

NetApp, Inc.
Form 10-Q
November 19, 2018
a

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 October 26, 2018

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)

Delaware
(State or other jurisdiction of
incorporation or organization)

77-0307520
(I.R.S. Employer
Identification No.)

1395 Crossman Avenue,

Sunnyvale, California 94089

(Address of principal executive offices, including zip code)

(408) 822-6000

(Registrant's telephone number, including area code)

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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 every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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.

As of November 14, 2018, there were 251,885,962 shares of the registrant’s common stock, \$0.001 par value, outstanding.

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PART I — FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

NETAPP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions, except par value)

(Unaudited)

| | October 26, 2018 | April 27, 2018 |
|--|----------------------------|--------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 2,359 | \$ 2,941 |
| Short-term investments | 1,940 | 2,450 |
| Accounts receivable | 765 | 1,047 |
| Inventories | 86 | 122 |
| Other current assets | 321 | 392 |
| Total current assets | 5,471 | 6,952 |
| Property and equipment, net | 770 | 756 |
| Goodwill | 1,742 | 1,739 |
| Other intangible assets, net | 69 | 94 |
| Other non-current assets | 499 | 450 |
| Total assets | \$ 8,551 | \$ 9,991 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 472 | \$ 609 |
| Accrued expenses | 652 | 825 |
| Commercial paper notes | 249 | 385 |
| Current portion of long-term debt | 399 | — |
| Short-term deferred revenue and financed unearned services revenue | 1,538 | 1,712 |
| Total current liabilities | 3,310 | 3,531 |
| Long-term debt | 1,144 | 1,541 |
| Other long-term liabilities | 899 | 992 |
| Long-term deferred revenue and financed unearned services revenue | 1,668 | 1,651 |
| Total liabilities | 7,021 | 7,715 |
| Commitments and contingencies (Note 15) | | |

| Stockholders' equity: | | |
|---|----------|----------|
| Common stock and additional paid-in capital, \$0.001 par value; 254 and 263 shares issued and outstanding as of October 26, 2018 and April 27, 2018 | 1,605 | 2,355 |
| Retained earnings (accumulated deficit) | — | (9) |
| Accumulated other comprehensive loss | (75) | (70) |
| Total stockholders' equity | 1,530 | 2,276 |
| Total liabilities and stockholders' equity | \$ 8,551 | \$ 9,991 |

See accompanying notes to condensed consolidated financial statements.

NETAPP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except per share amounts)

(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|--|-----------------------|----------------|---------------------|----------------|
| | October 26, | October 27, | October 26, | October 27, |
| | 2018 | 2017 | 2018 | 2017 |
| Revenues: | | | | |
| Product | \$913 | \$819 | \$1,788 | \$1,546 |
| Software maintenance | 236 | 224 | 465 | 447 |
| Hardware maintenance and other services | 368 | 372 | 738 | 743 |
| Net revenues | 1,517 | 1,415 | 2,991 | 2,736 |
| Cost of revenues: | | | | |
| Cost of product | 428 | 397 | 826 | 773 |
| Cost of software maintenance | 8 | 6 | 15 | 13 |
| Cost of hardware maintenance and other services | 107 | 112 | 213 | 226 |
| Total cost of revenues | 543 | 515 | 1,054 | 1,012 |
| Gross profit | 974 | 900 | 1,937 | 1,724 |
| Operating expenses: | | | | |
| Sales and marketing | 408 | 421 | 817 | 844 |
| Research and development | 211 | 194 | 419 | 387 |
| General and administrative | 69 | 69 | 142 | 137 |
| Restructuring charges | — | — | 19 | — |
| Total operating expenses | 688 | 684 | 1,397 | 1,368 |
| Income from operations | 286 | 216 | 540 | 356 |
| Other income, net | 7 | 6 | 25 | 11 |
| Income before income taxes | 293 | 222 | 565 | 367 |
| Provision for income taxes | 52 | 48 | 41 | 62 |
| Net income | \$241 | \$174 | \$524 | \$305 |
| Net income per share: | | | | |
| Basic | \$0.93 | \$0.65 | \$2.02 | \$1.13 |
| Diluted | \$0.91 | \$0.63 | \$1.96 | \$1.10 |
| Shares used in net income per share calculations: | | | | |
| Basic | 258 | 269 | 260 | 270 |
| Diluted | 264 | 275 | 267 | 277 |
| Cash dividends declared per share | \$0.40 | \$0.20 | \$0.80 | \$0.40 |

See accompanying notes to condensed consolidated financial statements.

NETAPP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)

(Unaudited)

| | Three Months Ended October 26, 27, | | Six Months Ended October 26, 27, | |
|--|---|--------|---|--------|
| | 2018 | 2017 | 2018 | 2017 |
| Net income | \$241 | \$ 174 | \$524 | \$ 305 |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustments | (3) | (2) | (3) | 8 |
| Defined benefit obligations: | | | | |
| Reclassification adjustments related to defined benefit obligations | (1) | (1) | (1) | (1) |
| Income tax effect | — | 1 | — | 1 |
| Unrealized gains (losses) on available-for-sale securities: | | | | |
| Unrealized holding gains (losses) arising during the period | (1) | (4) | (1) | 2 |
| Other comprehensive income (loss) | (5) | (6) | (5) | 10 |
| Comprehensive income | \$236 | \$ 168 | \$519 | \$ 315 |

See accompanying notes to condensed consolidated financial statements.

NETAPP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

(Unaudited)

| | Six Months Ended | |
|---|---------------------|----------------|
| | October 26, | October 27, |
| | 2018 | 2017 |
| Cash flows from operating activities: | | |
| Net income | \$ 524 | \$ 305 |
| Adjustments to reconcile net income to net cash provided by | | |
| operating activities: | | |
| Depreciation and amortization | 98 | 102 |
| Stock-based compensation | 78 | 87 |
| Deferred income taxes | (25) | 40 |
| Other items, net | 11 | (5) |
| Changes in assets and liabilities, net of acquisitions of businesses: | | |
| Accounts receivable | 269 | 146 |
| Inventories | 36 | 58 |
| Other operating assets | (19) | 29 |
| Accounts payable | (127) | 34 |
| Accrued expenses | (162) | (68) |
| Deferred revenue and financed unearned services revenue | (129) | (163) |
| Long-term taxes payable | (63) | 2 |
| Other operating liabilities | — | (3) |
| Net cash provided by operating activities | 491 | 564 |
| Cash flows from investing activities: | | |
| Purchases of investments | (20) | (609) |
| Maturities, sales and collections of investments | 509 | 657 |
| Purchases of property and equipment | (107) | (65) |
| Acquisitions of businesses, net of cash acquired | (3) | (75) |
| Other investing activities, net | 2 | — |
| Net cash provided by (used in) investing activities | 381 | (92) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of common stock under employee stock | | |
| award plans | 65 | 57 |
| Payments for taxes related to net share settlement of stock awards | (89) | (60) |
| Repurchase of common stock | (1,061) | (300) |
| Proceeds from (repayments of) commercial paper notes, net | (135) | 218 |
| Issuance of long-term debt, net | — | 795 |
| Dividends paid | (207) | (108) |

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| | | |
|---|---------|----------|
| Other financing activities, net | (2) | (1) |
| Net cash provided by (used in) financing activities | (1,429) | 601 |
| Effect of exchange rate changes on cash, cash equivalents and restricted cash | (25) | 13 |
| Net increase (decrease) in cash, cash equivalents and restricted cash | (582) | 1,086 |
| Cash, cash equivalents and restricted cash: | | |
| Beginning of period | 2,947 | 2,450 |
| End of period | \$2,365 | \$ 3,536 |

See accompanying notes to condensed consolidated financial statements.

NETAPP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Description of Business and Significant Accounting Policies

NetApp, Inc. (we, us, or the Company) provides global organizations the ability to manage and share their data across on-premises, private and public clouds. Together with our partners, we provide a full range of enterprise-class software, systems and services solutions that customers use to modernize their infrastructures, build next generation data centers and harness the power of hybrid clouds.

Basis of Presentation and Preparation

Our fiscal year is reported on a 52- or 53-week year ending on the last Friday in April. An additional week is included in the first fiscal quarter approximately every six years to realign fiscal months with calendar months. Fiscal years 2019 and 2018, ending on April 26, 2019, and April 27, 2018, respectively, are each 52-week years, with 13 weeks in each of their quarters.

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, comprehensive income 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. 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 27, 2018 contained in our Annual Report on Form 10-K. The results of operations for the three and six months ended October 26, 2018 are not necessarily indicative of the operating results to be expected for the full fiscal year or future operating periods.

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, reserves and allowances; inventory valuation and purchase order accruals; valuation of goodwill and intangibles; restructuring reserves; product warranties; employee compensation and benefit accruals; stock-based compensation; loss contingencies; valuation of investment securities; income taxes and fair value measurements. Actual results could differ materially from those estimates.

Accounting Changes

In May 2014, the Financial Accounting Standards Board (FASB) issued a new standard, Revenue from Contracts with Customers (ASC 606), which establishes a comprehensive new revenue recognition model designed to depict the transfer of goods or services to a customer in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services. In the first quarter of fiscal 2019, we adopted this new standard using the full retrospective method of adoption. Accordingly, our prior period condensed consolidated financial statements and

information, as presented herein, have been restated to conform to the new rules. Refer to Note 5 – Revenue for a summary of the impacts of adopting this standard, and a discussion of our updated policies related to revenue recognition.

In October 2016, the FASB issued an accounting standards update (ASU) which eliminates the deferred tax effects of intra-entity asset transfers other than inventory. As a result, tax expense from the sale of an asset in the seller’s tax jurisdiction is recognized when the transfer occurs, even though the pre-tax effects of that transaction are eliminated in consolidation. In the first quarter of fiscal 2019, we adopted this ASU using a modified retrospective transition approach and recorded a cumulative-effect adjustment to decrease retained earnings by \$51 million, with a corresponding reduction of prepaid taxes, which were classified as other non-current assets on our condensed consolidated balance sheets.

In November 2016, the FASB issued an ASU that requires a statement of cash flows to explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. In the first quarter of fiscal 2019, we adopted this ASU using a retrospective transition method. Accordingly, our condensed consolidated statement of cash flows for the three and six months ended October 27, 2017, as presented herein, has been restated to comply with the new requirements. Refer to Note 4 – Supplemental Financial Information for a detail of the components of our cash, cash equivalents and restricted cash balances.

There have been no other significant changes in our significant accounting policies as of and for the six months ended October 26, 2018, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended April 27, 2018.

2. Recent Accounting Standards Not Yet Effective

Leases

In February 2016, the FASB issued an accounting standards update on financial reporting for leasing arrangements, including requiring lessees to recognize an operating lease with a term greater than one year on their balance sheets as a right-of-use asset and corresponding lease liability, measured at the present value of the lease payments. This new standard will be effective for us in our first quarter of fiscal 2020, although early adoption is permitted. Upon adoption, the new standard, as amended, allows lessees to apply the transition requirements either (1) retrospectively to each prior reporting period presented in the financial statements with the cumulative effect of applying the new rules recognized at the beginning of the earliest comparative period presented, or (2) retrospectively at the beginning of the period of adoption with the cumulative effect of applying the new rules recognized then. We are currently in the assessment phase to determine the adoption methodology and are evaluating the impact of this new standard on our consolidated financial statements and disclosures. We expect that most of our operating lease commitments will be subject to the new standard and recognized as lease liabilities and right-of-use assets upon adoption, which will increase the total assets and total liabilities we report.

