, subject to adjustment, on a series of days commencing on September 3, 2013. Upon exercise of the warrants, we have the option to deliver cash or shares of our common stock equal to the difference between the then market price and the strike price of the warrants.

As of January 27, 2012, we were subject to potential dilution on the approximately 20% unhedged portion of our Notes upon conversion, if on the date of conversion, the per-share market price of our common stock exceeds the conversion price of \$31.85.

## Edgar Filing: NetApp, Inc. - Form 10-Q

As of January 27, 2012, we received a minimal number of shares related to the Note hedge transactions and no cash or shares were delivered related to the warrant transactions.

### ***Fair Value of Notes***

As of January 27, 2012, the approximate fair value of the principal amount of the Notes, which includes the debt and equity components, was approximately \$1,630.8 million, or 129% of the face value of the Notes, based upon quoted market information.

**Table of Contents****Other Long-Term Financing Arrangements**

The following presents the amounts due under other long-term financing arrangements (in millions):

	January 27, 2012	April 29, 2011
Current portion of other long-term financing arrangements	\$ 9.3	\$ 5.5
Non-current portion of other long-term financing arrangements	5.4	6.0
<b>Total</b>	<b>\$ 14.7</b>	<b>\$ 11.5</b>

**10. Stockholders Equity****Stock Options**

A summary of the activity under our stock option plans and agreements is as follows (in millions, except for the exercise price and contractual term):

	Number of Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at April 29, 2011	24.5	\$ 26.62		
Options granted	2.1	51.36		
Options exercised	(3.0)	20.98		
Options forfeitures and cancellations	(0.7)	35.96		
<b>Outstanding at January 27, 2012</b>	<b>22.9</b>	<b>29.28</b>	<b>3.91</b>	<b>\$ 239.6</b>
Options vested and expected to vest as of January 27, 2012	22.1	28.86	3.86	236.7
Exercisable at January 27, 2012	15.1	25.64	3.25	188.9

The aggregate intrinsic value represents the pre-tax difference between the exercise price of stock options and the quoted market price of our stock on that day for all in-the-money options. As of January 27, 2012, the total unrecognized compensation expense related to stock options was \$80.8 million, which is expected to be recognized on a straight-line basis over a weighted-average remaining service period of 2.2 years.

Additional information related to our stock options is summarized below (in millions, except per share information):

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Weighted-average fair value per share granted	\$ 13.26	\$ 18.79	\$ 16.88	\$ 15.72
Weighted-average fair value per share of options assumed in acquisition	N/A	N/A	N/A	\$ 21.15
Intrinsic value of options exercised	\$ 21.0	\$ 79.4	\$ 71.6	\$ 294.0
Proceeds received from the exercise of stock options	\$ 19.5	\$ 53.9	\$ 62.2	\$ 278.8
Fair value of options vested	\$ 18.1	\$ 23.1	\$ 56.8	\$ 77.5

N/A - Not Applicable

**Restricted Stock Units**

The following table summarizes activity related to our restricted stock units (RSUs) (in millions, except for the fair value):

	<b>Number of Shares</b>	<b>Weighted- Average Grant Date Fair Value</b>
Outstanding at April 29, 2011	10.1	\$ 35.79
RSUs granted	5.3	48.84
RSUs vested	(3.1)	29.92
RSUs forfeitures and cancellations	(0.7)	39.90
Outstanding at January 27, 2012	11.6	43.10

**Table of Contents**

RSUs are converted into common stock upon vesting. Upon the vesting of RSUs, we primarily use the net share settlement approach, where a portion of the shares are withheld and retired as settlement of statutory employee withholding taxes, which decreases the shares issued to the employee by a corresponding value. The number and value of the shares netted for employee taxes are summarized in the table below (in millions):

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Shares withheld for taxes	0.4	0.3	1.0	0.8
Fair value of shares withheld and retired	\$ 16.4	\$ 15.9	\$ 44.2	\$ 35.5

As of January 27, 2012, the total unrecognized compensation expense related to RSUs was \$340.8 million, which is expected to be recognized on a straight-line basis over a weighted-average remaining service period of 2.7 years.

**Employee Stock Purchase Plan**

Under the Employee Stock Purchase Plan (ESPP), employees are entitled to purchase shares of our common stock at a 15% discount from the quoted market price of our common stock at certain specified dates over a two-year period. Additional information related to our purchase rights issued under the ESPP is provided below (in millions, except per share information):

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Weighted-average fair value per right granted	\$ 12.93	\$ 16.54	\$ 13.34	\$ 15.35
Shares issued under the ESPP	1.5	3.2	2.6	6.0
Weighted-average price per share issued	\$ 31.03	\$ 11.87	\$ 34.53	\$ 11.50

**Stock-Based Compensation Expense**

Stock-based compensation expense included in the condensed consolidated statements of operations for the three and nine months ended January 27, 2012 and January 28, 2011, respectively, is as follows (in millions):

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Cost of product revenues	\$ 1.6	\$ 1.0	\$ 4.1	\$ 2.7
Cost of service revenues	5.7	3.6	13.8	10.6
Sales and marketing	37.5	21.3	96.5	59.2
Research and development	22.8	11.3	57.0	31.6
General and administrative	9.1	7.8	26.4	22.9
Total stock-based compensation expense	\$ 76.7	\$ 45.0	\$ 197.8	\$ 127.0

The following table summarizes stock-based compensation associated with each type of award (in millions):

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Employee stock options	\$ 13.8	\$ 13.8	\$ 43.0	\$ 39.7
RSUs and restricted stock awards	42.1	23.9	115.4	61.7



Edgar Filing: NetApp, Inc. - Form 10-Q

ESPP	20.8	7.3	39.4	25.6
Total stock-based compensation expense	\$ 76.7	\$ 45.0	\$ 197.8	\$ 127.0

Total income tax benefits associated with employee stock transactions and recognized in stockholders' equity were as follows (in millions):

	Nine Months Ended	
	January 27, 2012	January 28, 2011
Income tax benefits associated with employee stock transactions	\$ 74.7	\$ 74.9

**Table of Contents****Valuation Assumptions**

The fair value of each award is estimated on the grant date using the Black-Scholes option pricing model, assuming no expected dividends and the following weighted-average assumptions:

	Stock Options			
	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Expected term in years	4.8	4.8	4.8	4.8
Risk-free interest rate	0.84%	2.07%	1.54%	1.99%
Volatility	43%	37%	36%	37%

	ESPP			
	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Expected term in years	1.2	1.3	1.2	1.2
Risk-free interest rate	0.18%	0.35%	0.19%	0.43%
Volatility	45%	39%	44%	39%

**Stock Repurchase Program**

During the nine months ended January 27, 2012, 14.6 million shares of our common stock were repurchased as described below. Since the May 13, 2003 inception of our stock repurchase program through January 27, 2012, we repurchased a total of 119.0 million shares of our common stock at an average price of \$29.65 per share, for an aggregate purchase price of \$3.5 billion. As of January 27, 2012, our Board of Directors had authorized the repurchase of up to \$4.0 billion of our common stock under this stock repurchase program. As of January 27, 2012, the remaining authorized amount for stock repurchases under this program was \$0.5 billion with no termination date. The stock repurchase program may be suspended or discontinued at any time.

**Accelerated Share Repurchase Agreements**

On July 8, 2011, we entered into a collared accelerated share repurchase agreement (ASR) with Bank of America, N.A, under which we prepaid \$200.0 million to purchase shares of our common stock. The aggregate number of shares ultimately purchased was determined based on the volume weighted-average share price of our common stock over a specified period of time. The contract was settled in August 2011. The total number of shares repurchased and retired under this ASR was 4.1 million shares at a price of \$48.30.

On August 19, 2011, we entered into an ASR with Wells Fargo Bank, National Association, under which we prepaid \$400.0 million to purchase shares of our common stock. The aggregate number of shares ultimately purchased was determined based on the volume weighted-average share price of our common stock over a specified period of time. The contract was settled in November 2011. The total number of shares repurchased and retired under this ASR was 10.5 million shares at a price of \$38.08.

The value of the contracts was allocated to the cost of the shares repurchased and to the value of the ASR forward contracts as follows for the nine months ended January 27, 2012 (in millions):

	Shares of Common Stock	Additional Paid-in Capital	Retained Earnings	Total Repurchase Activity
Repurchase and retirement of common stock	(14.6)	\$ (125.8)	\$ (474.1)	\$ (599.9)
Value of ASR forward contracts		(0.1)		(0.1)

Edgar Filing: NetApp, Inc. - Form 10-Q

Total cash payment	(14.6)	\$ (125.9)	\$ (474.1)	\$ (600.0)
--------------------	--------	------------	------------	------------

**Comprehensive Income**

The components of accumulated other comprehensive income, net of related immaterial tax effects, were as follows (in millions):

	January 27, 2012	April 29, 2011
Accumulated translation adjustments	\$ 4.2	\$ 11.6
Accumulated unrealized gains on available-for-sale investments	1.5	3.4
Accumulated unrealized gains (losses) on derivatives qualifying as cash flow hedges	1.9	(2.2)
Accumulated defined benefit obligation adjustments	(3.0)	0.0
<b>Total accumulated other comprehensive income</b>	<b>\$ 4.6</b>	<b>\$ 12.8</b>

**Table of Contents**

The components of comprehensive income, net of related immaterial tax effects, were as follows (in millions):

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Net income	\$ 119.6	\$ 186.4	\$ 424.7	\$ 512.5
Change in currency translation adjustments	(4.3)	0.4	(7.4)	4.7
Change in unrealized gains (losses) on available-for-sale investments	3.5	(6.4)	(1.9)	(0.1)
Change in unrealized gains (losses) on derivatives qualifying as cash flow hedges	1.4	2.2	4.1	(0.2)
Change in defined benefit obligation adjustments	(3.0)	0.0	(3.0)	0.0
Comprehensive income	\$ 117.2	\$ 182.6	\$ 416.5	\$ 516.9

**11. Derivatives and Hedging Activities**

We use derivative instruments to manage exposures to foreign currency risk. The maximum length of time over which forecasted foreign denominated revenues are hedged is six months. The notional value of our outstanding foreign currency forward contracts that were entered into to hedge forecasted foreign currency denominated sales and our foreign currency denominated monetary asset and liability exposures consisted of the following (in millions):

	January 27, 2012	April 29, 2011
<b>Cash Flow Hedges</b>		
Euro	\$ 147.9	\$ 104.0
British Pound Sterling	36.5	20.9
<b>Balance Sheet Contracts</b>		
Euro	256.3	253.7
British Pound Sterling	45.4	70.8
Australian Dollar	39.8	34.4
Canadian Dollar	22.9	56.0
Other	63.6	52.6

As of January 27, 2012 and April 29, 2011, the fair value of our short-term foreign currency contracts was not material. Certain of these contracts are designed to hedge our exposure to foreign currency denominated monetary assets and liabilities and are not designated as hedging instruments. Accordingly, changes in the fair value of these instruments are recognized in earnings during the period of change.

The effect of derivative instruments designated as cash flow hedges recognized in net revenues on our consolidated statements of operations for the three and nine months ended January 27, 2012 and January 28, 2011, respectively, was as follows (in millions):

	Three Months Ended January 27, 2012		Three Months Ended January 28, 2011	
	Gain (Loss) Recognized in AOCI	Gain (Loss) Reclassified from AOCI into Income	Gain (Loss) Recognized in AOCI	Gain (Loss) Reclassified from AOCI into Income
<b>Derivatives in Cash Flow Hedging Relationships</b>				
Foreign exchange forward contracts	\$ 11.9	\$ 10.5	\$ 6.8	\$ 4.6

Edgar Filing: NetApp, Inc. - Form 10-Q

	Nine Months Ended January 27, 2012		Nine Months Ended January 28, 2011	
	Gain (Loss) Recognized in AOCI	Gain (Loss) Reclassified from AOCI into Income	Gain (Loss) Recognized in AOCI	Gain (Loss) Reclassified from AOCI into Income
<b>Derivatives in Cash Flow Hedging Relationships</b>				
Foreign exchange forward contracts	\$ 22.2	\$ 18.1	\$ 8.8	\$ 9.0

The effect of derivative instruments not designated as hedges recognized in other income (expense), net on our consolidated statements of operations for the three and nine months ended January 27, 2012 and January 28, 2011, respectively, was as follows (in millions):

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
<b>Derivatives Not Designated as Hedging Instruments</b>	<b>Gain (Loss) Recognized into Income</b>		<b>Gain (Loss) Recognized into Income</b>	
Foreign exchange forward contracts	\$ 10.7	\$ (0.2)	\$ 24.9	\$ (4.4)

**Table of Contents****12. Income Taxes**

Our effective tax rates for the periods presented were as follows:

	Nine Months Ended	
	January 27, 2012	January 28, 2011
Effective tax rates	14.7%	12.5%

Our effective tax rates reflect the impact of a significant amount of our earnings being taxed in foreign jurisdictions at rates below the U.S. statutory tax rate.

In January 2012, we reached agreement with the U.S. Internal Revenue Service (IRS) with regards to a tax position taken during prior periods. As a result of the settlement and resulting remeasurement of our tax positions, we recorded a discrete tax expense of \$11.7 million, net of federal benefit, during the three and nine months ended January 27, 2012. In addition, we recognized a net increase of \$17.4 million to the balance of our unrecognized tax benefits related to prior years as a result of the settlement and remeasurement.

As of January 27, 2012, we had \$155.5 million of unrecognized tax benefits, of which \$104.3 million has been recorded in other long-term liabilities and \$96.6 million, including penalties and interest, would affect our provision for income taxes if recognized. During the nine months ended January 27, 2012, there was a gross increase in our unrecognized tax benefits of \$8.0 million for tax positions related to the current year, and a gross increase of \$20.3 million and gross decrease of \$6.0 million for tax positions related to prior years.

In accordance with our accounting policy, we recognize accrued interest and penalties related to unrecognized tax benefits as a component of tax expense. Interest and penalties recognized through income tax expense during the three and nine months ended January 27, 2012 and January 28, 2011 were not material.

In February 2012, the IRS commenced an examination of our fiscal 2008 through fiscal 2010 income tax returns. We are also under audit by the California Franchise Tax Board for our fiscal 2007 and 2008 California income tax returns. Our open years in U.S. federal jurisdictions are fiscal 2005 and later years. In addition, we are effectively subject to federal tax examination adjustments for tax years ended on or after fiscal year 2000, in that we have tax attribute carryforwards from these years that could be subject to adjustments, if and when utilized.

On September 17, 2010, the Danish Tax Authorities issued a decision concluding that distributions declared in 2005 and 2006 from our Danish subsidiary were subject to Danish at-source dividend withholding tax. We do not believe that our Danish subsidiary is liable for withholding tax and filed an appeal with the Danish Tax Tribunal to that effect. On December 19, 2011, the Danish Tax Tribunal issued a ruling that our Danish subsidiary was not liable for Danish withholding tax. The ruling is subject to appeal to the Danish High Court.

We are in various stages of the examination and appeals process in connection with tax audits worldwide and it is difficult to determine when these examinations will be settled. It is reasonably possible that over the next twelve-month period, we may experience an increase or decrease in unrecognized tax benefits. It is not possible to determine either the magnitude or the range of any increase or decrease at this time.

In April 2010, our Dutch subsidiary received a favorable tax ruling from the Dutch tax authorities effective May 1, 2010 that replaced the previous Dutch tax ruling which expired on April 30, 2010. This ruling resulted in both a lower level of earnings subject to tax in the Netherlands and an extension of the expiration date to April 30, 2015.

On December 17, 2010, the Tax Relief Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the Act) was signed into law. Under the Act, the federal research credit was retroactively extended for amounts paid or incurred after December 31, 2009, and before January 1, 2012. Unless retroactively extended again, the federal research credit expired on December 31, 2011.

**Table of Contents****13. Net Income per Share**

The following is a calculation of basic and diluted net income per share for the periods presented (in millions):

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
<b>Numerator:</b>				
Net income	\$ 119.6	\$ 186.4	\$ 424.7	\$ 512.5
<b>Denominator:</b>				
Shares used in basic computation	360.3	364.8	364.0	358.8
Dilutive potential shares related to employee equity award plans	7.6	14.7	9.1	15.3
Dilutive impact of assumed conversion of Notes	5.8	16.9	9.3	11.9
Dilutive impact of warrants	0.0	9.8	2.7	4.7
Shares used in diluted computation	373.7	406.2	385.1	390.7
<b>Net Income per Share:</b>				
Basic	\$ 0.33	\$ 0.51	\$ 1.17	\$ 1.43
Diluted	\$ 0.32	\$ 0.46	\$ 1.10	\$ 1.31

The following potential weighted-average shares of common stock have been excluded from the diluted net income per share calculations, as their effect would have been anti-dilutive (in millions):

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Options and RSUs	13.5	1.0	10.9	2.8

Dilutive shares outstanding during the three months ended January 27, 2012 do not include any effect resulting from warrants, as their impact would have been anti-dilutive. The Note hedges (as described in Note 9) are not included in the calculation of earnings per share as their effect would have been anti-dilutive. The Note hedges, if exercised upon conversion of the Notes, are expected to reduce approximately 80% of the dilutive effect of the Notes when our stock price is above \$31.85 per share.

**14. Segment, Geographic, and Significant Customer Information**

We operate in one reportable industry segment: the design, manufacturing, marketing, and technical support of high-performance networked storage solutions. We conduct business globally, and our sales and support activities are managed on a geographic basis. Our management reviews financial information presented on a consolidated basis, accompanied by disaggregated information it receives from its internal management system about revenues by geographic region, based on the location from which the customer relationship is managed, for purposes of allocating resources and evaluating financial performance. We do not allocate costs of revenues, research and development, sales and marketing, or general and administrative expenses to our geographic regions in this internal management system because management does not review operations or operating results, or make planning decisions, below the consolidated entity level.

Summarized revenues by geographic region based on our internal management system and utilized by our Chief Executive Officer, who is considered our Chief Operating Decision Maker, is as follows (in millions):

	Three Months Ended	Nine Months Ended
--	--------------------	-------------------

Edgar Filing: NetApp, Inc. - Form 10-Q

	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Americas (United States, Canada and Latin America)*	\$ 853.7	\$ 702.8	\$ 2,564.2	\$ 2,094.2
Europe, Middle East and Africa	525.5	457.1	1,411.1	1,232.5
Asia Pacific and Japan	186.3	129.7	555.4	367.6
Net revenues	\$ 1,565.5	\$ 1,289.6	\$ 4,530.7	\$ 3,694.3

\* Americas revenues consist of Americas commercial and U.S. public sector markets. Sales to customers inside the United States comprised \$730.5 million and \$631.2 million of Americas net revenues during the three months ended January 27, 2012 and January 28, 2011, respectively, and \$2,190.2 million and \$1,879.9 million of Americas net revenues during the nine months ended January 27, 2012 and January 28, 2011, respectively.



**Table of Contents**

As of January 27, 2012 and April 29, 2011, the majority of our assets, excluding cash, cash equivalents, restricted cash, investments and accounts receivable, were attributable to our domestic operations. The following table presents cash, cash equivalents, restricted cash and debt investments held in the U.S. and internationally in various foreign subsidiaries (in millions):

	January 27, 2012	April 29, 2011
United States	\$ 2,391.9	\$ 3,037.5
International	2,536.7	2,211.8
<b>Total cash, cash equivalents, restricted cash and debt investments</b>	<b>\$ 4,928.6</b>	<b>\$ 5,249.3</b>

With the exception of property and equipment, we do not identify or allocate our long-lived assets by geographic area. The following table presents property and equipment, net for geographic areas based on the physical location of the assets (in millions):

	January 27, 2012	April 29, 2011
United States	\$ 982.6	\$ 840.2
International	99.2	71.4
<b>Total property and equipment, net</b>	<b>\$ 1,081.8</b>	<b>\$ 911.6</b>

No more than ten percent of property and equipment was located in any single foreign country.

International sales to a single foreign country that accounted for ten percent or more of net revenues are as follows:

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Germany	\$ 181.9	\$ 164.4	\$ 470.9	\$ 461.3

The following customers, each of which is a distributor, accounted for ten percent or more of our net revenues (in millions):

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Arrow Electronics, Inc.	\$ 238.8	\$ 223.4	\$ 725.9	\$ 619.7
Avnet, Inc.	179.3	151.3	537.2	461.9

The following customers accounted for ten percent or more of net accounts receivable (in millions):

	January 27, 2012	April 29, 2011
Arrow Electronics, Inc.	\$ N/A	\$ 101.4
Avnet, Inc.	70.9	107.5

N/A - Not Applicable

## 15. Commitments and Contingencies

### *Lease Commitments*

As of January 27, 2012, future annual minimum lease payments under all non-cancelable facilities and equipment operating leases with an initial term in excess of one year totaled \$402.7 million.