Credit Losses on Financial Instruments

In June 2016, the FASB issued an accounting standards update on the measurement of credit losses on financial instruments. The standard introduces a new model for measuring and recognizing credit losses on financial instruments, requiring financial assets measured at amortized cost basis to be presented at the net amount expected to be collected. It also requires that credit losses be recorded through an allowance for credit losses. This new standard will be effective for us in our first quarter of fiscal 2021, although early adoption is permitted. Upon adoption, companies must apply a modified retrospective transition approach through a cumulative-effect adjustment to retained earnings, though a prospective transition approach is required for debt securities for which an other-than-temporary impairment had been recognized before the effective date. Based on the composition of our investment portfolio, current market conditions, and historical credit loss activity, the adoption of this standard is not expected to have a material impact on our consolidated financial statements.

3. Goodwill and Purchased Intangible Assets, Net

Goodwill activity is summarized as follows (in millions):

| | |
|--------------------------------|----------|
| Balance as of April 27, 2018 | \$ 1,739 |
| Additions | 3 |
| Balance as of October 26, 2018 | \$ 1,742 |

On September 17, 2018, we acquired all of the outstanding shares of a privately-held software company for \$3 million in cash. Substantially all of the purchase price was recorded to goodwill.

Purchased intangible assets, net are summarized below (in millions):

October 26, 2018

April 27, 2018

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| | Gross Assets | Accumulated Amortization | Net Assets | Gross Assets | Accumulated Amortization | Net Assets |
|-----------------------------------|--------------|--------------------------|------------|--------------|--------------------------|------------|
| Developed technology | \$160 | \$ (95) | \$ 65 | \$164 | \$ (80) | \$ 84 |
| Customer contracts/relationships | 41 | (37) | 4 | 43 | (33) | 10 |
| Other purchased intangibles | — | — | — | 9 | (9) | — |
| Total purchased intangible assets | \$201 | \$ (132) | \$ 69 | \$216 | \$ (122) | \$ 94 |

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

| | Three Months Ended October 26, 2018 | | Six Months Ended October 27, 2018 | | Statements of Operations |
|----------------------------------|-------------------------------------|-------|-----------------------------------|-------|--------------------------|
| | 2018 | 2017 | 2018 | 2017 | Classification |
| Developed technology | \$9 | \$ 9 | \$18 | \$ 17 | Cost of revenues |
| Customer contracts/relationships | 3 | 4 | 7 | 8 | Operating expenses |
| Other purchased intangibles | — | 1 | — | 2 | Operating expenses |
| Total | \$12 | \$ 14 | \$25 | \$ 27 | |

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As of October 26, 2018, future amortization expense related to purchased intangible assets is as follows (in millions):

| Fiscal Year | Amount |
|-------------------|--------|
| Remainder of 2019 | \$ 22 |
| 2020 | 31 |
| 2021 | 16 |
| Total | \$ 69 |

4. Supplemental Financial Information

Cash, cash equivalents and restricted cash (in millions):

The following table presents cash and cash equivalents as reported in our condensed consolidated balance sheets, as well as the sum of cash, cash equivalents and restricted cash as reported on our condensed consolidated statement of cash flows in accordance with our adoption of the ASU discussed in Note 1 – Description of Business and Significant Accounting Policies:

| | October 26, 2018 | April 27, 2018 |
|--|------------------------|----------------------|
| Cash | \$ 2,251 | \$ 2,727 |
| Cash equivalents | 108 | 214 |
| Cash and cash equivalents | \$ 2,359 | \$ 2,941 |
| Short-term restricted cash | 5 | 5 |
| Long-term restricted cash | 1 | 1 |
| Restricted cash | \$ 6 | \$ 6 |
| Cash, cash equivalents and restricted cash | \$ 2,365 | \$ 2,947 |

Inventories (in millions):

| | October 26, 2018 | April 27, 2018 |
|----------------------|------------------------|----------------------|
| Purchased components | \$ 12 | \$ 12 |
| Finished goods | 74 | 110 |
| Inventories | \$ 86 | \$ 122 |

Property and equipment, net (in millions):

| | October 26, | April 27, |
|---|----------------|--------------|
| | 2018 | 2018 |
| Land | \$106 | \$106 |
| Buildings and improvements | 604 | 594 |
| Leasehold improvements | 87 | 88 |
| Computer, production, engineering and other equipment | 786 | 733 |
| Computer software | 357 | 357 |
| Furniture and fixtures | 104 | 99 |
| Construction-in-progress | 8 | 27 |
| | 2,052 | 2,004 |
| Accumulated depreciation and amortization | (1,282) | (1,248) |
| Property and equipment, net | \$770 | \$756 |

In September 2017, we entered into an agreement to sell certain land and buildings located in Sunnyvale, California, through two separate and independent closings, the first of which was completed in the third quarter of fiscal 2018. The remaining properties, consisting of land with a net book value of \$52 million, were classified as assets held for sale, and included as other current assets in our condensed consolidated balance sheets as of October 26, 2018 and April 27, 2018. We will consummate the sale of these properties, and receive cash proceeds of \$96 million, upon the completion of the second closing, which is expected to occur within the next 12 months. That closing is subject to due diligence, certain termination rights and customary closing conditions, including local governmental approval of the subdivision of a land parcel.

Other non-current assets (in millions):

| | October 26, | April 27, |
|--------------------------|----------------|--------------|
| | 2018 | 2018 |
| Deferred tax assets | \$ 223 | \$229 |
| Other assets | 276 | 221 |
| Other non-current assets | \$ 499 | \$450 |

Accrued expenses (in millions):

| | October 26, | April 27, |
|-----------------------------------|----------------|--------------|
| | 2018 | 2018 |
| Accrued compensation and benefits | \$ 314 | \$441 |
| Product warranty liabilities | 26 | 25 |
| Other current liabilities | 312 | 359 |
| Accrued expenses | \$ 652 | \$825 |

Product warranty liabilities:

Equipment and software systems sales include a standard product warranty. The following tables summarize the activity related to product warranty liabilities and their balances as reported in our condensed consolidated balance sheets (in millions):

| | Three Months Ended October 26, 27, | | Six Months Ended October 26, 27, | |
|-----------------------------------|---|-------|---|-------|
| | 2018 | 2017 | 2018 | 2017 |
| Balance at beginning of period | \$38 | \$ 44 | \$40 | \$ 50 |
| Expense accrued during the period | 6 | 7 | 10 | 8 |
| Warranty costs incurred | (5) | (7) | (11) | (14) |
| Balance at end of period | \$39 | \$ 44 | \$39 | \$ 44 |

| | October 26, | April 27, |
|--|----------------|--------------|
| | 2018 | 2018 |

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| | | |
|-----------------------------|-------|-------|
| Accrued expenses | \$ 26 | \$ 25 |
| Other long-term liabilities | 13 | 15 |
| Total warranty liabilities | \$ 39 | \$ 40 |

Warranty expense accrued during the period includes amounts accrued for systems at the time of shipment, adjustments for changes in estimated costs for warranties on systems shipped in the period and changes in estimated costs for warranties on systems shipped in prior periods.

Other long-term liabilities (in millions):

| | October 26, | April 27, |
|---------------------------------------|----------------|--------------|
| | 2018 | 2018 |
| Liability for uncertain tax positions | \$ 324 | \$ 314 |
| Income taxes payable | 476 | 549 |
| Product warranty liabilities | 13 | 15 |
| Other liabilities | 86 | 114 |
| Other long-term liabilities | \$ 899 | \$ 992 |

Statements of cash flows additional information (in millions):

Non-cash investing and financing activities and supplemental cash flow information are as follows:

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| | Six Months Ended October 26, 27, | |
|---|---|-------|
| | 2018 | 2017 |
| Non-cash Investing and Financing Activities: | | |
| Capital expenditures incurred but not paid | \$7 | \$ 17 |
| Supplemental Cash Flow Information: | | |
| Income taxes paid, net of refunds | \$104 | \$ 28 |
| Interest paid | \$26 | \$ 24 |

5. Revenue

Effective our first quarter of fiscal 2019, we adopted ASC 606 using the full retrospective method and have restated each prior reporting period presented to conform to the new rules. The most significant impact of the new standard relates to our accounting for arrangements containing software. For our enterprise software license agreements (ELAs), we now recognize the license fee component of such arrangements up front. Under the prior rules, the software license fee was recognized over the term of the enterprise license based on our inability to establish vendor specific objective evidence of fair value for the undelivered software support element of these arrangements. In addition, for other software arrangements, revenue deferred for the undelivered elements that was previously allocated based on the residual method is now allocated based on relative fair value, which generally results in more software arrangement revenue being recognized earlier. The new standard also impacts our estimation of variable consideration for certain arrangements with contract terms such as rights of return, potential penalties and acceptance clauses.

The following table presents the impacts of adoption of ASC 606 to select line items of our condensed consolidated balance sheet as of the end of fiscal 2018:

| | As of April 27, 2018 | | |
|--|------------------------------|----------------------------------|----------------|
| | As Previously Reported | Impact of ASC 606 Adoption | As Adjusted |
| ASSETS | | | |
| Accounts receivable | \$1,009 | \$38 (1) | \$1,047 |
| Inventories | \$126 | \$(4) | \$122 |
| Other current assets | \$330 | \$62 (2) | \$392 |
| Other non-current assets | \$420 | \$30 (2) | \$450 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Short-term deferred revenue and financed unearned services revenue | \$1,804 | \$(92) (3) | \$1,712 |
| Other long-term liabilities | \$961 | \$31 (4) | \$992 |
| Long-term deferred revenue and financed unearned services revenue | \$1,673 | \$(22) (3) | \$1,651 |

Accumulated deficit

\$(218) \$209 (5)\$ (9)

- (1) Netting of accounts receivable and deferred revenue balances for certain customer arrangements has been updated to reflect the impact of adoption
- (2) Reflects capitalization of commissions and reduction of long-term deferred tax assets
- (3) Reflects cumulative change in revenue and the impact of adoption to the netting of accounts receivable and deferred revenue balances for certain customer arrangements
- (4) Reflects increase in long-term deferred tax liabilities
- (5) Reflects cumulative impact to net income (loss)

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The following table presents the impacts of adoption of ASC 606 to our statement of operations for the second quarter and first six months of fiscal 2018:

| | Three Months Ended October 27, 2017 | | | Six Months Ended October 27, 2017 | | |
|--|--|----------------------------------|----------------|--------------------------------------|----------------------------------|----------------|
| | As Previously Reported | Impact of ASC 606 Adoption | As Adjusted | As Previously Reported | Impact of ASC 606 Adoption | As Adjusted |
| Revenues: | | | | | | |
| Product | \$807 | \$12 | \$819 | \$1,530 | \$16 | \$1,546 |
| Software maintenance | 240 | (16) | 224 | 474 | (27) | 447 |
| Hardware maintenance and other services | 375 | (3) | 372 | 743 | — | 743 |
| Net revenues | 1,422 | (7) | 1,415 | 2,747 | (11) | 2,736 |
| Cost of revenues: | | | | | | |
| Cost of product | 399 | (2) | 397 | 770 | 3 | 773 |
| Cost of software maintenance | 6 | — | 6 | 13 | — | 13 |
| Cost of hardware maintenance and other services | 115 | (3) | 112 | 228 | (2) | 226 |
| Total cost of revenues | 520 | (5) | 515 | 1,011 | 1 | 1,012 |
| Gross profit | 902 | (2) | 900 | 1,736 | (12) | 1,724 |
| Operating expenses: | | | | | | |
| Sales and marketing | 420 | 1 | 421 | 845 | (1) | 844 |
| Research and development | 194 | — | 194 | 387 | — | 387 |
| General and administrative | 69 | — | 69 | 137 | — | 137 |
| Total operating expenses | 683 | 1 | 684 | 1,369 | (1) | 1,368 |
| Income from operations | 219 | (3) | 216 | 367 | (11) | 356 |
| Other income, net | 6 | — | 6 | 11 | — | 11 |
| Income before income taxes | 225 | (3) | 222 | 378 | (11) | 367 |
| Provision for income taxes | 50 | (2) | 48 | 67 | (5) | 62 |
| Net income | \$175 | \$(1) | \$174 | \$311 | \$(6) | \$305 |
| Net income per share: | | | | | | |
| Basic | \$0.65 | \$— | \$0.65 | \$1.15 | \$(0.02) | \$1.13 |
| Diluted | \$0.64 | \$(0.01) | \$0.63 | \$1.12 | \$(0.02) | \$1.10 |
| Shares used in net income per share calculations: | | | | | | |
| Basic | 269 | 269 | 269 | 270 | 270 | 270 |
| Diluted | 275 | 275 | 275 | 277 | 277 | 277 |

The adoption of ASC 606 had no impact to cash provided by or used in operating, investing or financing activities as presented on our condensed consolidated statement of cash flows.

The core principle of ASC 606 is to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration the entity expects to be entitled in exchange for those goods or services. This principle is achieved through applying the following five-step approach.

Identification of the contract, or contracts, with a customer — A contract with a customer exists when (i) we enter into an enforceable contract with a customer that (ii) defines each party's rights regarding the goods or services to be transferred and (iii) identifies the payment terms related to these goods or services. Additionally, (iv) the contract has commercial substance and, (v) we determine that collection of substantially all consideration for goods or services that are transferred is probable based on the customer's intent and ability to pay the promised consideration. We apply judgment in determining the customer's ability and intention to pay, which is based on a variety of factors including the customer's historical payment experience or, in the case of a new customer, published credit and financial information pertaining to the customer. We also combine two or more contracts entered into at or near the same time with the same customer as a single contract if the contracts are negotiated as one package with a single commercial objective, the amount of consideration to be paid on one contract depends on the price or performance of the other contract or if the goods and services promised in each of the contracts are a single performance obligation.

Identification of the performance obligations in the contract — Performance obligations promised in a contract are identified based on the goods or services (or a bundle of goods and services) that will be transferred to the customer that are distinct. A good or service is distinct if it is capable of being distinct, where the customer can benefit from the goods or service either on its own or together with other resources that are readily available from third parties or from us, and is distinct in the context of the contract, meaning the transfer of the goods or services is separately identifiable from other promises in the contract. To the extent a contract includes multiple promised goods or services, we apply judgment to determine whether promised goods or services are capable of being distinct and distinct in the context of the contract. If these criteria are not met, we combine the goods and services until we have a distinct performance obligation.

Determination of the transaction price — The transaction price is determined based on the consideration to which we will be entitled in exchange for transferring goods or services to the customer. Consideration promised may include fixed amounts, variable amounts or both. We use judgment in determining variable consideration, particularly if consideration is contingent on the occurrence or nonoccurrence of a future event. We use the expected value, primarily relying on our history, to estimate variable consideration. We may also use, in certain situations, the most likely amount as the basis of our estimate. In either case, we consider variable consideration only to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur. Reassessments of our variable consideration may occur as historical information changes. Transaction prices should also be adjusted for the effects of time value of money if the timing of payments provides either the customer or ourselves a significant benefit of financing.

Allocation of the transaction price to the performance obligations in the contract — If the contract contains a single performance obligation, the entire transaction price is allocated to the single performance obligation. Contracts that contain multiple performance obligations require an allocation of the transaction price to each performance obligation based on a relative standalone selling price basis. We determine standalone selling price based on the price at which the performance obligation is sold separately. If the standalone selling price is not observable through past transactions, we estimate the standalone selling price taking into account available information such as market conditions and internally approved pricing guidelines related to the performance obligations. Variable consideration is also allocated to the performance obligations. If the terms of variable consideration relate to one performance obligation, it is entirely allocated to that obligation. Otherwise, it is allocated to all the performance obligations in the contract.

Recognition of revenue when, or as, we satisfy a performance obligation — We satisfy performance obligations either over time or at a point in time. We typically recognize revenue at a point in time for promises to transfer goods to a

customer. Services are typically transferred over time based on an appropriate method for measuring our progress toward completion of that performance obligation. Our stand-ready services, including both hardware and software maintenance support, are transferred ratably over the period of the contract. For other services such as our fixed professional services contract, we use an input method to determine the percentage of completion. That is, we estimate the effort to date versus the expected effort required over the life of the contract.

Disaggregation of revenue

To provide visibility into our transition from older products to our newer, higher growth products and clarity into the dynamics of our product revenue, we have historically grouped our products by “Strategic” and “Mature” solutions. Strategic solutions include Clustered ONTAP, branded E-Series, SolidFire, converged and hyper-converged infrastructure, ELAs and other optional add-on software products. Mature solutions include 7-mode ONTAP, add-on hardware and related operating system (OS) software and original equipment manufacturers (OEM) products. Both our Mature and Strategic product lines include a mix of disk, hybrid and all flash storage media. Additionally, we provide a variety of services including software maintenance, hardware maintenance and other services including professional services, global support solutions, and customer education and training.

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The following table depicts the disaggregation of revenue by our products and services (in millions):

| | Three Months | | Six Months | |
|--|-------------------------|----------------|-------------------------|----------------|
| | Ended October 26, | October 27, | Ended October 26, | October 27, |
| | 2018 | 2017 | 2018 | 2017 |
| Product revenues | \$913 | \$819 | \$1,788 | \$1,546 |
| Strategic | 649 | 566 | 1,261 | 1,064 |
| Mature | 264 | 253 | 527 | 482 |
| Software maintenance revenues | 236 | 224 | 465 | 447 |
| Hardware maintenance and other services revenues | 368 | 372 | 738 | 743 |
| Hardware maintenance support contracts | 303 | 306 | 606 | 604 |
| Professional and other services | 65 | 66 | 132 | 139 |
| Net revenues | \$1,517 | \$1,415 | \$2,991 | \$2,736 |

Revenues by geographic region are presented in Note 14 – Segment, Geographic, and Significant Customer Information.

Deferred revenue and financed unearned services revenue

The following table summarizes the components of our deferred revenue and financed unearned services balance as reported in our condensed consolidated balance sheets (in millions):

| | October 26, | April 27, |
|------------------------------------|----------------|--------------|
| | 2018 | 2018 |
| Deferred product revenue | \$102 | \$107 |
| Deferred services revenue | 3,010 | 3,134 |
| Financed unearned services revenue | 94 | 122 |
| Total | \$3,206 | \$3,363 |
| Reported as: | | |
| Short-term | \$1,538 | \$1,712 |
| Long-term | 1,668 | 1,651 |
| Total | \$3,206 | \$3,363 |

Deferred product revenue represents unrecognized revenue related to undelivered product commitments and other product deliveries that have not met all revenue recognition criteria. Deferred services revenue represents customer payments made in advance for services, which include software and hardware maintenance contracts and other services. Financed unearned services revenue represents undelivered services for which cash has been received under certain third-party financing arrangements. See Note 15 – Commitments and Contingencies for additional information related to these arrangements.

The following tables summarize the activity related to deferred revenue and financed unearned services revenue (in millions):

| | Six Months Ended | |
|--------------------------------------|---------------------|----------------|
| | October 26, | October 27, |
| | 2018 | 2017 |
| Balance at beginning of period | \$3,363 | \$3,213 |
| Additions | 1,067 | 1,031 |
| Revenue recognized during the period | (1,224) | (1,185) |
| Balance at end of period | \$3,206 | \$3,059 |

During the six months ended October 26, 2018 and October 27, 2017, we recognized \$1,019 million and \$1,017 million, respectively, that was included in the deferred revenue and financed unearned services revenue balance at the beginning of the respective periods.

As of October 26, 2018, the aggregate amount of the transaction price allocated to the remaining performance obligations related to customer contracts that are unsatisfied or partially unsatisfied was \$3,206 million, which is equivalent to our deferred revenue and unearned services revenue balance. Because customer orders are typically placed on an as-needed basis, and cancellable without penalty prior to shipment, orders in backlog may not be a meaningful indicator of future revenue and have not been included in this

amount. We expect to recognize as revenue approximately 48% of our deferred revenue and financed unearned services revenue balance in the next 12 months, approximately 27% in the next 13 to 24 months, and the remainder thereafter.

Deferred commissions

As a result of our adoption of ASC 606 in the first quarter of fiscal 2019, we capitalize sales commissions that are incremental direct costs of obtaining customer contracts for which revenue is not immediately recognized and classify them as current or non-current based on the terms of the related contracts. Capitalized commissions are amortized based on the transfer of goods or services to which they relate, typically over one to three years, and are also periodically reviewed for impairment. Amortization expense is recorded to sales and marketing expense in our condensed consolidated statements of operations. The following tables summarize the activity related to deferred commissions and their balances as reported in our condensed consolidated balance sheets (in millions):

| | Six Months Ended October 26, 27, | |
|--------------------------------------|---|--------|
| | 2018 | 2017 |
| Balance at beginning of period | \$ 137 | \$ 113 |
| Additions | 35 | 34 |
| Expense recognized during the period | (41) | (32) |
| Balance at end of period | \$ 131 | \$ 115 |

| | October 26, | April 27, |
|----------------------------|----------------|--------------|
| | 2018 | 2018 |
| Other current assets | \$ 61 | \$ 66 |
| Other non-current assets | 70 | 71 |
| Total deferred commissions | \$ 131 | \$ 137 |

6. Other income, net

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

| | Three Months Ended October 26, 27, | Six Months Ended October 26, 27, |
|--|---|---|
|--|---|---|

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| | 2018 | 2017 | 2018 | 2017 |
|-------------------------|------|-------|------|-------|
| Interest income | \$21 | \$ 19 | \$46 | \$ 35 |
| Interest expense | (14) | (17) | (28) | (30) |
| Other income, net | — | 4 | 7 | 6 |
| Total other income, net | \$7 | \$ 6 | \$25 | \$ 11 |

7. Financial Instruments and Fair Value Measurements

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; benchmark yields, reported trades, broker/dealer quotes, 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 ongoing 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 (in millions):

| | October 26, 2018 | | | April 27, 2018 | | | | |
|--|------------------|------------------------|------------|----------------|------------------------|------------|----------|----------|
| | Cost or | Estimated | | Cost or | Estimated | | | |
| | Gross | | Fair Value | Gross | | Fair Value | | |
| | Amortized Cost | Unrealized Gain/Losses | | Amortized Cost | Unrealized Gain/Losses | | | |
| Corporate bonds | \$1,614 | \$ — | \$ (40) | \$ 1,574 | \$1,865 | \$ 1 | \$ (39) | \$ 1,827 |
| U.S. Treasury and government debt securities | 362 | — | (4) | 358 | 497 | — | (5) | 492 |
| Commercial paper | — | — | — | — | 230 | — | — | 230 |
| Certificates of deposit | 116 | — | — | 116 | 115 | — | — | 115 |
| Mutual funds | 34 | — | — | 34 | 31 | — | — | 31 |
| Total debt and equity securities | \$2,126 | \$ — | \$ (44) | \$ 2,082 | \$2,738 | \$ 1 | \$ (44) | \$ 2,695 |

As of October 26, 2018 and April 27, 2018, the unrealized losses on our available-for-sale investments were caused by market value declines as a result of increasing market interest rates. Because the declines in market value are attributable to changes in market conditions and not credit quality, and because we have determined that (i) we do not have the intent to sell any of these investments and (ii) it is not more likely than not that we will be required to sell any of these investments before recovery of the entire amortized cost basis, we have determined that no other-than-temporary impairments were required to be recognized on these investments as of October 26, 2018 and April 27, 2018.