As of January 27, 2012, we have four leasing arrangements (Leasing Arrangements 1, 2, 3 and 4) with BNP Paribas LLC (BNPPLC), some of which require us to lease certain of our land to BNPPLC for a period of 99 years and to lease approximately 0.6 million square feet of office space from BNPPLC for our headquarters in Sunnyvale, California, which had an original cost of \$149.6 million. Under these leasing arrangements, we pay BNPPLC minimum lease payments, which vary based on LIBOR plus a spread or a fixed rate on the costs of the facilities on the respective lease commencement dates. We make payments for each of the leases for a term of five years. We have the option to renew each of the leases for two consecutive five-year periods upon approval by BNPPLC. Upon expiration (or upon any earlier termination) of the lease terms, we must elect one of the following options: (i) purchase the buildings from BNPPLC at cost; (ii) if certain conditions are met, arrange for the sale of the buildings by BNPPLC to a third-party, and be liable for any deficiency between the net proceeds received from the third-party and BNPPLC's cost, up to 85% of cost (residual guarantee); or (iii) pay BNPPLC supplemental payments for an amount equal to the difference between BNPPLC's cost and fair value, up to the residual guarantee, in which event we may recoup some or all of such payments by arranging for a sale of each or all buildings by BNPPLC during the ensuing two-year period.

**Table of Contents**

These leases require us to maintain specified financial covenants with which we were in compliance as of January 27, 2012.

As of January 27, 2012, we estimated that the fair value of certain properties under synthetic lease was \$51.0 million below the cost of the properties. We are accruing for this deficiency over the remaining terms of the respective leases. As of January 27, 2012, a deficiency reserve of \$32.4 million was included in other current liabilities.

**Purchase Orders and Other Commitments**

In the normal course of business we make commitments to our third-party contract manufacturers, to manage manufacturer lead times and meet product forecasts, and to other parties, to purchase various key components used in the manufacture of our products. We establish accruals for estimated losses on purchased components to the extent we believe it is probable that such components will not be utilized in future operations. To the extent that such forecasts are not achieved, our commitments and associated accruals may change. We had \$220.4 million in non-cancelable purchase commitments with our contract manufacturers as of January 27, 2012. In addition, we recorded a liability for firm, non-cancelable and unconditional purchase commitments with contract manufacturers for quantities in excess of our future demand forecasts through a charge to product cost of sales. As of January 27, 2012 and April 29, 2011, such liability amounted to \$3.2 million and \$4.5 million, respectively, and is included in other current liabilities in the condensed consolidated balance sheets.

In addition to commitments with contract manufacturers and component suppliers, we have open purchase orders and contractual obligations associated with our ordinary course business for which we have not received goods or services. As of January 27, 2012, we had \$48.5 million in capital purchase commitments and \$230.7 million in other purchase commitments.

**Product Warranties**

We provide customers a warranty on software of ninety days to five years and a warranty on hardware of one to five years. The following table summarizes our warranty reserves (in millions):

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
Beginning balance	\$ 65.0	\$ 33.5	\$ 40.5	\$ 31.9
Liability assumed in acquisition	0.0	0.0	17.5	0.0
Expense accrued during the period	14.1	8.0	41.5	20.9
Warranty costs incurred	(10.9)	(5.8)	(31.3)	(17.1)
Ending balance	\$ 68.2	\$ 35.7	\$ 68.2	\$ 35.7

**Financing Guarantees**

We have both nonrecourse and recourse lease financing arrangements with third-party financing companies through new and preexisting relationships with customers. In addition, from time to time we provide guarantees for a portion of financing arrangements under which we could be called upon to make payments to these third-party financing companies in the event of nonpayment by end-user customers. Under the terms of the nonrecourse leases, we do not have any continuing obligations or liabilities to the third-party financing companies. Under the terms of the recourse leases, which are generally three years or less, we remain liable for the aggregate unpaid remaining lease payments to the third-party financing companies in the event of end-user customer default. These arrangements are generally collateralized by a security interest in the underlying assets. Where we provide a guarantee, we defer revenues subject to the industry-specific software revenue recognition guidance, and recognize revenues for non-software deliverables in accordance with our multiple deliverable revenue arrangement policy. As of January 27, 2012, the maximum guaranteed payment contingencies under our financing arrangements totaled approximately \$101.2 million, and the related deferred revenue and cost of revenues totaled approximately \$98.9 million and \$9.6 million, respectively. To date, we have not experienced material losses under our lease financing programs or other financing arrangements.

**Table of Contents**

***Legal Contingencies***

We are subject to various legal proceedings and claims which may arise in the normal course of business. No accrual has been recorded as of January 27, 2012, as the outcome of these legal matters is currently not determinable.

On October 13, 2010, Amalgamated Bank (as trustee of the Longview Largecap 500 Index Fund and the Longview Largecap 500 Index Veba Fund) filed a derivative lawsuit on behalf of NetApp, Inc. and NetApp U.S. Public Sector, Inc. in the Superior Court of the State of California, Santa Clara County. The lawsuit named certain of our current and former directors as defendants. On February 3, 2011, the plaintiff filed an amended complaint in response to motions to dismiss that we and the individual defendants had filed. Like the original complaint, the amended complaint included claims of breach of fiduciary duty and waste of corporate assets and alleges that the defendants failed to monitor internal controls to ensure that we complied with legal requirements in our General Services Administration (GSA) contracting activities, resulting in us incurring defense and settlement costs. The amended complaint sought disgorgement of salaries and other compensation from the defendants and additional unspecified damages. We and the individual defendants filed motions to dismiss the amended complaint in early March 2011. Following a hearing on July 15, 2011, the Court granted the motions to dismiss, but permitted plaintiff leave to amend its complaint on or before September 16, 2011.

On August 9, 2011, Amalgamated Bank filed a complaint in Delaware Chancery Court against us for the purpose of obtaining, in a summary proceeding, books and records to help Amalgamated Bank amend its complaint in the California lawsuit. Each of the parties filed cross motions for summary judgment, and a hearing was held before the Delaware Chancery Court on November 16, 2011. Following that hearing, the Court directed Amalgamated Bank to more narrowly tailor its requests. On December 5, 2011, the court allowed plaintiff to conduct a very limited document inspection. On February 6, 2012, the court denied plaintiff's motion to compel further document production.

The plaintiff filed an amended complaint for a third time on September 15, 2011. This complaint alleged the same claims and requests for relief as the previous complaints. On January 9, 2012, the defendants filed motions to dismiss the amended complaint. A hearing on our motion to dismiss the California lawsuit will be held on March 23, 2012.

**Table of Contents**

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

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and is subject to the safe harbor provisions set forth in the Exchange Act. Forward-looking statements usually contain the words estimate, intend, plan, predict, seek, may, will, would, could, anticipate, expect, believe, or similar expressions and variations or negatives of these words or expressions. In addition, any statements that refer to expectations, projections, or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. All forward-looking statements, including but not limited to, statements about:

our future financial and operating results;

our business strategies;

management's plans, beliefs and objectives for future operations, research and development;

economic and industry trends or trend analysis;

product introductions, development, enhancements and acceptance;

acquisitions and joint ventures, growth opportunities, investments and legal proceedings;

competitive positions;

future cash flows and cash deployment strategies;

short-term and long-term cash requirements, including anticipated capital expenditures;

our anticipated tax rate;

the dilutive effect of our convertible notes (the Notes) and associated warrants on our earnings per share;

the conversion, maturation or repurchase of the Notes;

compliance with laws, regulations and debt covenants;

the continuation of our stock repurchase program; and

## Edgar Filing: NetApp, Inc. - Form 10-Q

the impact of completed acquisitions are inherently uncertain as they are based on management's current expectations and assumptions concerning future events, and are subject to numerous known and unknown risks and uncertainties. Therefore, our actual results may differ materially from the forward-looking statements contained herein. Factors that could cause actual results to differ materially from those described herein include, but are not limited to:

acceptance of, and demand for, our products, including our recent product introductions;

our ability to increase our customer base, market share and revenue;

general economic and market conditions, particularly the continuing fiscal challenges in the United States (U.S.) and Europe;

the effects of the recent flooding in Thailand;

the amount of orders received in future periods;

our ability to ship our products in a timely manner;

our ability to achieve anticipated pricing, cost, and gross margins levels;

**Table of Contents**

- our ability to successfully manage our backlog and increase revenue;
- our ability to successfully execute on our strategy;
- our ability to effectively integrate acquired products and technologies;
- our ability to successfully introduce new products and forecast demand for those products;
- our ability to maintain the quality of our hardware, software and services offerings;
- our ability to adapt to changes in market demand;
- demand for our services and support and the growth of the storage markets generally;
- our ability to identify and respond to significant market trends and emerging standards;
- the impact of industry consolidation;
- our ability to successfully manage our investment in people, process, and systems;
- our ability to maintain our partner, supplier and contract manufacturer relationships;
- the ability of our suppliers and contract manufacturers to meet our requirements;
- the ability of our competitors to introduce new products that compete successfully with our products;
- our ability to grow direct and indirect sales and to efficiently utilize global service and support;
- variability in our gross margins;
- our ability to sustain and/or improve our cash and overall financial position;
- our cash requirements and terms and availability of financing;

## Edgar Filing: NetApp, Inc. - Form 10-Q

valuation and liquidity of our investment portfolio;

our ability to finance business acquisitions, construction projects and capital expenditures through cash from operations and/or financing;

the results of our ongoing litigation, tax audits, government audits, inquiries and investigations; and

those factors discussed under the heading **Risk Factors** elsewhere in this Quarterly Report on Form 10-Q.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof and are based upon information available to us at this time. These statements are not guarantees of future performance. We disclaim any obligation to update information in any forward-looking statement. Actual results could vary from our forward-looking statements due to foregoing factors as well as other important factors, including those described in the Risk Factors included in Part II Item 1A.

### **Overview**

On May 6, 2011, we completed the acquisition of certain assets related to the Engenio external storage systems business (Engenio) of LSI Corporation (LSI). We paid LSI \$480.0 million in cash and also assumed certain liabilities related to Engenio. We expect this acquisition to enable us to address growing customer requirements in the areas of high bandwidth and intensive analytics workloads such as video, including full-motion video capture and digital video surveillance, as well as high-performance computing applications, such as genomics sequencing and scientific research. Our consolidated net revenues for the three and nine months ended January 27, 2012 include \$178.3 million and \$517.8 million, respectively, attributable to Engenio since the acquisition.



**Table of Contents**

Net revenues for the three and nine months ended January 27, 2012 were \$1,565.5 million, up \$275.9 million, or 21%, and \$4,530.7 million, up \$836.4 million, or 23%, respectively, from the comparable periods in the prior year. The revenue growth in each of these periods was primarily due to our acquisition of Engenio, continued demand for our storage efficiency and data management solutions, and an increase in hardware maintenance contract revenue. Gross profit as a percentage of net revenues decreased during the three and nine months ended January 27, 2012 compared to the same periods in the prior year, primarily due to the inclusion of lower gross margin E-Series OEM products resulting from the Engenio acquisition in the revenue mix and the impact of higher discounting. These decreases were partially offset by manufacturing cost reductions.

Sales and marketing, research and development, and general and administrative expenses for the three and nine months ended January 27, 2012 totaled \$748.5 million, up 20%, and \$2,185.9 million, up 22%, respectively, from the comparable periods in the prior year. These increases were primarily due to a 25% and 27% increase in average headcount in the three and nine months ended January 27, 2012, respectively, from the comparable periods in the prior year. The May 2011 acquisition of Engenio represented approximately 10% of the average headcount for the three and nine months ended January 27, 2012.

**Critical Accounting Estimates and Policies**

Our discussion and analysis of financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of such statements requires us to make estimates and assumptions that affect the reported amounts of revenues and expenses during the reporting periods and the reported amounts of assets and liabilities as of the date of the financial statements. Our estimates are based on historical experience and other assumptions that we consider to be appropriate under the circumstances. However, future results may vary from our estimates.

We believe the accounting policies discussed under Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended April 29, 2011 are significantly affected by critical accounting estimates and that they are both highly important to the portrayal of our financial condition and results and require difficult management judgments and assumptions about matters that are inherently uncertain. There have been no material changes to the critical accounting policies and estimates as filed in such report.

**New Accounting Standards**

See Note 3 of the accompanying condensed consolidated financial statements for a full description of new accounting pronouncements, including the respective expected dates of adoption and effects on results of operations and financial condition.

All fiscal year 2011 results reflect the adoption of the new accounting standards related to revenue recognition. Previously reported quarterly results for fiscal 2011 have been adjusted to reflect the adoption of these new standards and differ from the originally reported results.

**Results of Operations**

The following table sets forth certain Condensed Consolidated Statements of Operations data as a percentage of net revenues for the periods indicated:

	Three Months Ended		Nine Months Ended	
	January 27, 2012	January 28, 2011	January 27, 2012	January 28, 2011
<b>Revenues:</b>				
Product	67.9%	65.5%	67.2%	65.1%
Software entitlements and maintenance	13.0	14.2	13.2	14.5
Service	19.1	20.3	19.6	20.4
Net revenues	100.0	100.0	100.0	100.0
<b>Cost of revenues:</b>				
Cost of product	33.1	25.5	31.2	26.1

Edgar Filing: NetApp, Inc. - Form 10-Q

Cost of software entitlements and maintenance	0.4	0.3	0.4	0.3
Cost of service	8.5	8.6	8.4	8.6
Gross profit	58.0	65.6	60.0	65.0
<b>Operating expenses:</b>				
Sales and marketing	30.5	30.8	30.6	30.7
Research and development	13.3	12.9	13.4	12.8
General and administrative	4.0	4.8	4.3	4.9
Restructuring and other charges		(0.1)		
Acquisition-related expense	0.2		0.2	
Total operating expenses	48.0	48.4	48.5	48.4
<b>Income from operations</b>	10.0	17.2	11.5	16.6
<b>Other expense, net:</b>				
Interest income	0.6	0.8	0.6	0.8
Interest expense	(1.2)	(1.5)	(1.2)	(1.5)
Other income (expense), net				
<b>Total other expense, net</b>	(0.6)	(0.7)	(0.6)	(0.7)
<b>Income before income taxes</b>	9.4	16.5	10.9	15.9
Provision for income taxes	1.7	2.0	1.6	2.0
<b>Net income</b>	7.7%	14.5%	9.3%	13.9%

**Table of Contents****Discussion and Analysis of Results of Operations**

*Net Revenues* Net revenues for the three and nine months ended January 27, 2012 and January 28, 2011 were as follows (in millions, except percentages):

	Three Months Ended			Nine Months Ended		
	January 27, 2012	January 28, 2011	% Change	January 27, 2012	January 28, 2011	% Change
Net revenues	\$ 1,565.5	\$ 1,289.6	21%	\$ 4,530.7	\$ 3,694.3	23%

Net revenues increased by \$275.9 million, or 21%, and increased by \$836.4 million, or 23%, for the three and nine months ended January 27, 2012, respectively, from the comparable periods in the prior year. The increase in our net revenues for both periods was primarily due to an increase in product revenues, which comprised 68% and 67% of net revenues for the three and nine months ended January 27, 2012, respectively compared to 65% in each of the three and nine months ended January 28, 2011.

Sales through our indirect channels represented 79% and 78% of net revenues for the three and nine months ended January 27, 2012, respectively, and represented 74% and 72% of net revenues for the three and nine months ended January 28, 2011, respectively. The increase in our indirect channels as a percentage of net revenues reflects the acquisition of Engenio.

The following customers, each of which is a distributor, accounted for 10% or more of net revenues (in millions, except percentages):

	Three Months Ended				Nine Months Ended			
	January 27, 2012	% of Net Revenues	January 28, 2011	% of Net Revenues	January 27, 2012	% of Net Revenues	January 28, 2011	% of Net Revenues
Arrow Electronics, Inc.	\$ 238.8	15%	\$ 223.4	17%	\$ 725.9	16%	\$ 619.7	17%
Avnet, Inc.	179.3	11%	151.3	12%	537.2	12%	461.9	13%

*Product Revenues (in millions, except percentages):*

	Three Months Ended			Nine Months Ended		
	January 27, 2012	January 28, 2011	% Change	January 27, 2012	January 28, 2011	% Change
Product revenues	\$ 1,062.7	\$ 844.3	26%	\$ 3,044.6	\$ 2,406.6	27%

Product revenues increased by \$218.4 million, or 26%, and increased by \$638.0 million, or 27%, for the three and nine months ended January 27, 2012, respectively, from the comparable periods in the prior year. Product revenues consist of configured systems, which are comprised of bundled hardware and software products, and non-configured products, which consist primarily of add-on hardware, storage, and software products, as well as OEM products.

Total configured system revenues of \$540.7 million increased by \$42.6 million, or 9%, for the three months ended January 27, 2012, and total configured system revenues of \$1,571.9 million increased by \$118.4 million, or 8%, for the nine months ended January 27, 2012, compared to the prior year, with the largest increase in the 6000 series systems, partially offset by decreases in the 2000 series systems. Configured systems unit volume increased by 5% and 3% for the three and nine months ended January 27, 2012, respectively, compared to the prior year, with increases in each period in both the 6000 and 3000 series systems, offset by a decrease in each period in the 2000 series systems. The increases in the unit volume of the 6000 and 3000 series in each period were due to customer demand for these newer systems. The decreases in the 2000 series unit volume in each period were primarily due to a decrease in demand for the older products within this series, as well as a shift in demand to the newer 3000 series systems. The average selling prices (ASPs) of total configured systems increased during the three and nine months ended January 27, 2012, compared to the prior year due to a shift in system revenue mix from the lower ASP 2000 series to the higher ASP 3000 and 6000 series. However, ASPs across each series decreased compared to the same periods in the prior year primarily due to higher discounting and, to a lesser extent, manufacturing cost reductions being passed along to customers as price reductions.



**Table of Contents**

Non-configured product revenues of \$522.0 million increased \$175.8 million, or 51%, during the three months ended January 27, 2012, and non-configured product revenues of \$1,472.7 million increased \$519.6 million, or 55%, during the nine months ended January 27, 2012, compared to the prior year. These increases were primarily due to E-Series OEM product revenues of \$174.3 million and \$504.1 million during the three and nine months ended January 27, 2012, respectively, that resulted from the Engenio acquisition and a 4% and 3% increase in sales of our add-on storage products during the three and nine months ended January 27, 2012, respectively.

Our systems are highly configurable to respond to customer requirements in the open systems storage markets that we serve. This can cause a wide variation in product configurations that can significantly impact revenues, cost of revenues and gross profit performance. Pricing changes, discounting practices, product competition, foreign currency, unit volumes, customer mix, natural disasters and product material costs can also impact revenues, cost of revenues and/or gross profit performance. Disks are a significant component of our storage systems. Industry disk pricing has fallen every year; however, with the recent flooding in Thailand, disk prices have increased and may continue to do so. To the extent that disk prices increase or decrease, we intend to pass along those price increases or decreases to our customers while working to maintain relatively constant profit margins on our disk drives. As our sales price per terabyte continues to decline, improved system performance, increased capacity and software to manage this increased capacity have an offsetting impact on product revenues.

**Software Entitlements and Maintenance Revenues (in millions, except percentages):**

	Three Months Ended			Nine Months Ended		
	January 27, 2012	January 28, 2011	% Change	January 27, 2012	January 28, 2011	% Change
Software entitlements and maintenance revenues	\$ 203.5	\$ 182.7	11%	\$ 599.7	\$ 533.6	12%

Software entitlements and maintenance (SEM) revenues increased by \$20.8 million, or 11%, and increased by \$66.1 million, or 12%, during the three and nine months ended January 27, 2012, respectively, from the comparable periods in the prior year. The increases in each period were due to an increase in the aggregate contract value of the installed base under SEM contracts, which is recognized as revenue ratably over the terms of the underlying contracts.

**Service Revenues (in millions, except percentages):**

	Three Months Ended			Nine Months Ended		
	January 27, 2012	January 28, 2011	% Change	January 27, 2012	January 28, 2011	% Change
Service revenues	\$ 299.3	\$ 262.6	14%	\$ 886.4	\$ 754.1	18%

Service revenues include hardware maintenance, professional services and educational and training services. Service revenues increased by \$36.7 million, or 14%, and by \$132.3 million, or 18%, during the three and nine months ended January 27, 2012, respectively, from the comparable periods in the prior year.

Hardware maintenance contract revenues constituted approximately 71% and 70% of our service revenues for the three and nine months ended January 27, 2012, respectively, and 66% and 65% for the three and nine months ended January 28, 2011, respectively. Such revenues increased by \$36.6 million, or 21%, and by \$128.6 million, or 26%, during the three and nine months ended January 27, 2012, respectively, from the comparable periods in the prior year, as a result of an increase in each period in the installed base under service contracts. Professional services and educational and training services constituted approximately 29% and 30% of our service revenues for the three and nine months ended January 27, 2012, respectively, and 34% and 35% of our service revenues for the three and nine months ended January 28, 2011, respectively.