The following table presents the contractual maturities of our debt investments as of October 26, 2018 (in millions):

| | Amortized Cost | Fair Value |
|--|----------------|------------|
| Due in one year or less | \$ 679 | \$676 |
| Due after one year through five years | 835 | 821 |
| Due after five years through ten years | 578 | 551 |
| | \$ 2,092 | \$2,048 |

Actual maturities may differ from the contractual maturities because borrowers may have the right to call or prepay certain obligations.

Fair Value of Financial Instruments

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis (in millions):

October 26, 2018
Fair Value
Measurements
at Reporting

| | Total | Date Using | |
|--|---------|------------|---------|
| | | Level 1 | Level 2 |
| Cash | \$2,251 | \$2,251 | \$— |
| Corporate bonds | 1,574 | — | 1,574 |
| U.S. Treasury and government debt securities | 358 | 190 | 168 |
| Certificates of deposit | 116 | — | 116 |
| Total cash, cash equivalents and short-term investments | \$4,299 | \$2,441 | \$1,858 |
| Other items: | | | |
| Mutual funds ⁽¹⁾ | \$6 | \$6 | \$— |
| Mutual funds ⁽²⁾ | \$28 | \$28 | \$— |
| Foreign currency exchange contracts assets ⁽¹⁾ | \$5 | \$— | \$5 |
| Foreign currency exchange contracts liabilities ⁽³⁾ | \$(3) | \$— | \$(3) |

⁽¹⁾Reported as other current assets in the condensed consolidated balance sheets

⁽²⁾Reported as other non-current assets in the condensed consolidated balance sheets

⁽³⁾Reported as accrued expenses in the condensed consolidated balance sheets

Our Level 2 debt instruments are held by a custodian who prices some of the investments using standard inputs in various asset price models or obtains investment prices from third-party pricing providers that incorporate standard inputs in various asset price models. These pricing providers utilize the most recent observable market information in pricing these securities or, if specific prices are not available for these securities, use other observable inputs like market transactions involving identical or comparable securities. We review Level 2 inputs and fair value for reasonableness and the values may be further validated by comparison to multiple

independent pricing sources. In addition, we review third-party pricing provider models, key inputs and assumptions and understand the pricing processes at our third-party providers in determining the overall reasonableness of the fair value of our Level 2 debt instruments. As of October 26, 2018 and April 27, 2018, we have not made any adjustments to the prices obtained from our third-party pricing providers.

Fair Value of Debt

As of October 26, 2018 and April 27, 2018, the fair value of our long-term debt was approximately \$1,524 million and \$1,523 million, respectively. The fair value of our long-term debt was based on observable market prices in a less active market. The fair value of our commercial paper notes approximated their carrying value. All of our debt obligations are categorized as Level 2 instruments.

8. Financing Arrangements

Long-Term Debt

The following table summarizes information relating to our long-term debt, which we collectively refer to as our Senior Notes (in millions, except interest rates):

| | October 26, 2018 | | April 27, 2018 | |
|---|------------------|-------------------------|----------------|-------------------------|
| | Amount | Effective Interest Rate | Amount | Effective Interest Rate |
| 2.00% Senior Notes Due September 2019 | \$400 | 2.32 % | \$400 | 2.32 % |
| 3.375% Senior Notes Due June 2021 | 500 | 3.54 % | 500 | 3.54 % |
| 3.25% Senior Notes Due December 2022 | 250 | 3.43 % | 250 | 3.43 % |
| 3.30% Senior Notes Due September 2024 | 400 | 3.42 % | 400 | 3.42 % |
| Total principal amount | 1,550 | | 1,550 | |
| Unamortized discount and issuance costs | (7) | | (9) | |
| Total senior notes | 1,543 | | 1,541 | |
| Less: Current portion of long-term debt | (399) | | — | |
| Total long-term debt | \$1,144 | | \$1,541 | |

Senior Notes

Our 2.00% Senior Notes and 3.30% Senior Notes, each with a principal amount of \$400 million, were issued in September 2017. Interest on these Senior Notes is paid semi-annually in March and September. Our 3.375% Senior Notes and 3.25% Senior Notes, with principal amounts of \$500 million and \$250 million, respectively, were issued in June 2014 and December 2012, respectively. Interest on these Senior Notes is paid semi-annually in June and December. Our Senior Notes, which are unsecured, unsubordinated obligations, rank equally in right of payment with any existing and future senior unsecured indebtedness.

We may redeem the Senior Notes in whole or in part, at any time at our option at specified redemption prices. In addition, upon the occurrence of certain change of control triggering events, we may be required to repurchase the

Senior Notes under specified terms. The Senior Notes also include covenants that limit our ability to incur debt secured by liens on assets or on shares of stock or indebtedness of our subsidiaries; to engage in certain sale and lease-back transactions; and to consolidate, merge or sell all or substantially all of our assets. As of October 26, 2018, we were in compliance with all covenants associated with the Senior Notes.

As of October 26, 2018, our aggregate future principal debt maturities are as follows (in millions):

| Fiscal Year | Amount |
|-------------|----------|
| 2020 | \$ 400 |
| 2022 | 500 |
| 2023 | 250 |
| 2025 | 400 |
| Total | \$ 1,550 |

Commercial Paper Program and Credit Facility

We have a commercial paper program (the Program), under which we may issue unsecured commercial paper notes. Amounts available under the Program, as amended in July 2017, may be borrowed, repaid and re-borrowed, with the aggregate face or principal amount of the notes outstanding under the Program at any time not to exceed \$1.0 billion. The maturities of the notes can vary, but may not exceed 397 days from the date of issue. The notes are sold under customary terms in the commercial paper market and may

be issued at a discount from par or, alternatively, may be sold at par and bear interest at rates dictated by market conditions at the time of their issuance. The proceeds from the issuance of the notes are used for general corporate purposes. As of October 26, 2018, we had commercial paper notes outstanding with an aggregate principal amount of \$250 million, a weighted-average interest rate of 2.45% and maturities ranging from 4 days to 31 days. As of April 27, 2018, we had commercial paper notes outstanding with an aggregate principal amount of \$385 million, a weighted-average interest rate of 2.29% and maturities ranging from 19 days to 32 days.

In connection with the Program, we have a senior unsecured credit agreement with a syndicated group of lenders that expires on December 10, 2021. The credit agreement, as amended in July 2017, provides a \$1.0 billion revolving unsecured credit facility, with a \$50 million letter of credit sub-facility, that serves as a back-up for the Program. Proceeds from the facility may also be used for general corporate purposes to the extent that the credit facility exceeds the outstanding debt issued under the Program. The credit agreement includes options that allow us to request an increase in the facility of up to an additional \$300 million and to extend its maturity date for two additional one-year periods, both subject to certain conditions. As of October 26, 2018 we were in compliance with all associated covenants in this agreement. No amounts were drawn against this facility during any of the periods presented.

9. Stockholders' Equity

Equity Incentive Awards

As of October 26, 2018, we have certain equity incentive awards (awards) outstanding, which include stock options, restricted stock units (RSUs), including time-based RSUs and performance-based RSUs (PBRsUs), and Employee Stock Purchase Plan (ESPP) awards.

Stock Options

The following table summarizes information related to our stock options (in millions, except exercise price and contractual term):

| | Number of Shares | Weighted- Average Exercise Price | Weighted- Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|------------------------------------|------------------------|---|---|---------------------------------|
| Outstanding as of April 27, 2018 | 1 | \$ 31.19 | | |
| Outstanding as of October 26, 2018 | 1 | \$ 30.49 | 3.27 | \$ 29 |
| Exercisable as of October 26, 2018 | 1 | \$ 32.21 | 2.92 | \$ 25 |

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.

Additional information related to our stock options is summarized below (in millions):

| | Six Months Ended October 26, 27, | |
|----------------------------------|---|-------|
| | 2018 | 2017 |
| Intrinsic value of exercises | \$22 | \$ 11 |
| Proceeds received from exercises | \$17 | \$ 15 |
| Fair value of options vested | \$1 | \$ 5 |

Restricted Stock Units

In the six months ended October 26, 2018, we granted PBRsUs to certain of our executives. Each PBRsU has performance-based vesting criteria, in addition to the service based vesting criteria, such that the PBRsUs cliff-vest at the end of an approximate three year performance period, which began on the date specified in the grant agreements and ends the last day of fiscal 2021. The number of shares of common stock that will be issued to settle the PBRsUs at the end of the applicable performance and service period will range from 0% to 200% of a target number of shares originally granted. For half of the PBRsUs granted in the current year, the number of shares issued will depend upon our Total Stockholder Return (TSR) as compared to the TSR of a specified group of benchmark peer companies (each expressed as a growth rate percentage) calculated as of the end of fiscal 2021. The fair values of these awards were fixed at grant date using a Monte Carlo simulation model. For the remaining PBRsUs granted, the number of shares issued will depend upon our achievement against a cumulative Adjusted Operating Income (AOI) target, as defined in the grant agreements, for the three year period from fiscal 2019 through 2021. The fair values of these awards were established consistent with our methodology for valuing time-based RSUs, while compensation cost is being recognized based on the probable outcome of the performance condition. The aggregate grant date fair value of all PBRsUs granted in the current year was \$23 million, which is being recognized to compensation expense over the remaining applicable performance / service periods.

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The following table summarizes information related to our RSUs, including PBRs, (in millions, except fair value):

| | Number of Shares | Weighted- Average Grant Date Fair Value |
|------------------------------------|------------------------|---|
| Outstanding as of April 27, 2018 | 9 | \$ 32.91 |
| Granted | 3 | \$ 63.37 |
| Vested | (3) | \$ 31.67 |
| Forfeited | (1) | \$ 34.03 |
| Outstanding as of October 26, 2018 | 8 | \$ 44.55 |

We primarily use the net share settlement approach upon vesting, where a portion of the shares are withheld as settlement of 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):

| | Six Months Ended October 26, 27, | |
|-------------------------------|---|-------|
| | 2018 | 2017 |
| Shares withheld for taxes | 1 | 2 |
| Fair value of shares withheld | \$89 | \$ 60 |

Employee Stock Purchase Plan

The following table summarizes activity related to the purchase rights issued under the ESPP (in millions):

| | Six Months Ended October 26, 27, | |
|----------------------------------|---|-------|
| | 2018 | 2017 |
| Shares issued under the ESPP | 2 | 2 |
| Proceeds from issuance of shares | \$49 | \$ 42 |

Stock-Based Compensation Expense

Stock-based compensation expense is included in the condensed consolidated statements of operations as follows (in millions):

| | Three Months Ended October 26, 27, | | Six Months Ended October 26, 27, | |
|--|--|-------|---|-------|
| | 2018 | 2017 | 2018 | 2017 |
| Cost of product revenues | \$— | \$ 1 | \$1 | \$ 2 |
| Cost of hardware maintenance and other services revenues | 2 | 2 | 5 | 5 |
| Sales and marketing | 16 | 16 | 33 | 37 |
| Research and development | 12 | 12 | 24 | 27 |
| General and administrative | 8 | 8 | 15 | 16 |
| Total stock-based compensation expense | \$38 | \$ 39 | \$78 | \$ 87 |
| Income tax benefit for stock-based compensation expense | \$5 | \$ 9 | \$10 | \$ 18 |

As of October 26, 2018, total unrecognized compensation expense related to our equity awards was \$337 million, which is expected to be recognized on a straight-line basis over a weighted-average remaining service period of 2.3 years.

Stock Repurchase Program

Our Board of Directors has authorized the repurchase of up to \$13.6 billion of our common stock. Under this program, which we may suspend or discontinue at any time, we may purchase shares of our outstanding common stock through solicited or unsolicited transactions in the open market, in privately negotiated transactions, through accelerated share repurchase programs, pursuant to a Rule 10b5-1 plan or in such other manner as deemed appropriate by our management.

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The following table summarizes activity related to this program for the six months ended October 26, 2018 (in millions, except per share amounts):

| | |
|--|---------|
| Number of shares repurchased | 14 |
| Average price per share | \$77.94 |
| Aggregate purchase price | \$1,061 |
| Remaining authorization at end of period | \$2,939 |

The aggregate purchase price of our stock repurchases for the six months ended October 26, 2018 consisted of \$1,061 million of open market purchases, of which \$597 million and \$464 million were allocated to additional paid-in capital and retained earnings (accumulated deficit), respectively.

Since the May 13, 2003 inception of our stock repurchase program through October 26, 2018, we repurchased a total of 298 million shares of our common stock at an average price of \$35.87 per share, for an aggregate purchase price of \$10.7 billion.

Dividends

The following is a summary of our activities related to dividends on our common stock (in millions, except per share amounts):

| | Six Months Ended October 26, 2018 | October 27, 2017 |
|--|---|---------------------|
| Dividends per share declared | \$ 0.80 | \$ 0.40 |
| Dividend payments allocated to additional paid-in capital | \$ 207 | \$ — |
| Dividend payments allocated to retained earnings (accumulated deficit) | \$ — | \$ 108 |

On November 14, 2018, we declared a cash dividend of \$0.40 per share of common stock, payable on January 23, 2019 to holders of record as of the close of business on January 4, 2019. The timing and amount of future dividends will depend on market conditions, corporate business and financial considerations and regulatory requirements. All dividends declared have been determined by us to be legally authorized under the laws of the state in which we are incorporated.

Retained Earnings (Accumulated Deficit)

A reconciliation of retained earnings (accumulated deficit) is as follows (in millions):

| | |
|---|--------|
| Balance as of April 27, 2018 | \$(9) |
| Cumulative-effect of new accounting principle | (51) |
| Net income | 524 |
| Repurchases of common stock | (464) |
| Balance as of October 26, 2018 | \$— |

In the first quarter of fiscal 2019, we adopted an ASU that eliminates the deferred tax effects of intra-entity asset transfers other than inventory and recorded the cumulative-effect of adoption to retained earnings (accumulated deficit). Refer to Note 1 – Description of Business and Significant Accounting Policies for details.

Accumulated Other Comprehensive Income (Loss)

Changes in accumulated other comprehensive income (loss) (AOCI) by component, net of tax, are summarized below (in millions):

| | Foreign Currency Translation | Defined Benefit Obligation | Unrealized Gains (Losses) on Available- for-Sale Securities | Total |
|---|------------------------------------|----------------------------------|---|---------|
| Balance as of April 27, 2018 | \$ (27) | \$ — | \$ (43) | \$(70) |
| Other comprehensive income (loss), net of tax | (3) | — | (1) | (4) |
| Amounts reclassified from AOCI, net of tax | — | (1) | — | (1) |
| Total other comprehensive loss | (3) | (1) | (1) | (5) |
| Balance as of October 26, 2018 | \$ (30) | \$ (1) | \$ (44) | \$(75) |

10. Derivatives and Hedging Activities

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 exchange rates. The maximum length of time over which forecasted foreign currency denominated revenues are hedged is six months. The program is not designated for trading or speculative purposes. Our derivatives expose us to credit risk to the extent that the counterparties may be unable to meet the terms of our agreements with them. We seek to mitigate such risk by limiting our counterparties to major financial institutions. In addition, the potential risk of loss with any one counterparty resulting from this type of credit risk is monitored on an ongoing basis. We also have in place master netting arrangements to mitigate the credit risk of our counterparties and to potentially reduce our losses due to counterparty nonperformance. We present our derivative instruments as net amounts in our condensed consolidated balance sheets. The gross and net fair value amounts of such instruments were not material as of October 26, 2018 or April 27, 2018. We did not recognize any gains or losses in earnings due to hedge ineffectiveness for any period presented. All contracts have a maturity of less than six months.

The notional amount of our outstanding U.S. dollar equivalent foreign currency exchange forward contracts consisted of the following (in millions):

| | October 26, 2018 | April 27, 2018 |
|--------------------------------|------------------------|----------------------|
| Cash Flow Hedges | | |
| Forward contracts purchased | \$ 182 | \$— |
| Balance Sheet Contracts | | |
| Forward contracts sold | \$ 101 | \$115 |
| Forward contracts purchased | \$ 237 | \$412 |

The effect of cash flow hedges recognized in net revenues on our condensed consolidated statements of operations was immaterial in all periods presented.

The effect of derivative instruments not designated as hedging instruments recognized in other income, net on our condensed consolidated statements of operations was as follows (in millions):

| | Three Months Ended October 26, 2018 | | Six Months Ended October 26, 2017 | |
|-------------------------------------|---|-------------|---|-------------|
| | 2018 | 2017 | 2018 | 2017 |
| | Gain (Loss) | Gain (Loss) | Gain (Loss) | Gain (Loss) |
| | Recognized | Recognized | Recognized | Recognized |
| | into Income | into Income | into Income | into Income |
| Foreign currency exchange contracts | \$ 2 | \$ 1 | \$ 12 | \$ (1) |

11. Restructuring Charges`

In the first quarter of fiscal 2019, we announced a restructuring plan (the May 2018 Plan) to reduce costs and redirect resources to our highest return activities, which included a reduction in our global workforce of less than 2%. Charges related to the plan consisted primarily of employee severance-related costs. Substantially all activities under the plan have been completed.

Management previously approved the November 2016 Plan, under which we reduced our global workforce by approximately 6%. We completed all workforce related activities under this plan as of the end of fiscal 2017. The remaining balance as of October 26, 2018 principally relates to lease obligations that will be paid over their remaining terms.

Activities related to our restructuring plans are summarized as follows (in millions):

| | Six Months Ended October 26, 2018 | | | Six Months Ended October 27, 2017 |
|--------------------------------|--------------------------------------|------------------|-------|---|
| | May 2018 | November 2016 | Total | November 2016 |
| | Plan | Plan | Total | Plan |
| Balance at beginning of period | \$— | \$ 6 | \$6 | \$ 13 |
| Net charges | 19 | — | 19 | — |
| Cash payments | (17) | (1) | (18) | (5) |
| Balance at end of period | \$2 | \$ 5 | \$7 | \$ 8 |

12. Income Taxes

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

| | Six Months Ended October | |
|---------------------|--------------------------------|-------|
| | 26, | 27, |
| | 2018 | 2017 |
| Effective tax rates | 7.3% | 16.9% |

Our effective tax rates reflect the impact of a significant amount of our earnings, primarily income from our European operations which are headquartered in the Netherlands, being taxed in foreign jurisdictions at rates below the United States (U.S.) statutory tax rate. The differences in effective tax rates for the six months ended October 26, 2018 and October 27, 2017 were primarily related to the adoption of the new revenue standard, differences in discrete benefits for stock-based compensation and the reduced federal income tax rate due to U.S. tax reform.

The effective tax rate for the six months ended October 27, 2017 has been restated to reflect the retrospective application of the new revenue standard. During the six months ended October 26, 2018, we recognized a \$34 million discrete tax benefit for adjustments to certain intercompany transactions resulting from the retrospective application of the new standard. See Note 5 – Revenue for additional details.

On December 22, 2017, the Tax Cuts and Jobs Act (“TCJA”) was enacted into law. The TCJA made significant changes to the U.S. corporate income tax system including a reduction of the U.S. federal corporate income tax rate from 35% to 21%, the imposition of a one-time transition tax on deferred foreign earnings, and the creation of new taxes on certain foreign-sourced earnings. As of October 26, 2018, we have not fully completed the accounting for the tax impacts of the TCJA. No significant adjustments to prior period estimates or positions have been made in the current period. The provisional amounts recorded are based on reasonable estimates and our current interpretation and understanding of the TCJA. The final impacts of U.S. tax reform may differ, possibly materially, due to factors such as the issuance of further regulatory guidance, changes in interpretations, and the collection and analysis of additional information. The Company is also still evaluating the effects of the TCJA’s global minimum tax on intangible low-taxed income (“GILTI”) and has not yet made an accounting policy election to either account for the tax under a period cost method or a deferred method. For the six months ended October 26, 2018, we have accounted for the GILTI tax under a period cost method as we continue to evaluate potential impacts. In accordance with Staff Accounting Bulletin 118, we will complete the accounting of the tax effects of the TCJA within the measurement period not to extend beyond one year from the enactment date.

As of October 26, 2018, we had \$356 million of gross unrecognized tax benefits. Inclusive of penalties, interest and certain income tax benefits, \$306 million would affect our provision for income taxes if recognized, and \$324 million has been recorded in other long-term liabilities.

We are currently undergoing federal income tax audits in the U.S. and several foreign tax jurisdictions. Transfer pricing calculations are key issues under audits in various jurisdictions, and are often subject to dispute and appeals.

The IRS has concluded the examination of our tax returns for our fiscal years through 2010. The IRS commenced the examination of our federal income tax returns for our fiscal years 2012 and 2013 in August 2016. We expect this examination to conclude within the next 12 months.