**Revenues by Geographic Area (in millions, except percentages):**

	Three Months Ended			Nine Months Ended		
	January 27, 2012	January 28, 2011	% Change	January 27, 2012	January 28, 2011	% Change
Americas (United States, Canada and Latin America)	\$ 853.7	\$ 702.8	21%	\$ 2,564.2	\$ 2,094.2	22%

Edgar Filing: NetApp, Inc. - Form 10-Q

Europe, Middle East and Africa (EMEA)	525.5	457.1	15%	1,411.1	1,232.5	14%
Asia Pacific and Japan (APAC)	186.3	129.7	44%	555.4	367.6	51%
Net revenues	\$ 1,565.5	\$ 1,289.6		\$ 4,530.7	\$ 3,694.3	

**Table of Contents**

Americas revenues consist of Americas commercial and U.S. public sector markets. Sales to customers inside the United States comprised 86% and 90% of Americas net revenues during the three months ended January 27, 2012 and January 28, 2011, respectively, and 85% and 90% of Americas net revenue during the nine months ended January 27, 2012 and January 28, 2011, respectively. Sales to Germany accounted for 12% and 10% of net revenues during the three and nine months ended January 27, 2012, respectively. Sales to Germany accounted for 13% and 12% of net revenues during the three and nine months ended January 28, 2011, respectively. No other single foreign country accounted for 10% or more of net revenues in any of the periods presented.

**Cost of Revenues**

Our cost of revenues consists of three elements: (1) cost of product revenues, which includes the costs of manufacturing and shipping of our storage products, amortization of purchased intangible assets, inventory write-downs, and warranty costs; (2) cost of SEM, which includes the costs of providing SEM and third-party royalty costs, and (3) cost of service revenues, which reflects costs associated with providing support activities for hardware, global support partnership programs, professional services and educational and training services.

Our gross profit is impacted by a variety of factors, including pricing changes, discounting practices, foreign currency, product configuration, unit volumes, customer mix, revenue mix, natural disasters and product material costs. Service gross profit is typically impacted by factors such as changes in the size of our installed base of products, as well as the timing of support service initiations and renewals, and incremental investments in our customer support infrastructure. If any of these factors that impact our gross profit are adversely affected, whether by economic uncertainties or for other reasons, our gross profit could decline.

**Cost of Product Revenues (in millions, except percentages):**

	Three Months Ended			Nine Months Ended		
	January 27, 2012	January 28, 2011	% Change	January 27, 2012	January 28, 2011	% Change
Cost of product revenues	\$ 517.8	\$ 328.4	58%	\$ 1,415.9	\$ 962.9	47%

Cost of product revenues increased by \$189.4 million, or 58%, and \$453.0 million, or 47%, during the three and nine months ended January 27, 2012, from the comparable periods in the prior year. The changes were comprised of the following elements (in percentage points of the total change):

	Three Months Ended	Nine Months Ended Fiscal
	Fiscal 2012 to Fiscal 2011	2012 to Fiscal 2011
	Percentage Change	Percentage Change
	Points	Points
Materials cost	49	38
Amortization of developed technology	4	3
Warranty	2	2
Manufacturing overhead	2	2
Excess and obsolete inventory	(1)	1
Other	2	1
<b>Total change</b>	<b>58</b>	<b>47</b>

During the three and nine months ended January 27, 2012, the increase in materials cost was primarily due to \$99.6 million and \$283.1 million, respectively, in materials cost relating to the sales of E-Series OEM products resulting from the Engenio acquisition. The increase in materials cost was also impacted by the 5% and 3% unit volume increases in configured systems during these periods; however, the average cost per unit of configured systems across all product families decreased as a result of materials cost reductions, partially offsetting volume increases during these reporting periods.

The increase in the amortization of developed technology was due to identified intangible assets acquired from the Engenio acquisition, which are amortized on a straight-line basis over their estimated useful life.





**Table of Contents**

Cost of product revenues represented 49% and 39% of product revenue for the three months ended January 27, 2012 and January 28, 2011, respectively, and 47% and 40% of product revenue for the nine months ended January 27, 2012 and January 28, 2011, respectively. The overall increases in costs as a percentage of revenues for the three and nine months ended January 27, 2012, as compared to the same periods in the prior year, were primarily the result of E-Series OEM products acquired through the Engenio transaction, which have lower material margins than configured systems and add-on products as well as the decrease in ASPs.

**Cost of Software Entitlements and Maintenance Revenues (in millions, except percentages):**

	Three Months Ended			Nine Months Ended		
	January 27, 2012	January 28, 2011	% Change	January 27, 2012	January 28, 2011	% Change
Cost of software entitlements and maintenance revenues	\$ 6.2	\$ 4.0	55%	\$ 17.1	\$ 10.9	57%

Cost of SEM revenues increased by \$2.2 million, or 55%, and \$6.2 million, or 57%, during the three and nine months ended January 27, 2012, respectively, from the comparable periods in the prior year, primarily due to an increase in volume-related software support costs. Cost of SEM revenues represented 3% of SEM revenues for both the three and nine months ended January 27, 2012 and 2% of SEM revenues for both the three and nine months ended January 28, 2011.

**Cost of Service Revenues (in millions, except percentages):**

	Three Months Ended			Nine Months Ended		
	January 27, 2012	January 28, 2011	% Change	January 27, 2012	January 28, 2011	% Change
Cost of service revenues	\$ 133.0	\$ 111.0	20%	\$ 379.3	\$ 320.0	19%

Cost of service revenues increased by \$22.0 million, or 20%, and \$59.3 million, or 19%, during the three and nine months ended January 27, 2012, respectively, from the comparable periods in the prior year primarily due to the costs associated with servicing a larger installed base and an increase in logistics and materials costs. Costs represented 44% and 42% of service revenues for the three months ended January 27, 2012 and January 28, 2011, respectively, and represented 43% and 42% of service revenues for the nine months ended January 27, 2012 and January 28, 2011, respectively.

**Operating Expenses****Sales and Marketing, Research and Development, and General and Administrative Expenses**

Compensation costs comprise the largest component of operating expenses. Included in compensation costs are salaries, benefits, other compensation-related costs, stock-based compensation costs and employee incentive compensation plan costs. Compensation costs included in operating expenses increased approximately \$59.8 million, or 17%, and \$205.4 million, or 21%, for the three and nine months ended January 27, 2012, respectively, from the comparable periods in the prior year, primarily due to:

- (i) an increase in salaries, benefits and other compensation-related costs of \$63.8 million and \$210.1 million for the three and nine months ended January 27, 2012, respectively, due to an increase in average headcount, which included the impact of the Engenio acquisition;
- (ii) an increase in stock-based compensation of \$29.0 million and \$66.1 million for the three and nine months ended January 27, 2012, respectively, which includes the impact of the Engenio acquisition and \$10.9 million of expense related to the reset of the employee stock purchase plan (ESPP) offerings triggered by the decline in our stock price below the grant date prices of the offerings;
- (iii) partially offset by a decrease in incentive compensation expense of \$33.0 million and \$70.8 million for the three and nine months ended January 27, 2012, respectively, due to lower achievement of performance against plan operating targets during the three and nine months ended January 27, 2012.

**Sales and Marketing (in millions, except percentages):**

Edgar Filing: NetApp, Inc. - Form 10-Q

	Three Months Ended			Nine Months Ended		
	January 27, 2012	January 28, 2011	% Change	January 27, 2012	January 28, 2011	% Change
Sales and marketing expenses	\$ 477.0	\$ 397.4	20%	\$ 1,385.9	\$ 1,134.4	22%

**Table of Contents**

Sales and marketing expense consists primarily of compensation costs, commissions, outside services, allocated facilities and IT costs, advertising and marketing promotional expense, and travel and entertainment expense. Sales and marketing expenses increased due to the following:

	<b>Three Months Ended Fiscal 2012 to Fiscal 2011 Percentage Change Points</b>	<b>Nine Months Ended Fiscal 2012 to Fiscal 2011 Percentage Change Points</b>
Salaries	8	9
Stock-based compensation	4	3
Incentive plan compensation	(4)	(3)
Other compensation and benefit costs	2	2
<b>Total compensation costs</b>	<b>10</b>	<b>11</b>
Outside services	1	2
Amortization expense	2	2
Commissions	3	2
Facilities and IT support costs	2	2
Advertising and marketing promotional expense	2	2
Other		1
<b>Total change</b>	<b>20</b>	<b>22</b>

The increase in total compensation costs for the three and nine months ended January 27, 2012 reflects an increase in average sales and marketing headcount of 21% and 22%, respectively, as compared to the same periods in the prior year. These increases were partially offset by a decrease in incentive compensation expense. The increase in commissions expense for the three and nine months ended January 27, 2012 was due to higher sales levels compared to the same periods in the prior year. Amortization expense increased due to the addition of intangible assets as a result of the acquisition of Engenio.

*Research and Development (in millions, except percentages):*

	<b>Three Months Ended</b>			<b>Nine Months Ended</b>		
	<b>January 27, 2012</b>	<b>January 28, 2011</b>	<b>% Change</b>	<b>January 27, 2012</b>	<b>January 28, 2011</b>	<b>% Change</b>
Research and development expenses	\$ 208.3	\$ 166.0	25%	\$ 606.6	\$ 472.1	28%

Research and development expense consists primarily of compensation costs, allocated facilities and IT costs, depreciation and amortization, equipment and software related costs, prototypes, non-recurring engineering (NRE) charges and other outside services costs. Research and development expenses increased due to the following:

	<b>Three Months Ended Fiscal 2012 to Fiscal 2011 Percentage Change Points</b>	<b>Nine Months Ended Fiscal 2012 to Fiscal 2011 Percentage Change Points</b>
Salaries	12	13
Stock-based compensation	7	5
Incentive plan compensation	(8)	(5)

## Edgar Filing: NetApp, Inc. - Form 10-Q

Other compensation and benefit costs	3	4
Total compensation costs	14	17
Facilities and IT support costs	4	5
Depreciation expense	3	3
Outside services	2	2
Other	2	1
 Total change	 25	 28

The increase in total compensation costs reflects a 38% and 39% increase in average engineering headcount during the three and nine months ended January 27, 2012, respectively, compared to the same periods in the prior year. These increases were partially offset by a decrease in incentive compensation expense. The increase in facilities and IT support costs in each period reflects the acquisition of Engenio. Depreciation expense increased due to purchases of production and engineering equipment.

We believe that our future performance will depend in large part on our ability to maintain and enhance our current product line, develop new products that achieve market acceptance, maintain technological competitiveness and meet an expanding range of customer requirements. We expect to continue to spend on current and future product development efforts, broaden our existing product offerings and introduce new products that expand our solutions portfolio.

**Table of Contents**

*General and Administrative (in millions, except percentages):*

	Three Months Ended			Nine Months Ended		
	January 27, 2012	January 28, 2011	% Change	January 27, 2012	January 28, 2011	% Change
General and administrative expenses	\$ 63.2	\$ 61.9	2%	\$ 193.4	\$ 182.3	6%

General and administrative expense consists primarily of compensation costs, professional and corporate legal fees, outside services and allocated facilities and IT costs. General and administrative expenses increased due to the following:

	Three Months Ended	Nine Months Ended
	Fiscal 2012 to Fiscal 2011	Fiscal 2012 to Fiscal 2011
	Percentage Change Points	Percentage Change Points
Salaries	3	5
Stock-based compensation	2	2
Incentive plan compensation	(10)	(8)
Total compensation costs	(5)	(1)
Outside services	1	4
Professional and corporate legal fees	8	3
Other	(2)	
Total change	2	6

The decrease in total compensation costs was driven by a decrease in incentive compensation expense for the three and nine months ended January 27, 2012. These decreases were partially offset by the impact of a 13% and 16% increase in average general and administrative headcount during the three and nine months ended January 27, 2012, respectively, compared to the same periods in the prior year. Professional and corporate legal fees are higher than the comparable prior year periods as a result of a legal fee settlement in the three months ended January 28, 2011 associated with the resolution of the Sun Microsystems litigation. The increase in outside services for the nine months ended January 27, 2012 reflects additional spending on contractors and costs associated with the Engenio integration activities and various on-going operational projects.

*Acquisition-Related Expense (in millions, except percentages):*

	Three Months Ended			Nine Months Ended		
	January 27, 2012	January 28, 2011	% Change	January 27, 2012	January 28, 2011	% Change
Acquisition-related expense	\$ 3.5	\$ 0.6	483%	\$ 7.4	\$ 0.9	722%

During the three and nine months ended January 27, 2012, we incurred \$3.5 million and \$7.4 million, respectively, of due diligence, legal and other integration charges associated with our acquisition of Engenio. During the nine months ended January 28, 2011, we incurred \$0.9 million of costs associated with our acquisitions of Bycast Inc. and Akorri Networks, Inc.

*Other Expense, Net*

*Interest Income (in millions, except percentages):*

Edgar Filing: NetApp, Inc. - Form 10-Q

	Three Months Ended			Nine Months Ended		
	January 27, 2012	January 28, 2011	% Change	January 27, 2012	January 28, 2011	% Change
Interest income	\$ 8.7	\$ 10.3	(16)%	\$ 27.6	\$ 29.6	(7)%

The decrease in interest income during the three and nine months ended January 27, 2012, from the comparable periods in the prior year, was primarily due to lower yields on new investments.

*Interest Expense (in millions, except percentages):*

	Three Months Ended			Nine Months Ended		
	January 27, 2012	January 28, 2011	% Change	January 27, 2012	January 28, 2011	% Change
Interest expense	\$ (18.9)	\$ (19.0)	(1)%	\$ (54.7)	\$ (56.2)	(3)%

**Table of Contents**

Interest expense decreased 1% and 3% during the three and nine months ended January 27, 2012, respectively, from the comparable periods in the prior year. During the three and nine months ended January 27, 2012, we recognized incremental non-cash interest expense from the amortization of debt discount and issuance costs relating to our Notes of approximately \$13.5 million and \$38.7 million, respectively, net of capitalized interest. During the three and nine months ended January 28, 2011, we recognized incremental non-cash interest expense from the amortization of debt discount and issuance costs relating to our Notes of approximately \$13.3 million and \$39.2 million, respectively. The coupon interest expense related to the Notes was \$5.2 million and \$15.2 million during the three and nine months ended January 27, 2012, respectively, net of capitalized interest and \$5.5 million and \$16.5 million during the three and nine months ended January 28, 2011, respectively. During the three and nine months ended January 27, 2012, we capitalized interest of \$0.9 million and \$4.3 million, respectively, on facility assets under construction and on significant software development projects.

**Provision for Income Taxes (in millions, except percentages):**

	Three Months Ended			Nine Months Ended		
	January 27, 2012	January 28, 2011	% Change	January 27, 2012	January 28, 2011	% Change
Provision for income taxes	\$ 27.3	\$ 26.3	4%	\$ 73.2	\$ 73.5	%

Our effective tax rates for the three months ended January 27, 2012 and January 28, 2011 were 18.6% and 12.4%, respectively, and 14.7% and 12.5% for the nine months ended January 27, 2012 and January 28, 2011, respectively. Our effective tax rates for the three and nine months ended January 27, 2012 and January 28, 2011 differ from the U.S. statutory rate of 35% because our foreign earnings are taxed at rates lower than the U.S. statutory rate. In January 2012, we reached agreement with the U.S. Internal Revenue Service (IRS) with regards to a tax position taken during prior periods. Our provision for income taxes increased for the three months ended January 27, 2012 compared to the three months ended January 28, 2011 primarily as a result of a discrete tax expense of \$11.7 million, net of federal tax benefit, related to this settlement and the resulting remeasurement of our tax positions. Our provision for income taxes decreased for the nine months ended January 27, 2012 compared to the nine months ended January 28, 2011 primarily as a result of a decrease in U.S. pre-tax profits, partially offset by the tax effect of the remeasurement of a prior year tax position and lower tax benefits from disqualified dispositions of our ESPP.

As of January 27, 2012, we had \$155.5 million of unrecognized tax benefits, of which \$104.3 million has been recorded in other long-term liabilities and \$96.6 million, including penalties and interest, would affect our provision for income taxes if recognized. During the nine months ended January 27, 2012, there was a gross increase in our unrecognized tax benefits of \$8.0 million for tax positions related to the current year, and a gross increase of \$20.3 million and a gross decrease of \$6.0 million for tax positions related to prior years.

**Liquidity and Capital Resources**

The following sections discuss our principal liquidity requirements, as well as our sources and uses of cash flows on our liquidity and capital resources. The principal objectives of our investment policy are the preservation of principal and maintenance of liquidity. We attempt to mitigate default risk by investing in high-quality investment grade securities, limiting the time to maturity and monitoring the counter-parties and underlying obligors closely. We believe our cash equivalents and short-term investments are liquid and accessible. We are not aware of any significant deterioration in the fair value of our cash equivalents or investments from the values reported as of January 27, 2012.

**Liquidity Sources and Cash Requirements**

Our principal sources of liquidity as of January 27, 2012 consisted of approximately \$4.9 billion in cash, cash equivalents and short-term investments, as well as cash we expect to generate from operations.

Cash, cash equivalents and short-term investments consist of the following (in millions):

	January 27, 2012	April 29, 2011
Cash and cash equivalents	\$ 2,420.9	\$ 2,757.3
Short-term investments	2,445.2	2,417.4
Total cash, cash equivalents and short-term investments	\$ 4,866.1	\$ 5,174.7





## **Table of Contents**

As of January 27, 2012, \$2.4 billion of cash, cash equivalents and short-term investments were held in the U.S., while \$2.5 billion were held in foreign countries. Most of the amounts held outside the U.S. can be repatriated to the U.S. but, under current law, would be subject to U.S. federal and state income taxes. If we were to repatriate foreign earnings for cash requirements in the U.S., we would incur U.S. federal and state income taxes reduced by the current amount of our U.S. federal and state net operating loss and tax credit carry forwards. However, our intent is to keep these funds permanently reinvested outside of the U.S., and our current plans do not contemplate a need to repatriate them to fund our U.S. operations. Our principal liquidity requirements are primarily to meet our working capital needs, support ongoing business activities, fund research and development, meet capital expenditure needs, invest in critical or complementary technologies, and service our debt and synthetic leases. Our contractual obligations as of January 27, 2012 are summarized below in the Contractual Obligations table.

Key factors that could affect our cash flows include changes in our revenue mix and profitability, our ability to effectively manage our working capital, in particular, accounts receivable and inventories, our ability to effectively integrate acquired products, businesses and technologies, including Engenio, and conversions of our Notes by holders. Based on our current business outlook, we believe that our sources of cash will satisfy our working capital needs, capital expenditures, investment requirements, stock repurchases, contractual obligations, commitments, interest payments on our Notes and other liquidity requirements associated with operations and meet our cash requirements for at least the next 12 months. However, in the event our liquidity is insufficient, we may be required to curtail spending and implement additional cost saving measures and restructuring actions. We cannot be certain that we will continue to generate cash flows at or above current levels or that we will be able to obtain additional financing, if necessary, on satisfactory terms, if at all.

Our investment portfolio, including auction rate securities, has been and will continue to be exposed to market risk due to trends in the credit and capital markets. We continue to closely monitor current economic and market events to minimize our market risk on our investment portfolio. Based on our ability to access our cash and short-term investments, our expected operating cash flows, and our other potential sources of cash, we do not anticipate that the lack of liquidity of these investments will impact our ability to fund working capital needs, capital expenditures, acquisitions or other cash requirements. We intend to and believe that we have the ability to hold these investments until the market recovers. If current market conditions deteriorate, we may be required to record additional charges to earnings in future periods.

### ***Capital Expenditure Requirements***

We expect to fund our capital expenditures, including our commitments related to facilities, equipment, operating leases and internal-use software development projects over the next few years through existing cash, cash equivalents, investments and cash generated from operations. The timing and amount of our capital requirements cannot be precisely determined and will depend on a number of factors, including future demand for products, changes in the network storage industry, hiring plans and our decisions related to the financing of our facilities and equipment requirements. We expect that our existing facilities and those being developed in Sunnyvale, California; Research Triangle Park, North Carolina and other locations worldwide are adequate for our requirements over at least the next two years and that additional space will be available as needed. We anticipate capital expenditures to be between \$45.0 million and \$65.0 million over the next three months.

### ***Acquisition-Related Requirements***

On May 6, 2011, we completed the acquisition of certain assets related to the Engenio business of LSI. We paid LSI \$480.0 million in cash and also assumed certain assets and liabilities related to Engenio. As part of our efforts to integrate Engenio into our business, we expect to incur additional integration charges. See Note 5 of the accompanying condensed consolidated financial statements for more information.

### ***Cash Flows***

As of January 27, 2012, our cash, cash equivalents and short-term and long-term investments decreased by \$323.1 million from April 29, 2011, to \$4.9 billion. The decrease was primarily a result of \$600.0 million in cash paid for the repurchase of common stock, \$480.0 million net cash paid in connection with the acquisition of Engenio, \$282.9 million in capital expenditures and \$21.2 million of net purchases of investments, partially offset by \$880.0 million of cash provided by operating activities and \$101.0 million from issuances of common stock related to employee stock option exercises and purchases under the ESPP. We derive our liquidity and capital resources primarily from our operating cash flows and from working capital. Accounts receivable days sales outstanding as of January 27, 2012 decreased to 40 days, compared to 47 days as of April 29, 2011, primarily due to improvements in shipment linearity. Working capital increased by \$1.0 billion to \$4.0 billion as of January 27, 2012, compared to \$3.0 billion as of April 29, 2011, primarily due to the reclassification of our \$1.2 billion Notes to long-term liabilities as the underlying contingent conversion threshold was not met at January 27, 2012 and a decrease in accrued compensation and related benefits of \$168.0 million, partially offset by a decrease in cash, cash equivalents and short-term investments of \$308.6 million and accounts receivable of \$57.2 million.