In September 2010, the Danish Tax Authorities issued a decision concluding that distributions declared in 2005 and 2006 by our Danish subsidiary were subject to Danish at-source dividend withholding tax. We do not believe that our Danish subsidiary is liable for such withholding tax and filed an appeal with the Danish Tax Tribunal. In December 2011, the Danish Tax Tribunal issued a ruling in favor of NetApp. The Danish tax examination agency appealed this decision at the Danish High Court (DHC) in March 2012. In February 2016, the DHC requested a preliminary ruling from the Court of Justice of the European Union (CJEU). Parties were heard before the court in October 2017. During March 2018, the Advocate General issued an opinion which was largely in favor of NetApp, however, the CJEU is not bound by the opinion of the Advocate General. It is expected that the preliminary ruling will be issued during our fiscal year 2019. Once a ruling has been issued by the CJEU, it will be reviewed and may be subjected to additional briefing by the DHC. Once complete, the DHC will issue its final decision. We expect this decision to be issued during our fiscal year 2019 or 2020.

We continue to monitor the progress of ongoing discussions with tax authorities and the impact, if any, of the expected expiration of the statute of limitations in various taxing jurisdictions. We believe that within the next 12 months, it is reasonably possible that either certain audits will conclude, certain statutes of limitations will lapse, or both. As a result of uncertainties regarding tax audits and their possible outcomes, an estimate of the range of possible impacts to unrecognized tax benefits in the next twelve months cannot be made at this time.

13. Net Income per Share

The following is a calculation of basic and diluted net income per share (in millions, except per share amounts):

| | Three Months Ended October 26, 2018 | | Six Months Ended October 26, 2017 | |
|--|---|---------|---|---------|
| Numerator: | | | | |
| Net income | \$241 | \$ 174 | \$524 | \$ 305 |
| Denominator: | | | | |
| Shares used in basic computation | 258 | 269 | 260 | 270 |
| Dilutive impact of employee equity award plans | 6 | 6 | 7 | 7 |
| Shares used in diluted computation | 264 | 275 | 267 | 277 |
| Net Income per Share: | | | | |
| Basic | \$0.93 | \$ 0.65 | \$2.02 | \$ 1.13 |
| Diluted | \$0.91 | \$ 0.63 | \$1.96 | \$ 1.10 |

No potential shares from outstanding employee equity awards were excluded from the diluted net income per share calculation for the three or six months ended October 26, 2018. For the three and six months ended October 27, 2017, 1 million and 2 million potential shares from outstanding awards, respectively, were excluded from the calculation as their inclusion would have been anti-dilutive.

14. Segment, Geographic, and Significant Customer Information

We operate in one industry segment: the design, manufacturing, marketing, and technical support of high-performance storage and data management 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 our 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 reporting 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 information from 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 October 26, 2018 | | Six Months Ended October 26, 2017 | |
|--|---|--|---|--|
| | | | | |

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| | 2018 | 2017 | 2018 | 2017 |
|--|---------|---------|---------|---------|
| United States, Canada and Latin America (Americas) | \$868 | \$792 | \$1,711 | \$1,513 |
| Europe, Middle East and Africa (EMEA) | 429 | 426 | 859 | 827 |
| Asia Pacific (APAC) | 220 | 197 | 421 | 396 |
| Net revenues | \$1,517 | \$1,415 | \$2,991 | \$2,736 |

Americas revenues consist of sales to Americas commercial and U.S. public sector markets. Sales to customers inside the U.S. were \$789 million and \$722 million during the three months ended October 26, 2018 and October 27, 2017, respectively, and were \$1,550 million and 1,361 million during the six months ended October 26, 2018 and October 27, 2017, respectively.

The majority of our assets, excluding cash, cash equivalents, short-term investments and accounts receivable, were attributable to our domestic operations. The following table presents cash, cash equivalents and short-term investments held in the U.S. and internationally in various foreign subsidiaries (in millions):

| | October 26, | April 27, |
|---------------|----------------|--------------|
| | 2018 | 2018 |
| U.S. | \$405 | \$853 |
| International | 3,894 | 4,538 |
| Total | \$4,299 | \$5,391 |

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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 information for geographic areas based on the physical location of the assets (in millions):

| | October 26, | April 27, |
|---------------|----------------|--------------|
| | 2018 | 2018 |
| U.S. | \$ 580 | \$566 |
| International | 190 | 190 |
| Total | \$ 770 | \$756 |

The following customers, each of which is a distributor, accounted for 10% or more of our net revenues:

| | Three Months Ended October 26, 27, | | Six Months Ended October 26, 27, | |
|-------------------------|---|------|---|------|
| | 2018 | 2017 | 2018 | 2017 |
| Arrow Electronics, Inc. | 24% | 22 % | 23% | 23 % |
| Tech Data Corporation | 21 % | 19 % | 19% | 20 % |

The following customers accounted for 10% or more of accounts receivable:

| | October 26, | April 27, |
|-------------------------|----------------|--------------|
| | 2018 | 2018 |
| Arrow Electronics, Inc. | 11 % | 17 % |
| Tech Data Corporation | 24 % | 17 % |

15. Commitments and Contingencies

Operating Leases

We lease various equipment, vehicles and office space in the U.S. and internationally. Future annual minimum lease payments under non-cancelable operating leases with an initial term in excess of one year totaled \$172 million as of October 26, 2018.

Purchase Orders and Other Commitments

In the ordinary course of business, we make commitments to 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 manufacturing of our products. A significant portion of our reported purchase commitments arising from these agreements consists of firm, non-cancelable, and unconditional commitments. As of October 26, 2018, we had \$422 million in non-cancelable purchase commitments for inventory. We record a liability for firm, non-cancelable and unconditional purchase commitments for quantities in excess of our future demand forecasts consistent with the valuation of our excess and obsolete inventory. As of October 26, 2018 and April 27, 2018, such liability amounted to \$16 million and \$14 million, respectively, and is included in accrued expenses in our condensed consolidated balance sheets. To the extent that such forecasts are not achieved, our commitments and associated accruals may change.

In addition to inventory commitments with contract manufacturers and component suppliers, we have open purchase orders and contractual obligations associated with our ordinary course of business for which we have not yet received goods or services. As of October 26, 2018, we had \$5 million in construction related obligations and \$187 million in other purchase obligations.

Financing Guarantees

While most of our arrangements for sales include short-term payment terms, from time to time we provide long-term financing to creditworthy customers. We have generally sold receivables financed through these arrangements on a non-recourse basis to third party financing institutions within 10 days of the contracts' dates of execution, and we classify the proceeds from these sales as cash flows from operating activities in our condensed consolidated statements of cash flows. We account for the sales of these receivables as "true sales" as defined in the accounting standards on transfers of financial assets, as we are considered to have surrendered control of these financing receivables. Provided all other revenue recognition criteria have been met, we recognize product revenues for these arrangements, net of any payment discounts from financing transactions, upon product acceptance. We sold \$43 million and \$49 million of receivables during the six months ended October 26, 2018 and October 27, 2017, respectively.

In addition, we enter into arrangements with leasing companies for the sale of our hardware systems products. These leasing companies, in turn, lease our products to end-users. The leasing companies generally have no recourse to us in the event of default by the end-user and we recognize revenue upon delivery to the end-user customer, if all other revenue recognition criteria have been met.

Some of the leasing arrangements described above have been financed on a recourse basis through third-party financing institutions. Under the terms of recourse leases, which are generally three years or less, we remain liable for the aggregate unpaid remaining lease payments to the third-party leasing 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 for recourse leases, we recognize revenues in accordance with our revenue recognition policy, as updated to reflect the adoption of ASC 606. In connection with certain recourse financing arrangements, we receive advance payments associated with undelivered elements that are subject to customer refund rights. We defer revenue associated with these advance payments until the related refund rights expire and we perform the services. As of October 26, 2018 and April 27, 2018, the aggregate amount by which such contingencies exceeded the associated liabilities was not significant. To date, we have not experienced significant losses under our lease financing programs or other financing arrangements.

We have entered into service contracts with certain of our end-user customers that are supported by third-party financing arrangements. If a service contract is terminated as a result of our non-performance under the contract or our failure to comply with the terms of the financing arrangement, we could, under certain circumstances, be required to acquire certain assets related to the service contract or to pay the aggregate unpaid financing payments under such arrangements. As of October 26, 2018, we have not been required to make any payments under these arrangements, and we believe the likelihood of having to acquire a material amount of assets or make payments under these arrangements is remote. The portion of the financial arrangement that represents unearned services revenue is included in deferred revenue and financed unearned services revenue in our condensed consolidated balance sheets.

Legal Contingencies

When a loss is considered probable and reasonably estimable, we record a liability in the amount of our best estimate for the ultimate loss. However, the likelihood of a loss with respect to a particular contingency is often difficult to predict and determining a meaningful estimate of the loss or a range of loss may not be practicable based on the information available and the potential effect of future events and decisions by third parties that will determine the ultimate resolution of the contingency.

We are subject to various legal proceedings and claims that arise in the normal course of business. We may, from time to time, receive claims that we are infringing third parties' intellectual property rights, including claims for alleged patent infringement brought by non-practicing entities. We are currently involved in patent litigations brought by non-practicing entities and other third parties. We believe we have strong arguments that our products do not infringe and/or the asserted patents are invalid, and we intend to vigorously defend against the plaintiffs' claims. However, there is no guarantee that we will prevail at trial and if a jury were to find that our products infringe, we could be required to pay significant monetary damages, and may cause product shipment delays, require us to redesign our products, or require us to enter into royalty or licensing agreements.

Although management at present believes that the ultimate outcome of these proceedings, individually and in the aggregate, will not materially harm our financial position, results of operations, cash flows, or overall trends, legal proceedings are subject to inherent uncertainties, and unfavorable rulings or other events could occur. Unfavorable resolutions could include significant monetary damages. In addition, in matters for which injunctive relief or other conduct remedies are sought, unfavorable resolutions could include an injunction or other order prohibiting us from selling one or more products at all or in particular ways or requiring other remedies. An unfavorable outcome may result in a material adverse impact on our business, results of operations, financial position, and overall trends. No material accrual has been recorded as of October 26, 2018 related to such matters.

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

This section and other parts of this Form 10-Q contain forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that involve risks and uncertainties. Forward-looking statements provide current expectations of future events based on certain assumptions and include any statement that does not directly relate to any historical or current fact. Forward-looking statements also can be identified by words such as "future," "anticipates," "believes," "estimates," "expects," "intends," "will," "would," "could," "can," "may," and similar terms. Forward-looking statements are not guarantees of future performance and the actual results of NetApp, Inc. ("we," "us," or the "Company") may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part II, Item 1A of this Form 10-Q under the heading "Risk Factors," which are incorporated herein by reference. The following discussion should be read in conjunction with our consolidated financial statements as of and for the fiscal year ended April 27, 2018, and the notes thereto, contained in our Annual Report on Form 10-K, and the condensed consolidated financial statements and notes thereto included elsewhere in this Form 10-Q. We assume no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Overview

Our Company

We are the data authority for the hybrid cloud. Digital transformation remains top of mind for executives. In order to successfully digitally transform, data must become the lifeblood of an organization and be used as a business accelerator. Data-driven digital transformations accelerate business outcomes. Together with our partners, we empower global organizations to unleash the full potential of their data to enable new customer touchpoints, create innovative business opportunities and optimize operations.