---

## **Table of Contents**

### *Cash Flows from Operating Activities*

During the nine months ended January 27, 2012, we generated cash from operating activities of \$880.0 million. The primary sources of cash from operating activities consisted of net income of \$424.7 million, adjusted by depreciation and amortization of \$210.5 million, stock-based compensation of \$197.8 million and deferred income taxes of \$64.0 million. Significant changes in assets and liabilities impacting operating cash flows included an increase in deferred revenue of \$234.5 million and a decrease in accounts receivable of \$55.8 million, partially offset by a decrease in accrued compensation and other current liabilities of \$160.5 million, which was primarily attributable to cash payouts to employees related to the fiscal year 2011 commissions and incentive compensation plans.

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, shipment linearity, accounts receivable collections performance, inventory and supply chain management, tax benefits from stock-based compensation, and the timing and amount of compensation and other payments.

### *Cash Flows from Investing Activities*

During the nine months ended January 27, 2012, we completed our acquisition of Engenio for a total net cash payment of \$480.0 million, purchased \$282.9 million of capital expenditures and purchased \$21.2 million in net purchases of our investments.

### *Cash Flows from Financing Activities*

We used \$415.2 million in financing activities for the nine months ended January 27, 2012, which primarily consisted of \$600.0 million for the repurchase of common stock, partially offset by \$80.7 million of excess tax benefit from stock-based compensation and \$101.0 million of proceeds from employee equity award plans, net of shares withheld for taxes.

Net proceeds from the issuance of common stock related to employee participation in employee equity award programs have historically been a significant component of our liquidity. The extent to which our employees exercise stock options generally increases or decreases based upon changes in the market price of our common stock. As a result, our cash flow resulting from the issuance of common stock in connection with these programs and related tax benefits will vary.

### ***Stock Repurchase Program***

During the nine months ended January 27, 2012, 14.6 million shares of our common stock were repurchased as described below. Since the May 13, 2003 inception of our stock repurchase program through January 27, 2012, we have repurchased a total of 119.0 million shares of our common stock at an average price of \$29.65 per share, for an aggregate purchase price of \$3.5 billion. As of January 27, 2012, our Board of Directors had authorized the repurchase of up to \$4.0 billion of our common stock under this stock repurchase program. As of January 27, 2012, the remaining authorized amount for stock repurchases under this program was \$0.5 billion with no termination date. The stock repurchase program may be suspended or discontinued at any time.

### ***Accelerated Share Repurchase Agreements***

On July 8, 2011, we entered into a collared accelerated share repurchase agreement (ASR) with Bank of America, N.A., under which we prepaid \$200.0 million to purchase shares of our common stock. The aggregate number of shares ultimately purchased was determined based on the volume weighted-average share price of our common stock over a specified period of time. The contract was settled in August 2011. The total number of shares repurchased and retired under this ASR was 4.1 million shares at a price of \$48.30.

On August 19, 2011, we entered into an ASR with Wells Fargo Bank, National Association, under which we prepaid \$400.0 million to purchase shares of our common stock. The aggregate number of shares ultimately purchased was determined based on the volume weighted-average share price of our common stock over a specified period of time. The contract was settled in November 2011. The total number of shares repurchased and retired under this ASR was 10.5 million shares at a price of \$38.08.

**Table of Contents****Convertible Notes**

As of January 27, 2012, we had \$1.265 billion principal amount of 1.75% Convertible Senior Notes due 2013 (See Note 9 of the accompanying condensed consolidated financial statements). The Notes will mature on June 1, 2013, unless earlier repurchased or converted. Our common stock price did not exceed the conversion threshold price of \$41.41 per share set forth for these Notes for at least 20 trading days during the 30 consecutive trading days ended December 31, 2011. Accordingly, as of January 27, 2012, the Notes were not convertible at the option of the holder and, therefore, the carrying value of the Notes was classified as long-term debt and the difference between the principal amount and the carrying value of the Notes was reflected as equity on our condensed consolidated balance sheet as of January 27, 2012.

The determination of whether or not the Notes are convertible must continue to be performed quarterly. Consequently, the Notes may be convertible in future quarters, and therefore may be classified as short-term debt if the contingent conversion thresholds are met in such quarters. Additionally, since the Notes would be convertible at the option of the holder and the principal amount would be required to be paid in cash, the difference between the principal amount and the carrying value of the Notes would be reflected as convertible debt in mezzanine on our condensed consolidated balance sheets. As of January 27, 2012, shares issued related to conversion of the Notes were minimal. As of January 27, 2012, we received a minimal number of shares related to the Note hedge transactions and no cash or shares were delivered related to the warrant transactions.

**Contractual Obligations**

The following table summarizes our contractual obligations as of January 27, 2012 and the effect such obligations are expected to have on our liquidity and cash flows in future periods (in millions):

	Remainder of						
	2012	2013	2014	2015	2016	Thereafter	Total
<b>Off-balance sheet commitments:</b>							
Office operating lease payments	\$ 9.4	\$ 37.1	\$ 36.2	\$ 36.3	\$ 31.2	\$ 74.9	\$ 225.1
Real estate lease payments <sup>(1)</sup>	0.8	129.2					130.0
Less: sublease income	(0.5)	(1.2)	(0.8)	(0.8)	(0.5)		(3.8)
Equipment operating lease payments	7.4	20.5	13.4	4.4	1.3	0.6	47.6
Purchase commitments with contract manufacturers <sup>(2)</sup>	215.4	3.6	1.2	0.2			220.4
Capital expenditures	19.6	17.2	11.7				48.5
Other purchase obligations <sup>(3)</sup>	89.9	92.6	17.6	10.6	10.0	10.0	230.7
<b>Total off balance-sheet commitments</b>	<b>342.0</b>	<b>299.0</b>	<b>79.3</b>	<b>50.7</b>	<b>42.0</b>	<b>85.5</b>	<b>898.5</b>
1.75% Convertible notes <sup>(4)</sup>		22.1	1,276.0				1,298.1
Long-term financing arrangements	3.8	10.9	3.4	2.2	1.7	0.8	22.8
Uncertain tax positions <sup>(5)</sup>							105.9
<b>Total</b>	<b>\$ 345.8</b>	<b>\$ 332.0</b>	<b>\$ 1,358.7</b>	<b>\$ 52.9</b>	<b>\$ 43.7</b>	<b>\$ 86.3</b>	<b>\$ 2,325.3</b>
<b>Other Commercial Commitments:</b>							
Letters of credit	\$ 6.0	\$ 1.4	\$	\$ 0.2	\$ 0.4	\$ 1.2	\$ 9.2

(1) Included in real estate lease payments pursuant to four financing arrangements with BNP Paribas LLC (BNPPLC) are: (i) lease commitments of \$0.8 million for the remainder of fiscal 2012 and \$2.1 million in fiscal 2013, which are based on either the LIBOR rate as of January 27, 2012 plus a spread or a fixed rate for terms of five years and (ii) at the expiration or termination of the leasing arrangements, a supplemental payment obligation equal to our minimum guarantee of \$127.1 million in the event that we elect not to purchase or arrange for sale of the buildings.

(2) Contract manufacturer commitments consist of obligations for on-hand inventories and non-cancelable purchase orders with our contract manufacturers. As of January 27, 2012, we recorded accruals of \$3.2 million for firm, non-cancelable purchase commitments with contract manufacturers for quantities in excess of our future demand forecasts, which is consistent with the valuation of our excess and obsolete inventory.

(3)

## Edgar Filing: NetApp, Inc. - Form 10-Q

Purchase obligations represent an estimate of all open purchase orders and contractual obligations in the ordinary course of business, other than commitments with contract manufacturers and suppliers, for which we have not received the goods or services. Purchase obligations do not include contracts that may be cancelled without penalty. Although open purchase orders are considered enforceable and legally binding, the terms generally allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to the delivery of goods or performance of services.

**Table of Contents**

- (4) Included in these amounts are obligations related to the \$1.265 billion principal amount of 1.75% Notes due 2013 (see Note 9 of the accompanying condensed consolidated financial statements). Estimated interest payments for the Notes are \$33.2 million for the remainder of fiscal 2012 through fiscal 2014.
- (5) As of January 27, 2012, our liability for uncertain tax positions was \$105.9 million, including interest and penalties, which due to the uncertainty of the timing of future payments, are presented in the total column on a separate line in this table.

Some of the amounts in the table above are based on management's estimates and assumptions, including their duration, the possibility of renewal or termination, anticipated actions by management and third parties and other factors. Because these estimates and assumptions are subjective, our actual future obligations may vary from those reflected in the table. We expect to fund our contractual obligations and other commitments in the table above through existing cash, cash equivalents, investments, and cash generated from operations or obtain additional financing, if necessary.

As of January 27, 2012, we have four leasing arrangements (Leasing Arrangements 1, 2, 3 and 4) with BNPPLC, some of which require us to lease certain of our land to BNPPLC for a period of 99 years and to lease approximately 0.6 million square feet of office space from BNPPLC for our headquarters in Sunnyvale, California, which had an original cost of \$149.6 million. Under these leasing arrangements, we pay BNPPLC minimum lease payments, which vary based on LIBOR plus a spread or a fixed rate on the costs of the facilities on the respective lease commencement dates. We make payments for each of the leases for a term of five years. We have the option to renew each of the leases for two consecutive five-year periods upon approval by BNPPLC. Upon expiration (or upon any earlier termination) of the lease terms, we must elect one of the following options: (i) purchase the buildings from BNPPLC at cost; (ii) if certain conditions are met, arrange for the sale of the buildings by BNPPLC to a third-party, and be liable for any deficiency between the net proceeds received from the third-party and BNPPLC's cost, up to 85% of cost (residual guarantee); or (iii) pay BNPPLC supplemental payments for an amount equal to the difference between BNPPLC's cost and fair value, up to the residual guarantee, in which event we may recoup some or all of such payments by arranging for a sale of each or all buildings by BNPPLC during the ensuing two-year period. The following table summarizes the costs, the residual guarantee, the applicable LIBOR plus spread or fixed rate at January 27, 2012 and the date we began to make payments for each of our leasing arrangements (in millions):

Leasing Arrangements	Cost	Residual Guarantee	LIBOR		Lease Commencement Date	Term
			Plus Spread or Fixed Rate			
1	\$ 48.5	\$ 41.2	3.14%		January 2008	5 years
2	80.0	68.0	0.22%		December 2007	5 years
3	10.5	8.9	3.12%		December 2007	5 years
4	10.6	9.0	3.14%		December 2007	5 years

These leasing arrangements require us to maintain specified financial covenants with which we were in compliance as of January 27, 2012. Such financial covenants include a maximum ratio of Total Debt to Earnings before Interest, Taxes, Depreciation and Amortization of less than 3:1 and a minimum amount of Unencumbered Cash and Short-Term Investments of \$300.0 million. Our failure to comply with these financial covenants could result in a default under the leases, which, subject to our right and ability to exercise our purchase option, would give BNPPLC the right to, among other things, (i) terminate our possession of the leased property and require us to pay lease termination damages and other amounts as set forth in the lease agreements or (ii) exercise certain foreclosure remedies. If we were to exercise our purchase option, or be required to pay lease termination damages, these payments would significantly reduce our available liquidity, which could constrain our operating flexibility.

As of January 27, 2012, we estimated that the fair value of certain properties under synthetic lease was \$51.0 million below the cost of the properties. We are accruing for this deficiency over the remaining terms of the respective leases. As of January 27, 2012, a deficiency reserve of \$32.4 million was included in other current liabilities.

We may from time to time terminate one or more of our leasing arrangements and repay amounts outstanding in order to meet our operating or other objectives.

---

## **Table of Contents**

### ***Legal Contingencies***

We are subject to various legal proceedings and claims which may arise in the normal course of business. No accrual has been recorded as of January 27, 2012, as the outcome of these legal matters is currently not determinable.

On October 13, 2010, Amalgamated Bank (as trustee of the Longview Largecap 500 Index Fund and the Longview Largecap 500 Index Veba Fund) filed a derivative lawsuit on behalf of NetApp, Inc. and NetApp U.S. Public Sector, Inc. in the Superior Court of the State of California, Santa Clara County. The lawsuit named certain of our current and former directors as defendants. On February 3, 2011, the plaintiff filed an amended complaint in response to motions to dismiss that we and the individual defendants had filed. Like the original complaint, the amended complaint included claims of breach of fiduciary duty and waste of corporate assets and alleges that the defendants failed to monitor internal controls to ensure that we complied with legal requirements in our General Services Administration (GSA) contracting activities, resulting in us incurring defense and settlement costs. The amended complaint sought disgorgement of salaries and other compensation from the defendants and additional unspecified damages. We and the individual defendants filed motions to dismiss the amended complaint in early March 2011. Following a hearing on July 15, 2011, the Court granted the motions to dismiss, but permitted plaintiff leave to amend its complaint on or before September 16, 2011.

On August 9, 2011, Amalgamated Bank filed a complaint in Delaware Chancery Court against us for the purpose of obtaining, in a summary proceeding, books and records to help Amalgamated Bank amend its complaint in the California lawsuit. Each of the parties filed cross motions for summary judgment, and a hearing was held before the Delaware Chancery Court on November 16, 2011. Following that hearing, the Court directed Amalgamated Bank to more narrowly tailor its requests. On December 5, 2011, the court allowed plaintiff to conduct a very limited document inspection. On February 6, 2012, the court denied plaintiff's motion to compel further document production.

The plaintiff filed an amended complaint for a third time on September 15, 2011. This complaint alleged the same claims and requests for relief as the previous complaints. On January 9, 2012, the defendants filed motions to dismiss the amended complaint. A hearing on our motion to dismiss the California lawsuit will be held on March 23, 2012.

### ***Off-Balance Sheet Arrangements***

During the ordinary course of business, we provide standby letters of credit or other guarantee instruments to third parties as required for certain transactions initiated either by us or our subsidiaries. As of January 27, 2012, our financial guarantees of \$9.2 million that were not recorded on our condensed consolidated balance sheet consisted of standby letters of credit related to workers' compensation, a customs guarantee, a corporate credit card program, foreign rent guarantees and surety bonds, which were primarily related to self-insurance.

We use derivative instruments to manage exposures to foreign currency risk. Our primary objective in holding derivatives is to reduce the volatility of earnings and cash flows associated with changes in foreign currency. The program is not designated for trading or speculative purposes. Currently, we do not enter into any foreign exchange forward contracts to hedge exposures related to firm commitments or nonmarketable investments. Our major foreign currency exchange exposures and related hedging programs are described below:

We utilize monthly foreign currency forward and options contracts to hedge exchange rate fluctuations related to certain foreign monetary assets and liabilities.

We use currency forward contracts to hedge exposures related to forecasted sales denominated in certain foreign currencies. These contracts are designated as cash flow hedges and in general closely match the underlying forecasted transactions in duration. As of January 27, 2012, the notional fair value of foreign exchange forward and foreign currency option contracts totaled \$612.4 million. We do not believe that these derivatives present significant credit risks, because of the short term maturity of the outstanding contracts at any point in time, the counterparties to the derivatives consist of major financial institutions, and we manage the notional amount of contracts entered into with any one counterparty. Other than the risk associated with the financial condition of the counterparties, our maximum exposure related to foreign currency forward and option contracts is limited to the premiums paid. See Note 11 of the accompanying condensed consolidated financial statements for more information related to our hedging activities.

In the ordinary course of business, we enter into recourse lease financing arrangements with third-party financing companies and from time to time provide guarantees for a portion of financing arrangements under which we could be called upon to make payments to these third-party financing companies in the event of nonpayment by end-user customers. See Note 15 of the accompanying condensed consolidated financial

statements for more information related to these financing arrangements.



---

## **Table of Contents**

We enter into indemnification agreements with third parties in the ordinary course of business. Generally, these indemnification agreements require us to reimburse losses suffered by the third-parties due to various events, such as lawsuits arising from patent or copyright infringement. These indemnification obligations are considered off-balance sheet arrangements under accounting guidance.

We have commitments related to four leasing arrangements with BNPPLC for approximately 0.6 million square feet of office space for our headquarters in Sunnyvale, California (as further described above under *Contractual Obligations* ). Our future minimum lease payments and residual guarantees under these real estate leases will amount to a total of \$130.0 million as discussed above in *Contractual Obligations*.

We have evaluated these leases under variable interest entity accounting guidance and have determined the following:

BNPPLC is a leasing company for BNP Paribas in the U.S. BNPPLC is not a special purpose entity organized for the sole purpose of facilitating the leases to us. The obligation to absorb expected losses and receive expected residual returns rests with the parent, BNP Paribas. Therefore, we are not the primary beneficiary of BNPPLC as we do not absorb the majority of BNPPLC's expected losses or expected residual returns; and

BNPPLC has represented in the related closing agreements that the fair value of the properties leased to us by BNPPLC is less than half of the total of the fair value of all assets of BNPPLC, excluding any assets of BNPPLC held within a silo. Further, the property leased to us is not held within a silo. The definition of held within a silo means that BNPPLC has obtained funds equal to or in excess of 95% of the fair value of the leased asset to acquire or maintain its investment in such asset through nonrecourse financing or other contractual arrangements, the effect of which is to leave such asset (or proceeds thereof) as the only significant asset of BNPPLC at risk for the repayment of such funds.

Accordingly, we are not required to consolidate either the leasing entity or the specific assets that we lease under the BNPPLC lease.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to market risk related to fluctuations in interest rates, market prices, and foreign currency exchange rates. We use certain derivative financial instruments to manage these risks. We do not use derivative financial instruments for speculative or trading purposes. All financial instruments are used in accordance with management-approved policies.

#### **Market Risk and Market Interest Risk**

*Investment and Interest Income* As of January 27, 2012, we had debt investments of \$2.6 billion. Our investment portfolio primarily consists of investments with original maturities greater than three months at the date of purchase, and are classified as available-for-sale investments. These investments, which consist primarily of corporate bonds, commercial paper, and certificates of deposit, are subject to interest rate and interest income risk and will decrease in value if market interest rates increase. A hypothetical 10 percent increase in market interest rates from levels as of January 27, 2012 would cause an immaterial decline in the fair value of these available-for-sale investments. Volatility in market interest rates over time will cause variability in our interest income. We do not use derivative financial instruments in our investment portfolio.

Our investment policy is to limit credit exposure through diversification and investment in highly rated securities. We further mitigate concentrations of credit risk in our investments by limiting our investments in the debt securities of a single issuer and by diversifying risk across geographies and type of issuer. We actively review, along with our investment advisors, current investment ratings, company-specific events and general economic conditions in managing our investments and in determining whether there is a significant decline in fair value that is other-than-temporary. We will monitor and evaluate the accounting for our investment portfolio on a quarterly basis for any other-than-temporary impairment charges.

We are also exposed to market risk relating to our auction rate securities due to uncertainties in the credit and capital markets. As of January 27, 2012, we recorded cumulative unrealized losses of \$4.2 million, offset by \$0.8 million of cumulative unrealized gains related to these securities. The fair value of our auction rate securities may change significantly due to events and conditions in the credit and capital markets. These securities/issuers could be subject to review for possible downgrade. Any downgrade in these credit ratings may result in an additional decline in the estimated fair value of our auction rate securities. Changes in the various assumptions used to value these securities and any increase in the market's perceived risk associated with such investments may also result in a decline in estimated fair value.



**Table of Contents**

If current market conditions deteriorate, or the anticipated recovery in market values does not occur, we may be required to record additional unrealized losses in accumulated other comprehensive income or other-than-temporary impairment charges to earnings in future quarters. We intend, and have the ability, to hold these investments until the market recovers. We do not believe that the lack of liquidity relating to our portfolio investments will impact our ability to fund working capital needs, capital expenditures or other operating requirements.

*Lease Commitments* One of our four leasing arrangements with BNPPLC is based on a floating interest rate. The minimum lease payments will vary based on LIBOR plus a spread. All of these leases have an initial term of five years, and we have the option to renew these leases for two consecutive five-year periods upon approval by BNPPLC. A hypothetical 10 percent increase in market interest rate from the level at January 27, 2012 would increase our lease payments on the floating lease arrangement under the initial five-year term by an immaterial amount. We do not currently hedge against market interest rate increases.