NetApp delivers a Data Fabric built for the data-driven world. Our Data Fabric simplifies and integrates data management across clouds and on-premises to accelerate digital transformation, enabling our customers to manage, secure and protect their data at the scale needed to accommodate the exponential data growth of the digital world. It delivers integrated data management services and applications for data visibility and insights, data access and control, and data protection and security.

We focus on delivering an exceptional customer experience to become our customers' preferred data partner. NetApp's unique approach to managing data holistically enables organizations to inspire innovation with the cloud, build clouds to accelerate new services, and modernize IT architecture with cloud-connected flash.

With NetApp products and solutions, customers can:

- Continually fuel business growth by delivering data-rich customer experiences through new application deployments that easily use data and services regardless of where they reside or in what form.
- Accelerate digital transformation by developing a next-generation, cloud-architected infrastructure that manages data and services as one integrated resource supporting both public and private clouds.
- Free the resources necessary to fund transformation by deploying the industry's leading flash storage solution, which is highly efficient and scales from the edge to the core to the cloud.

Customers are attracted by the speed and scale benefits of the public cloud but need new data management capabilities to keep control of data as it moves beyond the walls of the enterprise. NetApp believes the hybrid cloud is fast becoming the dominant model for enterprise IT. Whether an organization is targeting an all-cloud, hybrid cloud, or multi-cloud strategy, NetApp Cloud Data Services accelerate the time it takes to deploy or develop an application by making the data requirements seamless to the application layer.

Budget constraints and skill imbalances lead our customers to seek help in integrating, deploying and managing the solutions they need to stay competitive. This drives demand for converged and hyper-converged infrastructure solutions. FlexPod is the converged infrastructure of choice for many of the largest enterprises around the globe. Customers can break free from the limits of first-generation HCI with NetApp HCI and attain guaranteed performance with high levels flexibility, scale, automation, and integration with the Data Fabric.

Flash plays a key role in customers' digital transformation efforts as they seek to gain advantage through greater speed, responsiveness and value from key business applications - all while lowering total cost of ownership. All-flash array technology is the de facto choice for primary application workloads as customers seek performance and economic benefits from replacing hard disk installations. With a highly differentiated and broad portfolio of all-flash and hybrid array offerings, NetApp is well positioned to enable customers to accomplish this transition.

To provide visibility into our transition from older products to our newer, higher growth products and clarity into the dynamics of our product revenue, we have historically grouped our products by "Strategic" and "Mature" solutions. Strategic solutions include Clustered ONTAP, branded E-Series, SolidFire, converged and hyper-converged infrastructure, enterprise software license agreements (ELAs) and other optional add-on software products. Mature solutions include 7-mode ONTAP, add-on hardware and related operating system (OS) software and original

equipment manufacturers (OEM) products. Both our Mature and Strategic product lines include a mix of disk, hybrid and all flash storage media.

Additionally, we provide a variety of services including software maintenance, hardware maintenance and other services including professional services, global support solutions, and customer education and training to help customers most effectively manage their data. Revenues generated by our Cloud Data Services offerings are included in software maintenance revenues.

Financial Results and Key Performance Metrics Overview

The following table provides an overview of some of our key financial metrics (in millions, except per share amounts, percentages and cash conversion cycle):

| | Three Months | | Six Months | |
|--|--------------|---------|------------|---------|
| | Ended | | Ended | |
| | October | October | October | October |
| | 26, | 27, | 26, | 27, |
| | 2018 | 2017 | 2018 | 2017 |
| Net revenues | \$1,517 | \$1,415 | \$2,991 | \$2,736 |
| Gross profit | \$974 | \$900 | \$1,937 | \$1,724 |
| Gross profit margin percentage | 64 % | 64 % | 65 % | 63 % |
| Income from operations | \$286 | \$216 | \$540 | \$356 |
| Income from operations as a percentage of net revenues | 19 % | 15 % | 18 % | 13 % |
| Net income | \$241 | \$174 | \$524 | \$305 |
| Diluted net income per share | \$0.91 | \$0.63 | \$1.96 | \$1.10 |
| Operating cash flows | \$165 | \$314 | \$491 | \$564 |

| | October | April |
|---|---------|---------|
| | 26, | 27, |
| | 2018 | 2018 |
| Deferred revenue and financed unearned services revenue | \$3,206 | \$3,363 |
| Cash conversion cycle (days) | (19) | (14) |

Stock Repurchase Program and Dividend Activity

During the first six months of fiscal 2019, we repurchased 14 million shares of our common stock at an average price of \$77.94 per share, for an aggregate of \$1,061 million. We also declared aggregate cash dividends of \$0.80 per share in that period, for which we paid an aggregate of \$207 million.

Adoption of Revenue Accounting Standard

As of the beginning of fiscal 2019, we adopted the new accounting standard Revenue from Contracts with Customers (ASC 606) using the full retrospective method of adoption. Accordingly, our prior period condensed consolidated financial statements and supplementary data, as presented herein, have been restated to conform to the new rules. As illustrated in Note 5 – Revenue of the Notes to Condensed Consolidated Financial Statements, the overall impact of adoption was not significant to prior periods. However, application of the new rules to our ELAs resulted in approximately \$20 million and \$110 million of product revenues for such arrangements in the second quarter and first six months of fiscal 2019, respectively, that are incremental to the amounts we would have recognized under the old standard. Under ASC 606, we recognize the software license fee component of our ELAs up-front, whereas under the prior rules the software license fee was recognized over the term of the ELA.

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, which require management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, net revenues and expenses, and the disclosure of contingent assets and liabilities. Our estimates are based on historical experience and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. We believe that the accounting estimates employed and the resulting balances are reasonable; however, actual results may differ from these estimates and such differences may be material.

The summary of our significant accounting policies is included under Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations of our fiscal 2018 Form 10-K. An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably could have been used, or if changes in the estimate that are reasonably possible could materially impact the financial statements. There have been no material changes to the critical accounting policies and estimates as filed in such report, except with respect to revenue recognition as a result of the adoption of ASC 606 in the first quarter of fiscal 2019. Refer to Note 5 – Revenue of the Notes to Condensed Consolidated Financial Statements for details.

New Accounting Standards

See Note 2 – Recent Accounting Standards Not Yet Effective of the Notes to Condensed Consolidated Financial Statements for a full description of new accounting pronouncements, including the respective expected dates of adoption and effects on our financial statements.

Results of Operations

Our fiscal year is reported as a 52- or 53-week year that ends on the last Friday in April. Fiscal years 2019 and 2018 are each 52-week years, with 13 weeks in each of their quarters. Unless otherwise stated, references to particular years, quarters, months and periods refer to the Company's fiscal years ended in April and the associated quarters, months and periods of those fiscal years.

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

| | Three Months | | Six Months Ended | |
|---|-------------------------|----------------|------------------|----------------|
| | Ended October 26, | October 27, | October 26, | October 27, |
| | 2018 | 2017 | 2018 | 2017 |
| Revenues: | | | | |
| Product | 60 % | 58 % | 60 % | 57 % |
| Software maintenance | 16 | 16 | 16 | 16 |
| Hardware maintenance and other services | 24 | 26 | 25 | 27 |
| Net revenues | 100 | 100 | 100 | 100 |
| Cost of revenues: | | | | |
| Cost of product | 28 | 28 | 28 | 28 |
| Cost of software maintenance | 1 | — | 1 | — |
| Cost of hardware maintenance and other services | 7 | 8 | 7 | 8 |
| Gross profit | 64 | 64 | 65 | 63 |
| Operating expenses: | | | | |
| Sales and marketing | 27 | 30 | 27 | 31 |
| Research and development | 14 | 14 | 14 | 14 |
| General and administrative | 5 | 5 | 5 | 5 |
| Restructuring charges | — | — | 1 | — |
| Total operating expenses | 45 | 48 | 47 | 50 |
| Income from operations | 19 | 15 | 18 | 13 |
| Other income, net | — | — | 1 | — |
| Income before income taxes | 19 | 16 | 19 | 13 |
| Provision for income taxes | 3 | 3 | 1 | 2 |
| Net income | 16 % | 12 % | 18 % | 11 % |

Percentages may not add due to rounding

Discussion and Analysis of Results of Operations

Overview

Net revenues for the second quarter and first six months of fiscal 2019 were \$1,517 million and \$2,991 million, respectively, reflecting an increase of \$102 million, or 7%, and \$255 million, or 9%, respectively, compared to the corresponding periods of the prior year, reflecting higher product revenues.

Gross profit as a percentage of net revenues for the second quarter increased by half of one percentage point compared to the corresponding period in fiscal 2018, and increased almost two percentage points in the first six months of fiscal 2019 when compared to the corresponding period in fiscal 2018, primarily reflecting higher margins on product revenues. Gross profit margins on product revenues increased one and a half percentage points in the second quarter of fiscal 2019 and four percentage points in the first six months of fiscal 2019 compared to the corresponding periods of fiscal 2018, primarily reflecting high margins on revenue recognized during the current year periods related to the software license components of several ELAs, and, to a lesser extent, higher average selling prices (ASPs).

Sales and marketing, research and development, and general and administrative expenses for the second quarter and the first six months of fiscal 2019 totaled \$688 million, or 45% of net revenues and \$1,378 million, or 46% of net revenues, respectively, representing a decrease of three percentage points and four percentage points when compared to the second quarter and the first six months of fiscal 2019, respectively, primarily due to higher net revenues in the current year periods.

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Net Revenues (in millions, except percentages):

| | Three Months Ended | | | Six Months Ended | | |
|--------------|--------------------|---------|--------|------------------|---------|--------|
| | October | October | | October | October | |
| | 26, | 27, | % | 26, | 27, | % |
| | 2018 | 2017 | Change | 2018 | 2017 | Change |
| Net revenues | \$1,517 | \$1,415 | 7 % | \$2,991 | \$2,736 | 9 % |

The increase in net revenues for the second quarter and first six months of fiscal 2019 compared to the corresponding periods of fiscal 2018 was primarily due to an increase in product revenues of \$94 million and \$242 million, respectively. Product revenues as a percentage of net revenues increased two percentage points and three percentage points in the second quarter and first six months of fiscal 2019, respectively, compared to the corresponding periods of fiscal 2018.

The following customers, each of which is a distributor, accounted for 10% or more of net revenues:

| | Three Months Ended | | Six Months Ended | |
|-------------------------|--------------------|---------|------------------|---------|
| | October | October | October | October |
| | 26, | 27, | 26, | 27, |
| | 2018 | 2017 | 2018 | 2017 |
| Arrow Electronics, Inc. | 24 % | 22 % | 23 % | 23 % |
| Tech Data Corporation | 21 % | 19 % | 19 % | 20 % |

Product Revenues (in millions, except percentages):

| | Three Months Ended | | | Six Months Ended | | |
|------------------|--------------------|---------|--------|------------------|---------|--------|
| | October | October | | October | October | |
| | 26, | 27, | % | 26, | 27, | % |
| | 2018 | 2017 | Change | 2018 | 2017 | Change |
| Product revenues | \$913 | \$819 | 11 % | \$1,788 | \$1,546 | 16 % |

Product revenues are derived through the sale of our strategic and mature solutions, and consist of sales of configured systems, which are bundled hardware and software products, as well as add-on flash, disk and/or hybrid storage and related OS, original equipment manufacturer (OEM) products and add-on hardware and software.