*Convertible Notes* In June 2008, we issued \$1.265 billion principal amount of 1.75% Notes due 2013, of which \$1,017.0 million was allocated to debt and \$248.0 million was allocated to equity. Holders may convert the Notes prior to maturity upon the occurrence of certain circumstances, including, but not limited to:

during the five business day period after any five consecutive trading day period in which the trading price of the Notes for each day in this five consecutive trading day period was less than 98% of an amount equal to (i) the last reported sale price of our common stock multiplied by (ii) the conversion rate of the Notes on each such day;

during any calendar quarter (and only during such calendar quarter) if the last reported sale price of our common stock for 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the applicable conversion price in effect for the Notes on the last trading day of such immediately preceding calendar quarter; or

upon the occurrence of specified corporate transactions described in the indenture for the Notes.

The Notes are convertible into the right to receive cash in an amount up to the principal amount and shares of our common stock for the conversion value in excess of the principal amount, if any, at an initial conversion rate of 31.40 shares of common stock per \$1,000 principal amount of Notes (which represents an initial effective conversion price of the Notes of \$31.85 per share), subject to adjustment as described in the indenture governing the Notes.

Concurrent with the issuance of the Notes, we entered into convertible Note hedge transactions and separately, warrant transactions, to reduce the potential dilution from the conversion of the Notes and to mitigate any negative effect such conversion may have on the price of our common stock. In fiscal 2010, we terminated the hedge transaction with a counterparty to 20% of our Note hedges, and because we have decided not to replace the hedge, we are subject to potential dilution on the 20% unhedged portion of our Notes upon conversion, if on the date of conversion, the per-share market price of our common stock exceeds the conversion price of \$31.85.

Our common stock price did not exceed the conversion threshold price of \$41.41 per share set forth for these Notes for at least 20 trading days during the 30 consecutive trading days ended December 31, 2011. Accordingly, as of January 27, 2012, the Notes were not convertible at the option of the holder and, therefore, the carrying value of the Notes was classified as long-term debt, and the difference between the principal amount and the carrying value of these Notes was reflected as equity on our condensed consolidated balance sheet as of January 27, 2012.

Our common stock price exceeded the conversion threshold for these Notes for at least 20 trading days during the 30 consecutive trading days ended March 31, 2011. Accordingly, as of April 29, 2011, the Notes were convertible at the option of the holder and, therefore, the carrying value of the Notes was classified as short-term debt. Since the Notes were convertible at the option of the holder and the principal amount would have been required to be paid in cash, the difference between the principal amount and the carrying value of the Notes was reflected as convertible debt in mezzanine on our condensed consolidated balance sheet as of April 29, 2011.

The determination of whether or not the Notes are convertible must continue to be performed quarterly. Consequently, the Notes may be convertible in future quarters, and therefore may be classified as short-term debt, if the conversion thresholds are met in such quarters. Additionally, since the Notes would be convertible at the option of the holder and the principal amount would be required to be paid in cash, the difference between the principal amount and the carrying value of the Notes would be reflected as convertible debt in mezzanine on our condensed consolidated balance sheets.



**Table of Contents**

Upon conversion of any Notes, we deliver cash up to the principal amount of the Notes and, with respect to any excess conversion value greater than the principal amount of the Notes, shares of our common stock. As of January 27, 2012, shares issued related to the Notes were minimal. Based on the closing price of our common stock of \$37.28 on January 27, 2012, the if-converted value of our Notes exceeded their principal amount by approximately \$215.6 million.

The fair value of our Notes is subject to interest rate risk, market risk and other factors due to the convertible feature. Generally, the fair value of Notes will increase as interest rates fall and/or our common stock price increases, and decrease as interest rates rise and/or our common stock price decreases. The interest and market value changes affect the fair value of our Notes, but do not impact our financial position, cash flows, or results of operations due to the fixed nature of the debt obligations. We do not carry the Notes at fair value, but present the fair value of the principal amount of the Notes for disclosure purposes. As of January 27, 2012, the principal amount of the Notes, which consists of the combined debt and equity components, was \$1.265 billion, and the total estimated fair value of the principal amount was \$1.631 billion based on the closing trading price of \$128.92 per \$100 of the Notes as of that date.

**Foreign Currency Exchange Rate Risk and Foreign Exchange Forward Contracts**

We hedge risks associated with foreign currency transactions to minimize the impact of changes in foreign currency exchange rates on earnings. We utilize forward and option contracts to hedge against the short-term impact of foreign currency fluctuations on certain foreign currency denominated monetary assets and liabilities. All balance sheet hedges are marked to market through earnings every period. We also use foreign exchange forward contracts to hedge foreign currency forecasted transactions related to forecasted sales transactions. These derivatives are designated as cash flow hedges under accounting guidance for derivatives and hedging. For cash flow hedges outstanding at January 27, 2012, the time-value component is recorded in earnings while all other unrealized gains or losses are included in other comprehensive income.

We do not enter into foreign exchange contracts for speculative or trading purposes. In entering into forward and option foreign exchange contracts, we have assumed the risk that might arise from the possible inability of counterparties to meet the terms of their contracts. We attempt to limit our exposure to credit risk by executing foreign exchange contracts with creditworthy multinational commercial banks. All contracts have a maturity of less than one year.

The following table provides information about our currency forward contracts outstanding on January 27, 2012 (in millions):

Currency	Local Currency Amount	Notional Contract Amount (USD)	Fair Value (USD)
<b>Forward Contracts:</b>			
Euro	306.1	\$ 404.2	\$ 404.7
British Pound Sterling	52.1	81.9	81.9
Australian Dollar	37.5	39.8	40.0
Canadian Dollar	23.0	22.9	22.9
Other	NM	63.6	64.0

**Item 4. Controls and Procedures***Disclosure Controls and Procedures*

Disclosure controls are controls and procedures designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, as amended (the Exchange Act), such as this Quarterly Report on Form 10-Q, is recorded, processed, summarized, and reported within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms. Disclosure controls and procedures are also designed to ensure that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of January 27, 2012, the end of the fiscal period covered by this Quarterly Report on Form 10-Q (the Evaluation Date). Based on this evaluation, our CEO and CFO concluded as of the Evaluation Date that our disclosure controls and procedures were effective such that

## Edgar Filing: NetApp, Inc. - Form 10-Q

the information relating to NetApp, including our consolidated subsidiaries, required to be disclosed in our Securities and Exchange Commission (SEC) reports (i) is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

**Table of Contents**

*Changes in Internal Control Over Financial Reporting*

As a result of our acquisition of the Engenio business on May 6, 2011, our internal control over financial reporting, subsequent to the date of acquisition, includes certain additional controls relating to Engenio. Except for the additional controls relating to Engenio, there were no other changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

---

**Table of Contents****PART II OTHER INFORMATION****Item 1. Legal Proceedings**

On October 13, 2010, Amalgamated Bank (as trustee of the Longview Largecap 500 Index Fund and the Longview Largecap 500 Index Veba Fund) filed a derivative lawsuit on behalf of NetApp, Inc. and NetApp U.S. Public Sector, Inc. in the Superior Court of the State of California, Santa Clara County. The lawsuit named certain of our current and former directors as defendants. On February 3, 2011, the plaintiff filed an amended complaint in response to motions to dismiss that we and the individual defendants had filed. Like the original complaint, the amended complaint included claims of breach of fiduciary duty and waste of corporate assets and alleges that the defendants failed to monitor internal controls to ensure that we complied with legal requirements in our General Services Administration (GSA) contracting activities, resulting in us incurring defense and settlement costs. The amended complaint sought disgorgement of salaries and other compensation from the defendants and additional unspecified damages. We and the individual defendants filed motions to dismiss the amended complaint in early March 2011. Following a hearing on July 15, 2011, the Court granted the motions to dismiss, but permitted plaintiff leave to amend its complaint on or before September 16, 2011.

On August 9, 2011, Amalgamated Bank filed a complaint in Delaware Chancery Court against us for the purpose of obtaining, in a summary proceeding, books and records to help Amalgamated Bank amend its complaint in the California lawsuit. Each of the parties filed cross motions for summary judgment, and a hearing was held before the Delaware Chancery Court on November 16, 2011. Following that hearing, the Court directed Amalgamated Bank to more narrowly tailor its requests. On December 5, 2011, the court allowed plaintiff to conduct a very limited document inspection. On February 6, 2012, the court denied plaintiff's motion to compel further document production.

The plaintiff filed an amended complaint for a third time on September 15, 2011. This complaint alleged the same claims and requests for relief as the previous complaints. On January 9, 2012, the defendants filed motions to dismiss the amended complaint. A hearing on our motion to dismiss the California lawsuit will be held on March 23, 2012.

**Item 1A. Risk Factors**

*The following risk factors and other information included in this Quarterly Report on Form 10-Q should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we presently deem less significant may also impair our business operations. Please see Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations of this Quarterly Report on Form 10-Q for a discussion of the forward-looking statements that are qualified by these risk factors. If any of the events or circumstances described in the following risk factors actually occurs, our business, operating results, and financial condition could be materially adversely affected.*

***Our operating results may be adversely affected by uncertain economic and market conditions.***

We are subject to the effects of general global economic and market conditions. Challenging economic conditions worldwide or in certain geographic regions, such as the continuing fiscal challenges in the United States (U.S.) and Europe, have from time to time contributed to slowdowns in the computer, storage, and networking industries at large, as well as the information technology (IT) market, resulting in:

Reduced demand for our products as a result of constraints on IT-related spending by our customers;

Risk of supply constraints, particularly the recent flooding in Thailand;

Increased price competition for our products from competitors;

Deferment of purchases and orders by customers due to budgetary constraints or changes in current or planned utilization of our systems;



Risk of excess and obsolete inventories;

Excess facilities costs;

Higher overhead costs as a percentage of revenues;

**Table of Contents**

Negative impacts from increased financial pressures on customers, distributors and resellers;

Negative impacts from increased financial pressures on key suppliers or contract manufacturers; and

Potential discontinuance of product lines or businesses and related asset impairments.

Any of the above-mentioned factors could have a material and adverse effect on our business and financial performance.

***Our quarterly operating results may fluctuate, which could adversely impact our common stock price.***

We believe that period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as indicators of future performance. Our operating results have been in the past, and will continue to be, subject to quarterly fluctuations as a result of numerous factors, some of which may contribute to more pronounced fluctuations during times of economic volatility. These factors include, but are not limited to, the following:

Fluctuations in demand for our products and services, in part due to changes in general economic conditions and specific economic conditions in the storage and data management market;

A shift in federal government spending patterns, particularly in light of continued worries about U.S. debt levels and spending;

Changes in sales and implementation cycles for our products and reduced visibility into our customers' spending plans and associated revenues;

The level of price and product competition in our target markets;

The impact of economic uncertainty on our customers' budgets and IT spending capacity;

Our ability to maintain appropriate inventory levels and purchase commitments, particularly in light of recent flooding in Thailand and resulting constraints on inventory supply;

Our reliance on a limited number of suppliers, and industry consolidation in our supply base, which could subject us to periodic supply-and-demand, price rigidity, and quality issues with our components;

Our ability to maintain product quality generally;

The timing of bookings, the cancellation of significant orders and the management of, or fluctuations in, our backlog;

Product configuration and mix;

## Edgar Filing: NetApp, Inc. - Form 10-Q

The extent to which our customers renew their service and maintenance contracts with us;

Seasonality, such as our historical seasonal decline in revenues in the first quarter of our fiscal year and seasonal increase in revenues in the second quarter of our fiscal year, with the latter due in part to the impact of the U.S. federal government's September 30 fiscal year end on the timing of its orders;

Linearity, such as our historical intra-quarter bookings and revenue pattern in which a disproportionate percentage of each quarter's total bookings and related revenue occur in the last month of the quarter;

Announcements and introductions of, and transitions to, new products by us or our competitors;

Deferrals of customer orders in anticipation of new products or product enhancements introduced by us or our competitors;

Our ability to develop, introduce, and market new products and enhancements in a timely manner;

Our ability to effectively integrate acquired products and technologies;

---

**Table of Contents**

Our levels of expenditure on research and development and sales and marketing programs;

Our ability to effectively manage our operating expenses;

Adverse movements in foreign currency exchange rates in the countries in which we do business;

The dilutive impact of our \$1.265 billion of 1.75% convertible senior notes due June 2013 (the Notes ) and related warrants on our earnings per share;

Excess or inadequate facilities;

Actual events, circumstances, outcomes and amounts differing from judgments, assumptions, and estimates used in determining the values of certain assets (including the amounts of valuation allowances), liabilities, and other items reflected in our consolidated financial statements;

Disruptions resulting from new systems and processes as we continue to enhance and scale our system infrastructure;

Disruptions resulting from reliance on third-party systems and processes during the transition period following the completion of mergers or other acquisitions; and

Future accounting pronouncements and changes in accounting rules, such as the increased use of fair value measures, changes in accounting standards related to revenue recognition, lease accounting, and financial instruments and the potential requirement that U.S. registrants prepare financial statements in accordance with International Financial Reporting Standards (IFRS).

Due to such factors, operating results for future periods are difficult to predict, and, therefore, prior results are not necessarily indicative of results to be expected in future periods. Any of the foregoing factors, or any other factors discussed elsewhere herein, could have a material adverse effect on our business, results of operations, and financial condition. It is possible that in one or more quarters our results may fall below our forecasts and the expectations of public market analysts and investors. In such event, the trading price of our common stock would likely decrease.

***Our revenues for a particular period are difficult to forecast, and a shortfall in revenues may harm our business and our operating results.***

Our revenues for a particular period are difficult to forecast, especially in times of economic uncertainty. Because the storage and data management market is rapidly evolving, our sales cycle varies substantially from customer to customer, and we rely increasingly on sales through our indirect channel partners, including value-added resellers, systems integrators, distributors, OEMs and strategic business partners. New product introductions and the transition from old to new products also increase the complexities of forecasting revenues.

In addition, we derive a majority of our revenues in any given quarter from orders booked in the same quarter. Bookings typically follow intra-quarter seasonality patterns weighted toward the back end of the quarter. If we do not achieve bookings in the latter part of a quarter consistent with our quarterly targets, our financial results will be adversely impacted. Additionally, due to the complexities associated with revenue recognition, we may not accurately forecast our non-deferred and deferred revenues, which could adversely impact our results of operations.

We use a pipeline system, a common industry practice, to forecast bookings and trends in our business. Sales personnel monitor the status of potential business and estimate when a customer will make a purchase decision, the dollar amount of the sale and the products or services to be sold. These estimates are aggregated periodically to generate a bookings pipeline. Our pipeline estimates may prove to be unreliable either in a particular quarter or over a longer period of time, in part because the conversion rate of the pipeline into revenues varies from customer to

## Edgar Filing: NetApp, Inc. - Form 10-Q

customer, can be difficult to estimate, and requires management judgment, and also because customers' purchasing decisions are subject to delay, reduction or cancellation. Small deviations from our forecasted conversion rate may result in inaccurate plans and budgets and could materially and adversely impact our business or our planned results of operations. In addition, the risks inherent in using a pipeline system are magnified with respect to indirect sales made through our channel partners because we have less control over, and visibility into, the sales process of our channel partners.

---

**Table of Contents**

Economic uncertainties have caused, and may in the future again cause, consumers, businesses and governments to defer purchases in response to tighter budgets, credit, decreased cash availability and declining customer confidence. Accordingly, future demand for our products could differ from our current expectations.

***Supply chain and logistics issues, including financial problems of contract manufacturers or component suppliers, or a shortage of adequate component supply or manufacturing capacity that increases our costs or causes a delay in our ability to fulfill orders, could have a material adverse impact on our business and operating results, and our failure to estimate customer demand properly may result in excess or obsolete component supply, which could adversely affect our gross margins.***

The fact that we do not own or operate our manufacturing facilities, supply chain and logistics exposes us to risks, including reduced control over quality assurance, production costs and product supply, which could have a material adverse impact on the supply of our products and on our business and operating results. We rely on a limited number of suppliers for components utilized in the assembly of our products, including certain single source suppliers, which has and could subject us to future price rigidity, periodic supply constraints, and the inability to produce our products. In addition, pursuant to the terms of the asset purchase agreement we entered into with LSI in connection with the acquisition of certain assets related to Engenio, we have the right to place orders with contract manufacturers and suppliers through LSI and access LSI's systems in order to help us manage the Engenio business for a period of time following the acquisition. Financial or other problems of either contract manufacturers, component suppliers or other parties in our supply chain, including LSI, and reservation of manufacturing capacity at our contract manufacturers by other companies, inside or outside of our industry, could either limit supply or increase costs of our products.

For instance, several of our disk drive suppliers with operations in Thailand were impacted by the October 2011 flooding, which has affected those suppliers' ability to manufacture a sufficient number of drives in order to meet the demands of their customers, including us. In addition, certain suppliers have also increased prices for available drives. Continued drive supply shortages and pricing complexities could materially and adversely affect our supply chain, customer relationships and results of operations. In addition, qualifying a new contract manufacturer and commencing volume production is expensive and time-consuming, and disruption or termination of manufacturing capacity with respect to any contract manufacturer could negatively impact our ability to manufacture, sell and ship our products.

We intend to regularly introduce new products and product enhancements, which will require us to rapidly achieve volume production by coordinating with our contract manufacturers and suppliers. A reduction or interruption in supply; a significant increase in the price of one or more components; a failure to adequately procure inventory by our contract manufacturers; a failure to timely cancel, reschedule, or adjust our requirements based on our business needs; perceived or real problems with product quality control; or a decrease in demand for our products could materially adversely affect our business, operating results, and financial condition and could materially damage customer relationships. Furthermore, as a result of binding price or purchase commitments with suppliers, we may be obligated to purchase components at prices that are higher than those available in the current market. In the event that we become committed to purchase components at prices in excess of the current market price when the components are actually used, our gross margins could decrease. As the demand for our products has increased, we have experienced, and may continue to experience, tightening of supply of some components leading to longer lead times and component supply constraints, which has resulted in and in the future could continue to result in the delay of shipments.

Our business operations are subject to business interruptions and other events beyond our control. Such events could make it difficult or impossible for us to receive components from our suppliers and create delays and inefficiencies in our supply chain.

***We have experienced periods of alternating growth and decline in revenues and operating expenses. If we are not able to successfully manage these fluctuations, our business, financial condition and results of operations could be significantly impacted.***

Changing market conditions and economic uncertainty create a challenging operating environment for our business. It is critical that we maintain appropriate alignment between our cost structure and our expected growth and revenues, while at the same time, continuing to make strategic investments for future growth.

Our expense levels are based in part on our expectations as to future revenues, and a significant percentage of our expenses are fixed. We have a limited ability to quickly or significantly reduce our fixed costs, and if revenue levels are below our expectations, operating results will be adversely impacted. During periods of uneven growth, we may incur costs before we realize the anticipated related benefits, which could harm our operating results. We have made, and will continue to make, significant investments in engineering, sales, service and support, marketing programs and other functions to support and grow our business. We are likely to recognize the costs associated with these investments earlier than some of the related anticipated benefits (revenue growth), and the return on these investments may be lower, or may develop more slowly, than we expect, which could harm our business, operating results and financial condition.



**Table of Contents**

Conversely, if we are unable to effectively manage our resources and capacity during periods of increasing demand for our products, we could also experience an adverse impact on our business, operating results and financial condition and our customer relationships may be adversely impacted. If the storage and data management market fails to grow, or grows slower than we expect, our revenues will be adversely affected. Also, even if spending in the IT market increases, our revenues may not grow at the same pace.

*Our gross margins have varied over time and may continue to vary, and such variation makes it more difficult to forecast our earnings.*

Our total gross margins are impacted by the mix of our product, software entitlements and maintenance and services revenues.

Our product gross margins have been and may continue to be affected by a variety of factors, including:

Demand for storage and data management products;

Pricing actions, rebates, sales initiatives, discount levels, and price competition;

Changes in the mix between direct versus indirect and OEM sales, particularly as a result of the recent acquisition of certain assets related to Engenio, which is based on a lower gross margin OEM business model;

Changes in customer, geographic, or product mix, including mix of configurations within products;

The timing and amount of revenue recognized and deferred;

New product introductions and enhancements;

Licensing and royalty arrangements;

Excess inventory levels or purchase commitments as a result of changes in demand forecasts or last time buy purchases;

Possible product and software defects as we transition our products; and

The cost of components, contract manufacturing costs, quality, warranty, and freight.

Changes in software entitlements and maintenance gross margins may result from various factors, such as:

The size of the installed base of products under support contracts;

The timing of technical support service contract renewals; and



## Edgar Filing: NetApp, Inc. - Form 10-Q

Demand for and the timing of delivery of upgrades.

Changes in service gross margins may result from various factors, such as:

The mix of customers;

The size and timing of service contract renewals;

Spares stocking requirements to support new product introductions;

The level of spending on our customer support infrastructure;

The volume, cost and use of outside partners to deliver support services on our behalf; and

---

**Table of Contents**

Product quality and serviceability issues.

Due to such factors, gross margins are subject to variation from period-to-period and are difficult to predict.

***An increase in competition and industry consolidation could materially and adversely affect our operating results.***

The storage and data management markets are intensely competitive and are characterized by rapidly changing technology. In the storage market, our primary and near-line storage system products and our associated software portfolio compete primarily with storage system products and data management software from EMC (including its acquisition of Isilon), Hitachi Data Systems, HP, IBM, Dell and Oracle Corporation. In the secondary storage market, which includes the disk-to-disk backup, compliance and business continuity segments, our solutions compete primarily against products from EMC and Oracle Corporation.

There has been a trend toward industry consolidation in our markets for several years. We expect this trend to continue as companies attempt to strengthen or hold their market positions in an evolving industry, as companies become unable to maintain their competitive positions or continue operations and as customers demand more flexible business models and terms. We believe that industry consolidation may result in stronger competitors that are better able to compete for customers as sole-source vendors. In addition, current and potential competitors have established or may establish strategic alliances among themselves or with third parties, including some of our partners. It is possible that new competitors or alliances among competitors may emerge and rapidly acquire significant market share. We may not be able to compete successfully against current or future competitors. Competitive pressures we face could materially and adversely affect our business and operating results.

***Disruption of, or changes in, our distribution model could harm our sales.***

If we fail to develop and maintain strong relationships with our channel partners, or if our channel partners fail to effectively manage the sale of our products or services on our behalf, our revenues and gross margins could be adversely affected.

We market and sell our storage data management solutions directly through our worldwide sales force and indirectly through channel partners such as value-added resellers, systems integrators, distributors, OEMs and strategic business partners, and we derive a significant portion of our revenues from these indirect channels. During the three and nine months ended January 27, 2012, revenues generated from sales through our indirect channel distribution accounted for 79% and 78% of net revenues, respectively, and we expect this percentage to continue to increase over time as we further develop these channels or acquire products distributed through indirect channels. In order for us to maintain or increase our revenues, we must effectively manage our relationships with channel partners.

Several factors could result in disruption of or changes in our indirect channel distribution model, which could materially harm our revenues and gross margins, including the following:

Our indirect channel partners may compete directly with other channel partners or with our direct sales force. Due to these conflicts, our indirect channel partners could stop or reduce their efforts in marketing our products.

Our indirect channel partners may demand that we absorb a greater share of the risks that their customers may ask them to bear;

Our indirect channel partners may have insufficient financial resources and may not be able to withstand changes and challenges in business conditions; and

Our indirect channel partners' financial condition or operations may weaken.

There is no assurance that we will be able to attract new indirect channel partners, retain these indirect channel partners or that we will be able to secure additional or replacement indirect channel partners in the future, especially in light of changes in end customer demand patterns and changes in available and competing technologies from competitors. The loss of one or more of our key indirect channel partners in a given geographic area could harm our operating results within that area, as qualifying and developing new indirect channel partners typically requires a significant investment of time and resources before acceptable levels of productivity are met. Our inability to effectively establish, train, retain and manage our indirect channel partners could harm our sales.



---

## **Table of Contents**

In addition, we depend on our indirect channel partners to comply with applicable regulatory requirements in the jurisdictions in which they operate. Their failure to do so could have a material adverse effect on our revenues and operating results.

***Our OEM relationship with IBM may not continue to generate significant revenues.***

In April 2005, we entered into an OEM agreement with IBM, which enables IBM to sell IBM-branded solutions based on our unified solutions, including NearStore® and V-Series systems, as well as associated software offerings. In addition, by acquiring Engenio, we have assumed LSI's rights under a second OEM agreement with IBM, which enables IBM to sell certain Engenio solutions. While these agreements are part of our general strategy to expand our reach to more customers and into more countries, we do not have an exclusive relationship with IBM under either OEM agreement, and there is no minimum commitment for any given period of time. Therefore, our relationship with IBM may not continue to generate significant revenues or, in the case of the OEM agreement related to Engenio, may not allow us to capture certain anticipated benefits of the Engenio acquisition. In addition, we have no control over the products that IBM selects to sell, or its release schedule and timing of those products; nor do we control its pricing.

In the event that sales through our OEM relationship with IBM increase, which we expect will occur as a result of the Engenio transaction, we may experience distribution channel conflicts between our direct sales force and the OEM or among our channel partners. If we fail to minimize channel conflicts, or if our OEM relationship does not continue to generate significant revenues, our operating results and financial condition could be harmed.

***A portion of our revenues is generated by large, recurring purchases from various customers, resellers and distributors. A loss, cancellation or delay in purchases by any of these parties has and in the future could negatively affect our revenues.***

During the three and nine months ended January 27, 2012, sales to distributors Arrow Electronics, Inc. and Avnet, Inc. accounted for approximately 15% and 16% and 11% and 12%, respectively, of our net revenues. We also have significant OEM agreements with IBM, which, as described above, enable IBM to sell IBM-branded solutions based on our solutions, as well as an agreement with Fujitsu Technology Solutions (Fujitsu), which enables Fujitsu to lease, sell, market and resell our products to end users and Fujitsu sales partners worldwide, to integrate our products into Fujitsu bundled offerings, and to market our support services. The loss of orders from these, or any of our more significant customers, strategic partners, distributors or resellers could cause our revenues and profitability to suffer.

We generally do not enter into binding purchase commitments with our customers for an extended period of time, and thus we may not be able to continue to receive large, recurring orders from these customers, resellers or distributors. For example, our reseller agreements generally do not require minimum purchases and our customers, resellers and distributors can stop purchasing and marketing our products at any time.

Unfavorable economic conditions may negatively impact our operations by affecting the solvency of our customers, resellers and distributors, or the ability of our customers to obtain credit to finance purchases of our products. If the uncertainty in the economy continues, or conditions deteriorate, and our sales decline, our financial condition and operating results could be adversely impacted.

Because our expenses are based on our revenue forecasts, a substantial reduction or delay in sales of our products to, or unexpected returns from customers and resellers, or the loss of any significant customer or reseller, could harm our business. We expect that our largest customers in the future could be different from our largest customers today. End users could stop purchasing and indirect channel partners could stop marketing our products at any time. The loss of one or more of our key indirect channel partners or the failure to obtain and ship a number of large orders each quarter could harm our operating results. In addition, a change in the pricing practices of one or more of our large indirect channel partners could adversely affect our revenues and gross margins.

***The U.S. government has contributed to our revenue growth and has become an important customer for us. Future revenues from the U.S. government are subject to shifts in government spending patterns. A decrease in government demand for our products could materially and adversely affect our revenues. In addition, our business could be adversely affected by claims that we or a channel partner have failed to comply with regulatory and contractual requirements applicable to sales to the U.S. government.***

The U.S. government has become an important customer for the storage and data management market generally and for us in particular; however, government demand is unpredictable, and there can be no assurance that we will maintain or grow our revenues from the U.S. government. Government agencies are subject to budgetary processes and expenditure constraints that could lead to delays or decreased capital expenditures in IT spending, particularly in light of recent and continued uncertainties about U.S. spending levels. If the government or individual agencies within the government reduce or shift their capital spending patterns, our revenues and operating results may be harmed.



**Table of Contents**

Selling our products to the U.S. government, whether directly or through channel partners, also subjects us to certain regulatory and contractual requirements. Failure to comply with these requirements by either us or our channel partners could subject us to investigations, fines, and other penalties, which could have a material adverse effect on our revenues, operating results and financial position. As an example, the United States Department of Justice ( DOJ ) and the General Services Administration ( GSA ) have in the past pursued claims against and financial settlements with IT vendors, including us and several of our competitors and channel partners, under the False Claims Act and other statutes related to pricing and discount practices and compliance with certain provisions of GSA contracts for sales to the federal government. The DOJ and GSA continue to pursue actively such claims. We are currently discussing contract compliance matters regarding sales made through a channel partner with the DOJ and GSA, and have produced documents and met with the DOJ and GSA on several occasions. If the DOJ determines to initiate an action against a channel partner and/or us, we would be subject to litigation, could be subjected to fines and penalties, and could decide to pay the DOJ a settlement. Violations of certain regulatory and contractual requirements could also result in us being suspended or debarred from future government contracting. Any of these outcomes could have a material adverse effect on our revenues, operating results and financial position.

***Certain of our products are subject to U.S. export control laws, which prohibit the sale or distribution of products to certain prohibited countries, including Cuba, Sudan, North Korea, Iran and Syria; if we were found to have violated these laws, the consequences of such a determination could have a material and adverse effect on our business, financial condition and results of operations.***

Due to the global nature of our business, we are subject to import and export restrictions and regulations, including the Export Administration Regulations (EAR) administered by the Commerce Department's Bureau of Industry and Security (BIS) and the trade and economic sanctions regulations administered by the Treasury Department's Office of Foreign Assets Control (OFAC). The U.S., through the BIS and OFAC, places restrictions on the sale or export of certain products and services to certain countries and persons. These restrictions limit or completely bar sales of our products to Cuba, North Korea, Iran, Sudan and Syria. Violators of these export control and sanctions laws may be subject to significant penalties, which may include significant monetary fines, criminal proceedings against us and our officers and employees, a denial of export privileges, and suspension or debarment from selling products to the federal government. Even though we take precautions to prevent our products from being shipped to U.S.-sanctioned targets, our products could be shipped to those targets by our channel partners, despite such precautions. For instance, media reports starting in November 2011 have asserted that certain of our products were delivered to Syria through a third party vendor possibly in violation of U.S. export-control laws. We have publicly stated that we condemn any illegal shipments of our products to Syria, notified BIS of an internal review we are conducting and our intention to cooperate, and have offered our assistance to the U.S. government. We are aware that three U.S. senators have sent letters to the departments of Commerce and State requesting an investigation into how our products came into the possession of the Syrian government and asking that certain penalties be considered, such as suspension or debarment from conducting business with the U.S. government until the conclusion of a governmental investigation into the matters asserted in the media. If we are found to have violated U.S. export control laws, we may be subject to various penalties available under the laws, any of which could have a material and adverse impact on our business, operating results and financial position. Even if we are not found to have violated such laws, the political and media scrutiny surrounding any governmental investigation of us, including any suspension or debarment from conducting business with the U.S. government, could cause us significant financial and reputational harm and distract senior executives from managing our normal day-to-day operations, which could have a material and adverse impact on our business, operating results and financial position.

***If we are unable to maintain our existing relationships and develop new relationships with major strategic partners, our revenues may be impacted negatively.***

An element of our strategy to increase revenues is to strategically partner with major third-party software and hardware vendors to integrate our products into their products and also co-market our products with them. We have significant partner relationships with database, business application, backup management and server virtualization companies, including Microsoft, Oracle, SAP, Symantec and VMware. In January 2010, we announced an expansion of our collaboration with Cisco and VMware, including a cooperative support arrangement, and in October 2010, we expanded our relationship with Fujitsu Technology Solutions. A number of these strategic partners are industry leaders that offer us expanded access to segments of the storage and data management market. There is intense competition for attractive strategic partners, and even if we can establish relationships with these or other partners, these partnerships may not generate significant revenues or may not continue to be in effect for any specific period of time. If these relationships are not maintained or fail to materialize as expected, we could experience lower than expected revenue growth, suffer delays in product development, or experience other operational difficulties.

---

## **Table of Contents**

In addition, some of our partners, including Oracle, Cisco and VMware, are also partnering with other storage vendors, which may increase the availability of competing solutions, harm our ability to continue as the vendor of choice for those partners and harm our ability to grow our business with those partners.

We intend to continue to establish and maintain business relationships with technology companies to expand our marketing reach and accelerate the development of our storage and data management solutions. To the extent that we are unsuccessful in developing new relationships or maintaining our existing relationships, our future revenues and operating results could be negatively impacted. In addition, the loss of a strategic partner could have a material adverse effect on our revenues and operating results.

***Our future financial performance depends on growth in the storage and data management markets. If the performance of these markets does not meet the expectations upon which we calculate and forecast our revenues, our operating results will be materially and adversely impacted.***

All of our products address the storage and data management markets. Accordingly, our future financial performance will depend in large part on continued growth in the storage and data management markets and on our ability to adapt to emerging standards in these markets. The markets for storage and data management have been recently adversely impacted by the global economic uncertainty, and as a result of continued uncertainty, the markets may not grow as anticipated or may decline.

Additionally, emerging standards in these markets may adversely affect the UNIX®, Windows® and the World Wide Web server markets upon which we depend. For example, we provide our open access data retention solutions to customers within the financial services, healthcare, pharmaceutical and government market segments, industries that are subject to various evolving governmental regulations with respect to data access, reliability and permanence (such as Rule 17(a)(4) of the Securities Exchange Act of 1934, as amended) in the U.S. and in the other countries in which we operate. If our products do not meet and continue to comply with these evolving governmental regulations in this regard, customers in these market and geographical segments will not purchase our products, and we will not be able to expand our product offerings in these market and geographical segments at the rates which we have forecasted.

***We are exposed to the credit and non-payment risk of our customers, resellers, and distributors, especially during times of economic uncertainty and tight credit markets, which could result in material losses.***

Most of our sales to customers are on an open credit basis, with typical payment terms of 30 days. While we monitor individual customer payment capability in granting such open credit arrangements, and seek to limit such open credit to amounts we believe are reasonable, we may experience losses due to a customer's inability to pay.

Beyond our open credit arrangements, we also have recourse and nonrecourse customer financing leasing arrangements using third-party leasing companies. Under the terms of recourse leases, which are treated as off-balance sheet arrangements, we remain liable for the aggregate unpaid remaining lease payments to the third-party leasing company in the event of end-user customer default.

We also offer financing arrangements whereby the end-user customer pays a fixed monthly amount plus a variable amount based on actual storage capacity used. These arrangements subject us to additional risk with respect to revenue recognition and profitability due to the uncertainties associated with the variable portion of the arrangements. In addition, from time to time we provide guarantees for a portion of other financing arrangements under which we could be called upon to make payments to our funding parties in the event of nonpayment by end-user customers.

We expect demand for customer financing to continue. During periods of economic uncertainty, our exposure to credit risks from our customers increases. In addition, our exposure to credit risks of our customers may increase further if our customers and their customers or their lease financing sources are adversely affected by global economic conditions.

In the past, there have been bankruptcies by our customers to whom we had extended open credit or provided lease financing arrangements, causing us to incur bad debt charges, and, in the case of financing arrangements, a loss of revenues. We may be subject to similar losses in future periods. Any future losses could harm our business and have a material adverse effect on our operating results and financial condition. Additionally, to the extent that the recent turmoil in the credit markets makes it more difficult for customers to obtain open credit or lease financing, those customers' ability to purchase our products could be adversely impacted, which in turn could have a material adverse impact on our financial condition and operating results.





**Table of Contents**

*The market price for our common stock has fluctuated significantly in the past and will likely continue to do so in the future.*

The market price for our common stock has experienced substantial volatility in the past, and several factors could cause substantial fluctuation in the future. These factors include but are not limited to:

Fluctuations in our operating results compared to prior periods and forecasts;

Variations between our operating results and either the guidance we have furnished to the public or the published expectations of securities analysts;

Industry consolidation and the resulting perception of increased competition;

Economic developments in the storage and data management market as a whole;

Fluctuations in the valuation of companies perceived by investors to be comparable to us;

Changes in analysts' recommendations or projections;

Changes in our relationships with our suppliers, customers, channel and strategic partners;

Announcements of the completion or dissolution of strategic alliances within the industry;

Dilutive impacts of our convertible Notes and related warrants;

International conflicts and acts of terrorism;

Announcements of new products, applications, or product enhancements by us or our competitors;

Announcements related to planned or completed mergers or other acquisitions by us or our competitors;

Inquiries by the SEC, NASDAQ, law enforcement, or other regulatory bodies; and

General market conditions, including recent global or regional economic uncertainties.

In addition, the stock market has experienced volatility that has particularly affected the market prices of the equity securities of many technology companies. Certain macroeconomic factors such as the market climate for the technology sector, changes in interest rates, and levels of corporate spending on IT, could continue to have an impact on the trading price of our stock, and the market price of our common stock may fluctuate significantly in the future.

*If we are unable to develop and introduce new products and respond to technological change, if our new products do not achieve market acceptance, if we fail to manage the interoperability and transition between our new and old products, or if we cannot provide the expected level of service and support for our new products, our operating results could be materially and adversely affected.*

Our future growth depends upon the successful development and introduction of new hardware and software products. Due to the complexity of storage subsystems and storage security appliances and the difficulty in gauging the engineering effort required to produce new products, such products are subject to significant technical and quality control risks. In addition, our new products must respond to technological changes and evolving industry standards. If we are unable, for technological or other reasons, to develop and introduce new products in a timely manner in response to changing market conditions or customer requirements, or if such products do not achieve market acceptance, our operating results could be materially and adversely affected. New or additional product introductions increase the complexities of forecasting revenues, and subject us to additional financial and operational risks. If they are not managed effectively, we could experience material risks to our operations, financial condition and business model.

As new or enhanced products are introduced, we must attempt to successfully manage the interoperability and transition from older products in order to minimize disruption in customers' ordering patterns, avoid excessive levels of older product inventories, and ensure that enough supplies of new products can be delivered to meet customers' demands.

As we enter new or emerging markets, we will likely increase demands on our service and support operations and may be exposed to additional competition. We may not be able to provide products, service and support to effectively compete for these market opportunities.

---

## **Table of Contents**

***Undetected software errors, hardware errors, or failures found in new products may result in loss of or delay in market acceptance of our products, which could increase our costs and reduce our revenues. Product quality problems could lead to reduced revenues, gross margins and operating results.***

Our products may contain undetected software errors, hardware errors or failures when first introduced or as new versions are released. Despite testing by us and by current and potential customers, errors may not be found in new products until after commencement of commercial shipments, resulting in loss of or delay in market acceptance, which could materially and adversely affect our operating results.

In addition, if we fail to remedy a product defect, we may experience a failure of a product line, temporary or permanent withdrawal from a product or market, damage to our reputation, inventory costs or product reengineering expenses, and these occurrences could have a material impact on our revenues, gross margins and operating results. We may be subject to losses that may result from or are alleged to result from defects in our products, which could subject us to claims for damages, including consequential damages.

***Due to the global nature of our business, risks inherent in our international operations could have a material adverse effect on our business.***

Although a substantial portion of our business is located and conducted in the U.S., a significant portion of our operations are located, and a significant portion of our revenues are derived, outside of the U.S. During the three and nine months ended January 27, 2012, our international revenues accounted for 53% and 52% of our total revenues, respectively. A substantial portion of our products are manufactured outside of the U.S., and we have research and development and service centers overseas. Accordingly, our business and our future operating results could be adversely affected by a variety of factors affecting our international operations, some of which are beyond our control, including regulatory, political, or economic conditions in a specific country or region, trade protection measures and other regulatory requirements, government spending patterns, and acts of terrorism and international conflicts. In addition, we may not be able to maintain or increase international market demand for our products.

We face exposure to adverse movements in foreign currency exchange rates as a result of our international operations. These exposures may change over time as business practices evolve, and they could have a material adverse impact on our financial results and cash flows. Our international sales are denominated in U.S. dollars and in foreign currencies. An increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive and therefore potentially less competitive in foreign markets. Conversely, lowering our price in local currency may result in lower U.S.-based revenues. A decrease in the value of the U.S. dollar relative to foreign currencies could increase operating expenses in foreign markets. Additionally, we have exposures to emerging market currencies, which can experience extreme volatility. We utilize forward and option contracts to hedge our foreign currency exposure associated with certain assets and liabilities as well as anticipated foreign currency cash flows on a short-term basis. All balance sheet hedges are marked-to-market through earnings every quarter. The time-value component of our cash flow hedges is recorded in earnings while all other gains and losses are marked to market through other comprehensive income until forecasted transactions occur, at which time such realized gains and losses are recognized in earnings. These hedges attempt to reduce, but do not always entirely eliminate, the impact of currency exchange movements. Factors that could have a negative impact on the effectiveness of our hedging program include inaccuracies in forecasting, widening interest rate differentials, and volatility in the foreign exchange market. Our hedging strategies may not be successful and currency exchange rate fluctuations could have a material adverse effect on our operating results.

Additional risks inherent in our international business activities generally include, among others, longer accounts receivable payment cycles and difficulties in managing international operations.

In addition, due to the global nature of our business, we are subject to complex legal and regulatory requirements in the U.S. and the foreign jurisdictions in which we operate and sell our products, including antitrust and anti-competition laws, rules and regulations, and regulations related to data privacy. We are also subject to the potential loss of proprietary information due to piracy, misappropriation or laws that may be less protective of our intellectual property rights than U.S. laws. Such factors could have an adverse impact on our business, operating results and financial position.

Moreover, in many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by our internal policies and procedures, or U.S. laws and regulations applicable to us, such as the Foreign Corrupt Practices Act. There can be no assurance that all of our employees, contractors and agents, as well as those companies to which we outsource certain of our business operations, will comply with these policies, procedures, laws and/or regulations. Any such violation could subject us to fines and other penalties, which could have a material adverse effect on our business, financial condition or results of operations.



---

**Table of Contents**

*Changes in our effective tax rate or adverse outcomes resulting from examination of our income tax returns could adversely affect our results.*

Our effective tax rate could be adversely affected by several factors, many of which are outside of our control, including:

Earnings being lower than anticipated in countries where we are taxed at lower rates as compared to the U.S. statutory tax rate;

Material differences between forecasted and actual tax rates as a result of a shift in the mix of pretax profits and losses by tax jurisdiction, our ability to use tax credits or effective tax rates by tax jurisdiction that differ from our estimates;

Changing tax laws or related interpretations, accounting standards, regulations, and interpretations in multiple tax jurisdictions in which we operate, as well as the requirements of certain tax rulings;

An increase in expenses not deductible for tax purposes, including certain stock-based compensation, write-offs of acquired in-process research and development, and impairment of goodwill;

The tax effects of purchase accounting for acquisitions and restructuring charges that may cause fluctuations between reporting periods;

Changes related to our ability to ultimately realize future benefits attributed to our deferred tax assets, including those related to other-than-temporary impairments;

Tax assessments resulting from income tax audits or any related tax interest or penalties could significantly affect our income tax provision for the period in which the settlements take place; and

A change in our decision to indefinitely reinvest foreign earnings.

We receive significant tax benefits from sales to our non-U.S. customers. These benefits are contingent upon existing tax laws and regulations in the U.S. and in the countries in which our international operations are located. Future changes in domestic or international tax laws and regulations could adversely affect our ability to continue to realize these tax benefits. We have not provided for U.S. federal and state income taxes or foreign withholding taxes that may result from future remittances of undistributed earnings of foreign subsidiaries. The President's administration and Congress have announced several proposals to reform U.S. tax rules, including proposals that may result in a reduction or elimination of the deferral of U.S. income tax on our future unrepatriated earnings. Should such anti-deferral provisions be enacted, our effective tax rate could be adversely affected.

We are currently undergoing income tax audits in the U.S. and several foreign tax jurisdictions. The rights to some of our intellectual property (IP) are owned by certain of our foreign subsidiaries, and payments are made between U.S. and foreign tax jurisdictions relating to the use of this IP in a qualified cost sharing arrangement. In recent years, several other U.S. companies have had their foreign IP arrangements challenged as part of Internal Revenue Service (IRS) examinations, which have resulted in material proposed assessments and/or litigation with respect to those companies.

In February 2012, the IRS commenced an examination of our fiscal 2008 through fiscal 2010 income tax returns. We are also under audit by the California Franchise Tax Board for our fiscal 2007 and 2008 California income tax returns. Our open years in U.S. federal jurisdictions are fiscal 2005 and later years. In addition, we are effectively subject to federal tax examination adjustments for tax years ended on or after fiscal year 2000, in that we have tax attribute carryforwards from these years that could be subject to adjustments, if and when utilized.

## Edgar Filing: NetApp, Inc. - Form 10-Q

On September 17, 2010, the Danish Tax Authorities issued a decision concluding that distributions declared in 2005 and 2006 from our Danish subsidiary were subject to Danish at-source dividend withholding tax. We do not believe that our Danish subsidiary is liable for withholding tax and filed an appeal with the Danish Tax Tribunal to that effect. On December 19, 2011, the Danish Tax Tribunal issued a ruling that our Danish subsidiary was not liable for Danish withholding tax. The ruling is subject to appeal to the Danish High Court.

We are in various stages of the examination and appeals process in connection with tax audits worldwide and it is difficult to determine when these examinations will be settled. It is reasonably possible that over the next twelve-month period, we may experience an increase or decrease in unrecognized tax benefits. It is not possible to determine either the magnitude or the range of any increase or decrease at this time.

## **Table of Contents**

If the ultimate determination of income taxes or at-source withholding taxes assessed under the current IRS audits or under audits being conducted in any of the other tax jurisdictions in which we operate results in an amount in excess of the tax provision we have recorded or reserved for, our operating results, cash flows and financial condition could be adversely affected.

Our international operations currently benefit from a tax ruling concluded in the Netherlands which expires on April 30, 2015 and results in a lower level of earnings subject to tax in the Netherlands. If we are unable to negotiate a similar tax ruling upon expiration of the current ruling, our effective tax rate could increase and our operating results could be adversely affected. Our effective tax rate could also be adversely affected by different and evolving interpretations of existing law or regulations, which in turn would negatively impact our operating and financial results as a whole. Our effective tax rate could also be adversely affected if there is a change in international operations and how the operations are managed and structured. The price of our common stock could decline to the extent that our financial results are materially affected by an adverse change in our effective tax rate.

### ***Our acquisitions may disrupt our existing business and harm our results of operations.***

As part of our strategy, we are continuously evaluating opportunities to buy other businesses or technologies that would complement our current products, expand the breadth of our markets, or enhance our technical capabilities. In fiscal year 2011, we completed acquisitions of two technology companies, and in May 2011, we completed the acquisition of certain assets related to Engenio. The acquisition and ongoing integration of new businesses into our business may adversely affect our operations or profitability. We may not achieve the anticipated cost savings and synergies or realize our estimated revenue, gross margin, profit or other financial projections or business objectives in a timely manner or at all due to a number of factors, including the following:

The inability to successfully integrate the operations, technologies, products, personnel and business systems of the acquired companies;

In the case of an asset purchase, the failure to acquire all of the assets necessary to operate the acquired business;

The diversion of management's attention from normal daily operations of the existing business;

The loss of key employees of the acquired business could adversely impact our ability to manage the business and our ability to realize our financial forecasts;

The inability to retain the customers and partners of acquired businesses following the acquisition;

Substantial transaction costs and accounting charges; and

Exposure to litigation related to acquisitions.

Acquisitions may also result in risks to our existing business, including:

Deterioration of our internal control over financial reporting as a result of inconsistencies between our standards, procedures and policies and those of the acquired business;

## Edgar Filing: NetApp, Inc. - Form 10-Q

Reliance on the selling party's processes, data, supply chain management and reporting during the transition period following the completion of an acquisition;

Dilution of our current stockholders' percentage ownership to the extent we issue new equity;

Assumption of additional liabilities;

Incurrence of additional debt or a decline in available cash;

Adverse effects to our financial statements, such as the need to incur restructuring charges;

Liability for intellectual property infringement and other litigation claims, which we may or may not be aware of at the time of acquisition; and



---

**Table of Contents**

Creation of goodwill or other intangible assets that could result in significant future amortization expense or impairment charges. The failure to achieve the anticipated benefits of an acquisition may also result in impairment charges for goodwill and purchased intangible assets. For example, we have in the past discontinued certain products which were originally acquired through business acquisitions. Additional or realized risks of this nature could have a material adverse effect on our business, financial condition and results of operations.

***Our leverage and debt service obligations and note conversion may adversely affect our financial condition, results of operations and earnings per share.***

As a result of the sale of our Notes, we have a greater amount of debt than we have maintained in the past. In addition, we have various synthetic lease arrangements related to some of our facilities at our corporate headquarters in Sunnyvale, California, and, subject to the restrictions in our existing and any future financing agreements, we may incur additional debt. Our maintenance of higher levels of indebtedness could have adverse consequences including:

Impacting our ability to satisfy our obligations;

Increasing the portion of our cash flows from operations that may have to be dedicated to interest and principal payments and may not be available for operations, working capital, capital expenditures, expansion, acquisitions or general corporate or other purposes;

Impairing our ability to obtain additional financing in the future;

Limiting our flexibility in planning for, or reacting to, changes in our business and industry; and

Making us more vulnerable to downturns in our business, our industry or the economy in general.

Our ability to meet our expenses and debt obligations will depend on our future performance, which will be affected by financial, business, economic, regulatory and other factors. We will not be able to control many of these factors, such as economic conditions and governmental regulations. Furthermore, our operations may not generate sufficient cash flows to enable us to meet our expenses and service our debt. As a result, we may be required to repatriate funds from our foreign subsidiaries which could result in a significant tax liability to us. If we are unable to generate sufficient cash flows from operations, or if we are unable to repatriate sufficient or any funds from our foreign subsidiaries, in order to meet our expenses and debt service obligations, we may need to enter into new financing arrangements to obtain the necessary funds, or we may be required to raise additional funds through other means. If we determine it is necessary to seek additional funding for any reason, we may not be able to obtain such funding or, if funding is available, obtain it on acceptable terms. If we fail to make a payment on our debt, we could be in default on such debt, and this default could cause us to be in default on our other outstanding indebtedness.

Any conversion of the Notes may cause dilution to our shareholders and to our earnings per share. If the price of our common stock exceeds the conversion price, initially \$31.85 per share, the Notes will cause an increase in diluted share count and result in lower reported earnings per share. Based on the trading price of our common stock as of January 27, 2012, we had approximately 6 million shares of common stock potentially issuable on conversion of our Notes. The Note hedge transactions discussed below, if exercised upon conversion of the Notes, are expected to reduce approximately 80% of the common stock potentially issuable on conversion of the Notes. Upon conversion of any Notes, we would be required to deliver cash up to the principal amount of the Notes and, with respect to any excess conversion value greater than the principal amount of the Notes, shares of our common stock, which would result in dilution to our shareholders.

***The Note hedges and warrant transactions that we entered into in connection with the sale of the Notes may affect the trading price of our common stock.***

In connection with the issuance of the Notes, we entered into privately negotiated convertible Note hedge transactions with certain option counterparties (the Counterparties), which are expected to offset the potential dilution to our common stock upon any conversion of the Notes. At the same time, we also entered into warrant transactions with the Counterparties pursuant to which we may issue shares of our common stock above a certain strike price. In connection with these hedging transactions, the Counterparties may have entered into various over-the-counter derivative transactions with respect to our common stock or purchased shares of our common stock in secondary market transactions at or

## Edgar Filing: NetApp, Inc. - Form 10-Q

following the pricing of the Notes. Such activities may have had the effect of increasing the price of our common stock. The Counterparties are likely to modify their hedge positions from time to time prior to conversion or maturity of the Notes by purchasing and selling shares of our common stock or entering into other derivative transactions. Additionally, these transactions may expose us to counterparty credit risk for nonperformance. The effect, if any, of any of these transactions and activities on the market price of our common stock or the Notes will depend, in part, on market conditions and cannot be ascertained at this time, but any of these activities could adversely affect the value of our common stock. In addition, if our stock price exceeds the strike price for the warrants, there could be additional dilution to our shareholders, which could adversely affect the value of our common stock.

---

**Table of Contents**

In April 2010, we terminated our Note hedge transaction with Lehman Brothers OTC Derivatives, Inc. (Lehman OTC), which was a counterparty to 20% of our Note hedges, as a result of the bankruptcy filing by Lehman OTC, which constituted an event of default under the Note hedge. Because we have decided not to replace this Note hedge, we are subject to potential dilution on the unhedged portion of our Notes upon conversion if on the date of conversion the per-share market price of our common stock exceeds the conversion price of \$31.85. The terms of the Notes, the rights of the holders of the Notes and other counterparties to Note hedges and warrants were not affected by the termination of this Note hedge.

The price of our common stock could also be affected by sales of our common stock by investors who view the Notes as a more attractive means of equity participation in our Company and by hedging or arbitrage trading activity that we expect to develop involving our common stock by holders of the Notes. The hedging or arbitrage could, in turn, affect the trading price of the Notes and warrants.

***Future issuances of common stock related to our Notes, warrants, stock options, restricted stock units, and our Employee Stock Purchase Plan may adversely affect the trading price of our common stock and the Notes.***

The conversion of some or all of our outstanding Notes will dilute the ownership interest of existing stockholders to the extent we deliver common stock upon conversion of the Notes. Our common stock price did not exceed the conversion threshold price of \$41.41 per share set forth for these Notes for at least 20 trading days during the 30 consecutive trading days ended December 31, 2011. Accordingly, the Notes are not convertible at the option of the holder as of January 27, 2012. However, the determination of whether or not the Notes are convertible must continue to be performed quarterly. Upon conversion of any Notes, we would be required to deliver cash for the principal amount of the Notes and shares of common stock, if any, to the extent the conversion value exceeds the principal amount. Any new issuance of equity securities, including the issuance of shares upon conversion of the Notes or the exercise of related warrants which are not offset by our Note hedges, could dilute the interests of our then-existing stockholders, including holders who receive shares upon conversion of their Notes, and could substantially decrease the trading price of our common stock and the Notes. In addition, any sales in the public market of any common stock issuable upon such conversion or the exercise of warrants could adversely affect prevailing market prices of our common stock.

As of January 27, 2012, eligible individuals under our stock option and restricted stock unit plans held options to purchase approximately 23 million shares of our common stock and a total of approximately 12 million restricted stock units. If all the outstanding options were exercised, the proceeds to the Company would average approximately \$29 per share. We also had 16 million shares of our common stock reserved for future issuance under our stock plans with respect to equity awards that have not been granted. The exercise of all of the outstanding options and/or the vesting of all outstanding restricted shares and restricted stock units would dilute the interests of our then-existing stockholders, and any sales in the public market of the common stock issuable upon such exercise could adversely affect the trading price of our common stock.

In addition, we have an Employee Stock Purchase Plan (ESPP) under which employees are entitled to purchase shares of our common stock at a 15% discount from the quoted market price of our common stock at certain specified dates over a two-year period. As of January 27, 2012, we had approximately 5 million shares of our common stock available for future issuance under the ESPP. The issuance of shares under the ESPP would dilute the interests of our then-existing stockholders, and any sales in the public market of the common stock issuable upon such exercise could adversely affect the trading price of our common stock.

We may issue equity securities in the future for a number of reasons, including to finance our operations related to business strategy (including in connection with acquisitions, strategic alliances or other transactions), to increase our capital, to adjust our ratio of debt to equity, to satisfy our obligations upon the exercise of outstanding warrants or options upon conversion of the Notes, or for other reasons.

**Table of Contents**

***We are exposed to fluctuations in the market values of our portfolio investments and in interest rates; impairment of our investments could harm our financial results.***

As of January 27, 2012, we had \$4.9 billion in cash, cash equivalents, investments and restricted cash. We invest our cash in a variety of financial instruments, consisting principally of investments in corporate bonds, money market funds and U.S. Treasury securities. These investments are subject to general credit, liquidity, market and interest rate risks, which have been exacerbated by unusual events such as the financial and credit crisis, the recent downgrade in the U.S. credit rating, and bankruptcy filings in the U.S., which have affected various sectors of the financial markets and led to global credit and liquidity issues. Although a downgrade in credit ratings is not unprecedented, a downgrade of the U.S. credit rating is, and the potential impact is uncertain. This downgrade could materially affect global and domestic financial markets and economic conditions, which may affect our financial condition and liquidity. These securities are generally classified as available-for-sale and, consequently, are recorded on our condensed consolidated balance sheets at fair value with unrealized gains or losses reported as a component of accumulated other comprehensive income, net of tax.

Investments in both fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate debt securities may have their market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates. Currently, we do not use derivative financial instruments in our investment portfolio. We may suffer losses if forced to sell securities that have experienced a decline in market value because of changes in interest rates. Currently, we do not use financial derivatives to hedge our interest rate exposure.

The fair value of our investments may change significantly due to events and conditions in the credit and capital markets. Any investment securities that we hold or the issues comprising such securities could be subject to review for possible downgrade. Any downgrade in these credit ratings may result in an additional decline in the estimated fair value of our investments. Changes in the various assumptions used to value these securities and any increase in the markets perceived risk associated with such investments may also result in a decline in estimated fair value.

On occasion, we make strategic investments in other companies which may decline in value and/or not meet desired objectives. The success of these investments depends on various factors over which we may have limited or no control.

In the event of adverse conditions in the credit and capital markets, our investment portfolio may be impacted and we could determine that some or all of our investments have experienced an other-than-temporary decline in fair value, requiring impairment, which could adversely impact our financial position and operating results.

***A significant portion of our cash and cash equivalents are held overseas. If we are not able to generate sufficient cash domestically in order to fund our U.S. operations and strategic opportunities, and to service our debt and synthetic leases, we may incur a significant tax liability in order to repatriate the overseas cash balances, or we may need to raise additional capital in the future.***

As of January 27, 2012, \$2.5 billion of cash, cash equivalents and short-term investments were held in foreign countries. These amounts are not freely available for dividend repatriation to the U.S. without triggering significant adverse tax consequences in the U.S. As a result, if the cash generated by our domestic operations is not sufficient to fund our domestic operations, our broader corporate initiatives such as stock repurchases, acquisitions, and other strategic opportunities, and to service our outstanding indebtedness, we may need to raise additional funds through public or private debt or equity financings, or we may need to obtain new credit facilities to the extent we choose not to repatriate our overseas cash. Such additional financing may not be available on terms favorable to us, or at all, and any new equity financings or offerings would dilute our current stockholders' ownership. Furthermore, lenders, particularly in light of the current challenges in the credit markets, may not agree to extend us new, additional or continuing credit. If adequate funds are not available, or are not available on acceptable terms, we may be forced to repatriate our foreign sources of liquidity and incur a significant tax expense or we may not be able to take advantage of strategic opportunities, develop new products, respond to competitive pressures or repay our outstanding indebtedness. In any such case, our business, operating results or financial condition could be adversely impacted.

***Our synthetic leases are off-balance sheet arrangements that could negatively affect our financial condition and operating results. We have invested substantial resources in new facilities and physical infrastructure, which will increase our fixed costs. Our operating results could be harmed if our business does not grow proportionately to our increase in fixed costs.***

We have various synthetic leasing arrangements with BNP Paribas Leasing Corporation as lessor (BNPPLC) for our headquarters office buildings and land in Sunnyvale, California. These synthetic leases qualify for operating lease accounting treatment under the accounting guidance for leases and are not considered variable interest entities under applicable accounting guidance. Therefore, we do not include the

## Edgar Filing: NetApp, Inc. - Form 10-Q

properties or the associated debt on our condensed consolidated balance sheets. However, if circumstances were to change regarding our or BNPPLC's ownership of the properties, or in BNPPLC's overall portfolio, we could be required to consolidate the entity, the leased facilities and the associated debt.

## **Table of Contents**

Our future minimum lease payments under these synthetic leases limit our flexibility in planning for, or reacting to, changes in our business by restricting the funds available for use in addressing such changes. If we are unable to grow our business and revenues proportionately to our increase in fixed costs, our operating results will be harmed. If we elect not to purchase the properties at the end of the lease term, we have guaranteed a minimum residual value to BNPPLC. If the fair value of the properties declines below their cost, our residual value guarantee would require us to pay the difference to BNPPLC, up to the residual guarantee. As of January 27, 2012, the estimated fair value of certain properties was approximately \$51.0 million below the cost of the properties, which we are accruing over the remaining term of the respective leases. Any further decline in the fair value of the properties could adversely impact our cash flows, financial condition and operating results.

As a result of excess capacity in our Sunnyvale, California facilities, certain of our facilities subject to synthetic lease arrangements have been subleased or are vacant. These subleases will expire at various times through 2015 and some are at terms that do not generate sufficient sublease income to cover the carrying costs of these facilities. In addition, we may experience changes in our operations in the future that could result in additional excess capacity and vacant facilities. We will continue to be responsible for all carrying costs of these facilities under operating leases until such time as we can sublease these facilities or terminate the applicable leases based on the contractual terms of the operating lease agreements, and these costs may have an adverse effect on our business, operating results and financial condition.

***We are subject to restrictive and financial covenants in our synthetic lease arrangements. The restrictive covenants may restrict our ability to operate our business.***

Our ongoing extension of credit under our synthetic lease arrangements are subject to continued compliance with financial covenants. If we do not comply with these restrictive and financial covenants or otherwise default under the arrangements, we may be required to repay any outstanding amounts or repurchase the properties which are subject to the synthetic lease arrangements. If we lose access to the synthetic lease arrangements, we may not be able to obtain alternative financing on acceptable terms, which could limit our operating flexibility.

The agreements governing our synthetic lease arrangements contain restrictive covenants that limit our ability to operate our business, including restrictions on our ability to:

Incur indebtedness;

Incur indebtedness at the subsidiary level;

Grant liens;

Sell all or substantially all our assets;

Enter into certain mergers;

Change our business;

Enter into swap agreements;

Enter into transactions with our affiliates; and

Enter into certain restrictive agreements.

## Edgar Filing: NetApp, Inc. - Form 10-Q

As a result of these restrictive covenants, our ability to respond to changes in business and economic conditions and to obtain additional financing, if needed, may be restricted. We may also be prevented from engaging in transactions that might otherwise be beneficial to us, such as strategic acquisitions or joint ventures.

Our failure to comply with the restrictive and financial covenants could result in a default under our synthetic lease arrangements, which would give the counterparties thereto the ability to exercise certain rights, including the right to accelerate the amounts owed thereunder and to terminate the arrangements. In addition, our failure to comply with these covenants and the acceleration of amounts owed under synthetic lease arrangements could result in a default under the Notes, which could permit the holders to accelerate the Notes. If all of our debt is accelerated, we may not have sufficient funds available to repay such debt.

---

**Table of Contents*****We have credit exposure to our hedging counterparties.***

In order to minimize volatility in earnings associated with fluctuations in the value of foreign currency relative to the U.S. Dollar, we utilize forward and option contracts to hedge our exposure to foreign currencies. As a result of entering into these hedging contracts with major financial institutions, we may be subject to counterparty nonperformance risk. Should there be a counterparty default, we could be exposed to the net losses on the hedged arrangements or be unable to recover anticipated net gains from the transactions.

***Funds associated with certain of our auction rate securities may not be accessible for more than 12 months and our auction rate securities may experience further other-than-temporary declines in value, which would adversely affect our earnings.***

Auction rate securities (ARSs) held by us are securities with long-term nominal maturities, which, in accordance with our investment policy guidelines, had credit ratings of AAA and Aaa at time of purchase. Interest rates for ARSs are reset through a Dutch auction each month, which prior to February 2008 had provided a liquid market for these securities.

All of our ARSs are backed by pools of student loans guaranteed by the U.S. Department of Education, and we believe the credit quality of these securities is high, based on this guarantee. However, liquidity issues in the global credit markets resulted in the failure of auctions for certain of our ARS investments, with a par value of \$55.9 million. For each failed auction, the interest rate resets to a maximum rate defined for each security and the ARS continues to pay interest in accordance with its terms, although the principal associated with the ARS will not be accessible until there is a successful auction or such time as other markets for ARS investments develop or the final maturity of the individual securities.

As of January 27, 2012, we determined there was a total decline in the fair value of our ARS investments of approximately \$4.9 million, of which we recorded cumulative net temporary impairment charges of \$3.5 million, and \$1.4 million was recognized as an other than temporary impairment charge. In addition, we have classified all of our auction rate securities as other non-current assets in our condensed consolidated balance sheet as of January 27, 2012 as our ability to liquidate such securities in the next 12 months is uncertain. Although we currently have the ability and intent to hold these ARS investments until recovery in market value or until maturity, if current market conditions deteriorate, or the anticipated recovery in market values does not occur, we may be required to record additional impairment charges in future quarters.

***Changes in market conditions have led, and in the future could lead, to charges related to the discontinuance of certain of our products and asset impairments.***

In response to changes in economic conditions and market demands, we may decide to strategically realign our resources and consider cost containment measures including restructuring, disposing of, or otherwise discontinuing certain products. Any decision to limit investment in, dispose of, or otherwise exit products may result in the recording of charges to earnings, including inventory and technology-related or other intangible asset write-offs, workforce reduction costs, charges relating to consolidation of excess facilities, cancellation penalties or claims from third parties who were resellers or users of discontinued products, which would harm our operating results. Our estimates with respect to the useful life or ultimate recoverability of our carrying basis of assets, including purchased intangible assets, could change as a result of such assessments and decisions. Additionally, we are required to perform goodwill impairment tests on an annual basis, and between annual tests in certain circumstances when impairment indicators exist or if certain events or changes in circumstances have occurred. Future goodwill impairment tests may result in charges to earnings, which could materially harm our operating results.

***We may need to undertake cost-reduction initiatives and restructuring initiatives in the future.***

We have previously recognized restructuring and other charges related to initiatives to realign our business strategies and resize our business in response to economic and market conditions, including those announced in February 2009 and December 2008. We may undertake future cost-reduction initiatives and restructuring plans that may adversely impact our operations, and we may not realize all of the anticipated benefits of our prior or any future restructurings.



---

## **Table of Contents**

***Our business and operations are experiencing rapid growth and organizational change. If we fail to effectively manage such growth and change in a manner that preserves our reputation and the key aspects of our corporate culture, our business and operating results could be harmed.***

Due to recent organic growth and acquisitions, we have experienced, and may continue to experience, rapid growth and organizational change, which has placed, and may continue to place, significant demands on our management, operational and financial resources. Our headcount has grown from approximately 10,200 employees as of April 29, 2011 to over 12,000 employees as of January 27, 2012, which includes the employees added as a result of the Engenio acquisition in May 2011. We will incur significant expenditures and the allocation of valuable management resources to assimilate our additional human resources in a manner that preserves the key aspects of our corporate culture and enables us to maintain our reputation in the marketplace. If we do not effectively manage our growth and train, retain and manage our employee base, our corporate culture could be undermined, the quality of our products and customer service could suffer, and our reputation could be harmed, each of which could adversely impact our business, financial condition and results of operations.

In addition, as our headcount increases, our costs will also increase. Our business will be harmed if our efforts to expand our organization and headcount are not accompanied by a corresponding increase in revenues.

***If we are unable to establish fair value for any undelivered element of a sales arrangement, all or a portion of the revenues relating to the arrangement could be deferred to future periods.***

In the course of our sales efforts, we often enter into multiple element arrangements that include software related elements consisting of non-essential software and undelivered software entitlements and maintenance. If we are required to change the pricing of our software-related elements through discounting, or otherwise introduce variability in the pricing of such elements, we may be unable to maintain Vendor Specific Objective Evidence of fair value of the undelivered elements of the arrangement, and would therefore be required to delay the recognition of all or a portion of the related arrangement. A delay in the recognition of revenues may cause fluctuations in our financial results and may adversely affect our operating margins.

***We are continually seeking ways to make our cost structure, business processes and systems more efficient, including moving activities from higher-cost to lower-cost owned locations, outsourcing certain business process functions and implementing new business information systems. Problems with the execution of these activities could have an adverse effect on our business or results of operations.***

We continuously seek to make our cost structure and business processes more efficient. We are focused on increasing workforce flexibility and scalability, and improving overall competitiveness by leveraging our global capabilities, as well as external talent and skills worldwide. For example, certain engineering activities and projects that were formerly performed in the U.S. have been moved to lower cost international locations and we rely on partners or third-party service providers for the provision of certain business process functions and activities in IT, human resources and accounting.

The challenges involved with moving or outsourcing activities include executing business functions in accordance with local laws and other obligations while maintaining adequate standards, controls and procedures. We are also subject to increased business continuity risks as we increase our reliance on outsource providers. For example, we may no longer be able to exercise control over some aspects of the future development, support or maintenance of outsourced operations and processes, including the management and internal controls associated with those outsourced business operations and processes, which could adversely affect our business. If we are unable to effectively utilize or integrate and interoperate with external resources or if our partners or third-party service providers experience business difficulties or are unable to provide business services as anticipated, we may need to seek alternative service providers or resume providing these business processes internally, which could be costly and time-consuming and have a material adverse effect on our operating results. In addition, we may not achieve the expected benefits of our business process improvement initiatives.

We are currently implementing changes to our business information systems and processes and other IT initiatives. These initiatives involve a large investment of capital and resources and significant changes to our current operating processes. Failure to properly implement one or more of these initiatives, or an interruption in service or unavailability of our systems, could result in lost business and increased costs which could negatively impact our business, results of operations and cash flows.

***We are subject to risks related to the provision of employee health care benefits and recent health care reform legislation.***

We use a combination of insurance and self-insurance for workers' compensation coverage and health care plans. We record expenses under these plans based on estimates of the number and costs of expected claims, administrative costs and stop-loss premiums. These estimates are then adjusted each year to reflect actual costs incurred. Actual costs under these plans are subject to variability depending primarily upon

## Edgar Filing: NetApp, Inc. - Form 10-Q

participant enrollment and demographics, the actual number and costs of claims made and whether and how much the stop-loss insurance we purchase covers the cost of these claims. In the event that our cost estimates differ from actual costs, we could incur additional unplanned health care costs which could adversely impact our financial condition.

---

**Table of Contents**

In March 2010, comprehensive health care reform legislation under the Patient Protection and Affordable Care Act (HR 3590) and the Health Care Education and Affordability Reconciliation Act (HR 4872) was passed and signed into law. Among other things, the health reform legislation includes guaranteed coverage requirements, eliminates pre-existing condition exclusions and annual and lifetime maximum limits, restricts the extent to which policies can be rescinded, and imposes new and significant taxes on health insurers and health care benefits. Provisions of the health reform legislation become effective at various dates over the next several years. The Department of Health and Human Services, the National Association of Insurance Commissioners, the Department of Labor and the Treasury Department have yet to issue necessary enabling regulations and guidance with respect to the health care reform legislation.

Due to the breadth and complexity of the health reform legislation, the lack of implementing regulations and interpretive guidance, and the phased-in nature of the implementation, it is difficult to predict the overall impact of the health reform legislation on our business over the coming years. Possible adverse affects of the health reform legislation include reduced revenues, increased costs, exposure to expanded liability and requirements for us to revise the ways in which we conduct business or risk of loss of business. In addition, our results of operations, financial position, and cash flows could be materially adversely affected.

***We depend on attracting and retaining qualified personnel. If we are unable to attract and retain such personnel, our operating results could be materially and adversely impacted.***

Our continued success depends, in part, on our ability to identify, attract, motivate and retain qualified personnel. Because our future success is dependent on our ability to continue to enhance and introduce new products, we are particularly dependent on our ability to identify, attract, motivate and retain qualified engineers with the requisite education, background and industry experience. Competition for qualified employees, particularly in Silicon Valley, can be intense. The loss of the services of a significant number of our employees, particularly our engineers, salespeople and key managers, could be disruptive to our development efforts or business relationships and could materially and adversely affect our operating results.

A component of our strategy to hire and retain personnel consists of long-term compensation in the form of equity-based grants. We face increased risk of the inability to continue to offer equity if we are unable to obtain shareholder approval in light of increased shareholder activism, heightened focus on corporate compensation practices, and increased scrutiny of the dilutive effects of such equity compensation programs. Such inability could adversely impact our ability to continue to attract and retain employees.

In addition, because of the structure of our incentive compensation plans, we may be at increased risk of losing employees and other service providers at certain points in time. For example, the retention value of our compensation plans decreases after the payment of bonuses or the vesting of stock options, employee stock purchase rights or other equity compensation. As a result, employees may be more likely to leave us during periods following such payments or the vesting of such rights. The loss of services of a significant number of our key employees during a short period of time could be disruptive to our product development and sales efforts and adversely impact our business relationships and operating results.

***Our business could be materially and adversely affected as a result of a natural disaster, terrorist acts or other catastrophic events.***

We depend on the ability of our personnel, raw materials, equipment and products to move reasonably unimpeded around the world. Any political, military, terrorism, global trade, world health or other issue that hinders this movement or restricts the import or export of materials could lead to significant business disruptions. Furthermore, any strike, economic failure or other material disruption caused by fire, floods, hurricanes, earthquakes, volcanoes, power loss, power shortages, environmental disasters, telecommunications or business information systems failures, break-ins and similar events, such as the recent flooding in Thailand, could also adversely affect our ability to conduct business. If such disruptions result in cancellations of customer orders or contribute to a general decrease in economic activity or corporate spending on information technology, or directly impact our marketing, manufacturing, financial and logistics functions, or impair our ability to meet our customer demands, our results of operations and financial condition could be materially adversely affected. In addition, our headquarters are located in Northern California, an area susceptible to earthquakes. If any significant disaster were to occur, our ability to operate our business could be impaired.

---

## **Table of Contents**

***We are exposed to various risks related to legal proceedings or claims and protection of intellectual property rights, which could adversely affect our operating results.***

We may be a party to lawsuits and other claims in the normal course of our business from time to time, including intellectual property, commercial, product liability, employment, class action, whistleblower and other litigation and claims, and governmental and other regulatory investigations and proceedings. Litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a particular lawsuit could have a material adverse effect on our business, operating results, or financial condition.

If we are unable to protect our intellectual property, we may be subject to increased competition that could materially and adversely affect our operating results. Our success depends significantly upon our proprietary technology. We rely on a combination of copyright and trademark laws, trade secrets, confidentiality procedures, contractual provisions, and patents to protect our proprietary rights. We seek to protect our software, documentation and other written materials under trade secret, copyright and patent laws, which afford only limited protection. Some of our U.S. trademarks are registered internationally as well. We will continue to evaluate the registration of additional trademarks as appropriate. We generally enter into confidentiality agreements with our employees and with our resellers, strategic partners and customers. We currently have multiple U.S. and international patent applications pending and multiple U.S. patents issued. The pending applications may not be approved, and our existing and future patents may be challenged. If such challenges are brought, the patents may be invalidated. We may not be able to develop proprietary products or technologies that are patentable, and patents issued to us may not provide us with any competitive advantages and may be challenged by third parties. Further, the patents of others may materially and adversely affect our ability to do business. In addition, a failure to obtain and defend our trademark registrations may impede our marketing and branding efforts and competitive position.

Litigation may be necessary to protect our proprietary technology. Any such litigation may be time-consuming and costly. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or obtain and use information that we regard as proprietary. In addition, the laws of some foreign countries do not protect proprietary rights to as great an extent as do the laws of the U.S. Our means of protecting our proprietary rights may not be adequate or our competitors may independently develop similar technology, duplicate our products, or design around patents issued to us or other intellectual property rights of ours.

We are subject to intellectual property infringement claims. We may, from time to time, receive claims that we are infringing third parties intellectual property rights. Third parties may in the future, claim infringement by us with respect to current or future products, patents, trademarks or other proprietary rights. We expect that companies in the network storage and data management market will increasingly be subject to infringement claims as the number of products and competitors in our industry segment grows and the functionality of products in different industry segments overlaps. Any such claims could be time consuming, result in costly litigation, cause product shipment delays, require us to redesign our products or enter into royalty or licensing agreements, any of which could materially and adversely affect our operating results. Such royalty or licensing agreements, if required, may not be available on terms acceptable to us or at all.

***Our business could be materially adversely affected by changes in regulations or standards regarding energy efficiency of our products and climate change issues.***

We continually seek ways to increase the energy efficiency of our products. Recent analyses have estimated the amount of global carbon emissions that are due to information technology products. As a result, governmental and non-governmental organizations have turned their attention to development of regulations and standards to drive technological improvements and reduce such amount of carbon emissions. There is a risk that the development of these standards will not fully address the complexity of the technology developed by the IT industry or will favor certain technological approaches. Depending on the regulations or standards that are ultimately adopted, compliance could adversely affect our business, financial condition or operating results.

Climate change issues, energy usage and emissions controls may result in new environmental legislation and regulations, at any or all of the international, federal and state levels, that may unfavorably impact us, our suppliers, and our customers in how we conduct our business including the design, development, and manufacturing of our products. This could cause us to incur additional direct costs in complying with any new environmental regulations, as well as increased indirect costs resulting from our customers, suppliers or both incurring additional compliance costs that get passed on to us. These costs may adversely impact our operations and financial condition.

---

## **Table of Contents**

Our business and results of operations could be adversely impacted as a consequence of regulations or business trends such as:

Decreased demand for storage products that produce significant greenhouse gases;

Increased demand for storage products that produce lower emissions and are more energy efficient, and increased competition to develop such products; and

Reputational risk based on negative public perception of publicly reported data on our greenhouse gas emissions.

***Our business is subject to increasingly complex corporate governance, public disclosure, and accounting and tax requirements that have increased both our costs and the risk of noncompliance.***

Because our common stock is publicly traded, we are subject to certain rules and regulations of federal, state and financial market exchange entities charged with the protection of investors and the oversight of companies whose securities are publicly traded. These entities, including the Public Company Accounting Oversight Board, the SEC, and NASDAQ, have implemented requirements and regulations and continue developing additional regulations and requirements in response to corporate scandals and laws enacted by Congress, most notably the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act from July 2010. Our efforts to comply with these regulations have resulted in, and are likely to continue resulting in, increased general and administrative expenses and diversion of management time and attention from revenue-generating activities to compliance activities.

We have completed our evaluation of our internal controls over financial reporting for the fiscal year ended April 29, 2011 as required by Section 404 of the Sarbanes-Oxley Act of 2002. Although our assessment, testing and evaluation resulted in our conclusion that, as of April 29, 2011, our internal controls over financial reporting were effective, we cannot predict the outcome of our testing in future periods. If our internal controls are ineffective in future periods, our business and reputation could be harmed. We may incur additional expenses and commitment of management's time in connection with further evaluations, both of which could materially increase our operating expenses and accordingly reduce our operating results.

In July 2010, the President signed into law the Dodd-Frank Act. Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on us. However, as we continue to implement changes in response to this new law and its associated regulations, we expect to incur additional operating costs that could have a material adverse effect on our financial condition and results of operations.

Because new and modified laws, regulations, and standards are subject to varying interpretations in many cases due to their lack of specificity, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This evolution may result in continuing uncertainty regarding compliance matters and additional costs necessitated by ongoing revisions to our disclosure and governance practices.

***If a data center or other third-party who relies on our products experiences a disruption in service or a loss of data, such disruption or loss could be attributed to the quality of our products, thereby causing financial or reputational harm to our business.***

Third-party vendors, including data centers, Software as a Service (SaaS), cloud computing and Internet infrastructure and bandwidth providers rely on our products for their data storage needs. We exercise little control over how these third-party vendors use or maintain our products, and in some cases improper usage or maintenance could impair the performance of our products. A disruption in the services provided by these third-party vendors, or the loss of data stored by such vendors, could result in financial or reputational harm to our business to the extent that such disruption or loss is caused by, or perceived by our customers to have been caused by, defects in our products. Moreover, the risk of reputational harm may be magnified and/or distorted through the rapid dissemination of information over the Internet, including through news articles, blogs, chat rooms, and social media sites.

***Security and privacy breaches may expose us to liability, and our reputation and business could suffer.***

We obtain and store sensitive data related to our employees, customers and partners, including intellectual property, books of record and personally identifiable information. It is critical to our business strategy that our infrastructure remains secure and is perceived by our

## Edgar Filing: NetApp, Inc. - Form 10-Q

employees, customers and partners to be secure. If our security measures are breached as a result of technical problems, third-party actions, employee error, or malfeasance, our reputation could be damaged and our business could suffer.

**Table of Contents**

*Changes in financial accounting standards may cause adverse unexpected fluctuations and affect our reported results of operations.*

A change in accounting standards or practices and varying interpretations of existing accounting pronouncements, such as the changes to revenue recognition standards that we recently adopted, the increased use of fair value measures, additional proposed changes to revenue recognition, lease accounting, financial instruments and other accounting standards, and the potential requirement that U.S. registrants prepare financial statements in accordance with International Financial Reporting Standards (IFRS), could have a significant effect on our reported financial results or the way we conduct our business.

Implementation of accounting regulations and related interpretations and policies, particularly those related to revenue recognition, could cause us to defer recognition of revenue or recognize lower revenue, which may affect our results of operations.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table provides information with respect to the shares of common stock repurchased by us during the three months ended January 27, 2012:

Period	Total Number of Shares Purchased (Shares in thousands)	Average Price Paid per Share (2)	Total Number of Shares Purchased as Part of Publicly Announced Program (1) (Shares in thousands)	Approximate Dollar Value of Shares That May Yet Be Purchased Under The Repurchase Program (1) (Dollars in millions)
October 29, 2011 - November 25, 2011	222	\$	118,971	\$ 496.2
November 26, 2011 - December 30, 2011		\$	118,971	496.2
December 31, 2011 - January 27, 2012		\$	118,971	496.2
Total	222	\$	118,971	496.2

(1) On May 13, 2003, we announced that our Board of Directors had authorized a stock repurchase program. As of January 27, 2012, our Board of Directors had authorized the repurchase of up to \$4.0 billion of our common stock under this program. As of January 27, 2012, we had repurchased 119.0 million shares of our common stock at a weighted-average price of approximately \$29.65 per share for an aggregate purchase price of \$3.5 billion since inception of the stock repurchase program. As of January 27, 2012, the remaining authorized amount for stock repurchases under this program was \$0.5 billion with no termination date.

(2) On August 19, 2011, we entered into an ASR with Wells Fargo Bank, National Association, under which we prepaid \$400.0 million to purchase shares of our common stock. The aggregate number of shares ultimately purchased was determined based on the volume weighted-average share price of our common stock over a specified period of time. The contract was settled in November 2011. The total number of shares repurchased and retired under this ASR was 10.5 million shares at a price of \$38.08.

**Item 3. Defaults upon Senior Securities**

None

**Item 4. Mine Safety Disclosures**

Not Applicable.

**Item 5. Other Information**

None

**Item 6. Exhibits**

Edgar Filing: NetApp, Inc. - Form 10-Q

See the Exhibit Index immediately following the signature page of this Quarterly Report on Form 10-Q.



**Table of Contents**

**SIGNATURE**

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.

NETAPP, INC.

(Registrant)

/s/ NICHOLAS R. NOVIELLO  
Nicholas R. Noviello  
Executive Vice President of Finance and

Chief Financial Officer  
Dated: March 5, 2012

**Table of Contents****EXHIBIT INDEX****Exhibit**

<b>No</b>	<b>Description</b>
3.1 <sup>(1)</sup>	Certificate of Incorporation of the Company, as amended.
3.2 <sup>(2)</sup>	Bylaws of the Company.
31.1	Certification of the Chief Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

<sup>(1)</sup> Previously filed as an exhibit to the Company's Annual Report on Form 10-K dated June 24, 2008.

<sup>(2)</sup> Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q dated December 6, 2010.

\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and is otherwise not subject to liability under these sections.