Product revenues from strategic solutions represented 71% of product revenues in the second quarter and first six months of fiscal 2019, compared to 69% in the corresponding periods of the prior year. Product revenues from mature solutions represented 29% of product revenues in the second quarter and first six months of fiscal 2019, compared to 31% in the corresponding periods of the prior year.

Total product revenues from strategic solutions totaled \$649 million in the second quarter of fiscal 2019 reflecting a 15% increase from \$566 million in the second quarter of fiscal 2018. Total product revenues from strategic solutions totaled \$1,261 million in the first six months of fiscal 2019 reflecting a 19% increase from \$1,064 million in the first six months of fiscal 2018. Contributing to these increases was over \$20 million and \$110 million of revenues from the software license component of several ELAs in the second quarter and first six months of fiscal 2019, respectively, which, under ASC 606, were recognized up-front. There were no comparable ELAs in the second quarter or first six months of fiscal 2018. Revenues generated from the sale of optional add-on software, unrelated to ELAs, also increased in the second quarter and first six months of fiscal 2019 compared to the corresponding periods of the prior year.

Total product revenue from mature solutions totaled \$264 million in the second quarter of fiscal 2019 reflecting a 4% increase from \$253 million in the second quarter of fiscal 2018. Total product revenue from mature solutions totaled \$527 million in the first six months of fiscal 2019 reflecting a 9% increase from \$482 million in the first six months of fiscal 2018. These increases are primarily due to an increase in add-on hardware, storage and related OS revenues of 11% and 14% in the second quarter and first six months of fiscal 2019, respectively, compared to the corresponding periods of prior year. Additionally, OEM revenues increased by 6% and 25% in the second quarter and first six months of fiscal 2019, respectively, compared to the corresponding periods of the prior year. These increases were partially offset by our discontinuation of the 7-mode systems in the first quarter of fiscal 2019, reflecting the movement of customers to our newer products.

Software Maintenance Revenues (in millions, except percentages):

| | Three Months Ended | | | Six Months Ended | | |
|-------------------------------|--------------------|---------|--------|------------------|---------|--------|
| | October | October | % | October | October | % |
| | 2018 | 2017 | Change | 2018 | 2017 | Change |
| Software maintenance revenues | \$236 | \$224 | 5% | \$465 | \$447 | 4% |

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Software maintenance revenues are associated with contracts which entitle customers to receive unspecified product upgrades and enhancements on a when-and-if-available basis, bug fixes and patch releases, as well as internet and telephone access to technical support personnel located in our global support centers.

The fluctuations in software maintenance revenues reflect fluctuations in the aggregate contract value of the installed base under software maintenance contracts, which is recognized as revenue ratably over the terms of the underlying contracts.

Hardware Maintenance and Other Services Revenues (in millions, except percentages):

| | Three Months Ended | | | Six Months Ended | | |
|--|--------------------|------------------|----------|------------------|------------------|----------|
| | October 26, 2018 | October 27, 2017 | % Change | October 26, 2018 | October 27, 2017 | % Change |
| Hardware maintenance and other services revenues | \$368 | \$372 | (1)% | \$738 | \$743 | (1)% |

Hardware maintenance and other services revenues include hardware maintenance, professional services, and educational and training services revenues.

Hardware maintenance contract revenues were relatively flat year over year, at \$303 million and \$606 million, respectively, for the second quarter and first six months of fiscal 2019, compared to \$306 million and \$604 million, respectively, for the corresponding periods of the prior year.

Professional services and educational and training services revenues were \$65 million and \$132 million, respectively, for the second quarter and first six months of fiscal 2019, compared to \$66 million and \$139 million, respectively, for the corresponding periods of the prior year.

Revenues by Geographic Area:

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | October 26, 2018 | October 27, 2017 | October 26, 2018 | October 27, 2017 |
| United States, Canada and Latin America (Americas) | 57% | 56% | 57% | 55% |
| Europe, Middle East and Africa (EMEA) | 28% | 30% | 29% | 30% |
| Asia Pacific (APAC) | 15% | 14% | 14% | 14% |

Percentages may not add due to rounding

Americas revenues consist of sales to Americas commercial and U.S. public sector markets. Our geographic distribution of revenues as a percentage of net revenues was relatively consistent in the second quarter and first six months of fiscal 2019 compared to the corresponding periods of fiscal 2018.

Cost of Revenues

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

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

| | Three Months Ended | | | Six Months Ended | | |
|--------------------------|--------------------|--------|-----|------------------|--------|-----|
| | October | | % | October | | % |
| | 2018 | 2017 | | 2018 | 2017 | |
| Cost of product revenues | \$428 | \$ 397 | 8 % | \$826 | \$ 773 | 7 % |

The changes in cost of product revenues consisted of the following (in percentage points of the total change):

| | Three Months Ended Fiscal 2019 to Fiscal 2018 Percentage Change Points | Six Months Ended Fiscal 2019 to Fiscal 2018 Percentage Change Points |
|-----------------|---|---|
| Materials costs | 8 | 6 |
| Other | — | 1 |
| Total change | 8 | 7 |

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Cost of product revenues represented 47% and 46% of product revenues for the second quarter and first six months of fiscal 2019, respectively, compared to 48% and 50% for the corresponding periods of fiscal 2018. Materials costs represented 91% and 89% of product costs for the second quarter and first six months of fiscal 2019, respectively, compared to 91% and 90% in the corresponding periods of fiscal 2018.

Materials costs increased \$31 million and \$47 million in the second quarter and first six months of fiscal 2019, respectively, compared to the corresponding periods of the prior year, primarily due to higher unit volumes of certain products.

Average unit materials costs for Clustered ONTAP systems increased by 12% and 13% in the second quarter and first six months of fiscal 2019, respectively, compared to the corresponding periods of the prior year.

Margins on revenue recognized for strategic solutions were higher during the second quarter and first six months of fiscal 2019 compared to the corresponding periods of fiscal 2018 primarily as a result of the benefit of high margins realized on the software license components of several ELAs, and, to a lesser extent, higher ASPs. Margins for mature products increased slightly in the second quarter and first six months of fiscal 2019 compared to the corresponding periods of the prior year.

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

| | Three Months Ended | | | Six Months Ended | | |
|---------------------------------------|--------------------|------|--------|------------------|-------|--------|
| | October | | | October | | |
| | 26, | 27, | % | 26, | 27, | % |
| | 2018 | 2017 | Change | 2018 | 2017 | Change |
| Cost of software maintenance revenues | \$ 8 | \$ 6 | 33 | \$ 15 | \$ 13 | 15 |

Cost of software maintenance revenues in dollars was relatively flat in the second quarter and first six months of fiscal 2019 compared to the corresponding periods of fiscal 2018 and represented 3% of software maintenance revenues for both periods.

Cost of Hardware Maintenance and Other Services Revenues (in millions, except percentages):

| | Three Months Ended | | | Six Months Ended | | |
|--|--------------------|--------|--------|------------------|--------|--------|
| | October | | | October | | |
| | 26, | 27, | % | 26, | 27, | % |
| | 2018 | 2017 | Change | 2018 | 2017 | Change |
| Cost of hardware maintenance and other services revenues | \$ 107 | \$ 112 | (4) | \$ 213 | \$ 226 | (6) |

Cost of hardware maintenance and other services revenues decreased by \$5 million, or 4%, and \$13 million, or 6%, respectively, for the second quarter and first six months of fiscal 2019 compared to the corresponding periods of fiscal 2018, primarily due to the favorable impact of cost savings initiatives. Costs represented 29% of hardware

maintenance and other services revenues in the second quarter and first six months of fiscal 2019, compared to 30% in the second quarter and first six months of fiscal 2018.

Operating Expenses

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

Compensation costs represent the largest component of operating expenses. Included in compensation costs are salaries, benefits, other compensation-related costs, stock-based compensation expense and employee incentive compensation plan costs.

Total compensation costs included in operating expenses increased by \$5 million and \$10 million in the second quarter and first six months of fiscal 2019, respectively, compared to the corresponding periods of the prior year, each representing an increase of 1%. Stock-based compensation expenses decreased slightly in the current year, while the other components of compensation costs increased slightly. Average headcount was relatively flat in each period.

Sales and Marketing (in millions, except percentages):

| | Three Months Ended | | | Six Months Ended | | |
|------------------------------|--------------------|---------|--------|------------------|---------|--------|
| | October | October | % | October | October | % |
| | 2018 | 2017 | Change | 2018 | 2017 | Change |
| Sales and marketing expenses | \$408 | \$421 | (3)% | \$817 | \$844 | (3)% |

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Sales and marketing expenses consist primarily of compensation costs, commissions, outside services, allocated facilities and information technology (IT) costs, advertising and marketing promotional expense and travel and entertainment expense. The changes in sales and marketing expenses consisted of the following:

| | Three Months Ended Fiscal 2019 to Fiscal 2018 Percentage Change Points | Six Months Ended Fiscal 2019 to Fiscal 2018 Percentage Change Points |
|---------------------------------|---|---|
| Compensation costs | (1) | (1) |
| Facilities and IT support costs | (1) | (2) |
| Other | (1) | — |
| Total change | (3) | (3) |

Compensation costs decreased for the second quarter and first six months of fiscal 2019 compared to the corresponding periods of the prior year, reflecting a 2% decrease in average headcount in each of the current year periods. Facilities and IT support costs decreased in fiscal 2019 primarily due to cost containment efforts. Commissions expense was relatively consistent in each of the respective comparative periods.

Research and Development (in millions, except percentages):

| | Three Months Ended October 26, 27, % | | | Six Months Ended October 26, 27, % | | |
|-----------------------------------|---|-------|--------|---|-------|--------|
| | 2018 | 2017 | Change | 2018 | 2017 | Change |
| Research and development expenses | \$211 | \$194 | 9 % | \$419 | \$387 | 8 % |

Research and development expenses consist primarily of compensation costs, allocated facilities and IT costs, depreciation, equipment and software-related costs, prototypes, non-recurring engineering charges and other outside services costs. Changes in research and development expense consisted of the following:

| Three Months Ended Fiscal 2019 to Fiscal 2018 | Six Months Ended Fiscal 2019 to Fiscal 2018 |
|---|---|
|---|---|

| | Percentage Change Points | Percentage Change Points |
|---|--------------------------------|--------------------------------|
| Compensation costs | 5 | 5 |
| Development projects and outside services | 3 | 3 |
| Other | 1 | — |
| Total change | 9 | 8 |

The increase in compensation costs for the second quarter and first six months of fiscal 2019 compared to the corresponding periods in the prior year was attributable to an increase in average headcount of 6% and 7%, respectively, resulting in higher salaries, benefits and incentive compensation expense, partially offset by slightly lower stock-based compensation expense. The increase in headcount reflects our investment in additional engineering resources to support the expansion and enhancement of products and solutions targeted at our most important customer and market opportunities. Development projects and outside services for the second quarter and first six months of fiscal 2019 increased as a result of higher spending on materials and services associated with engineering activities to develop new products and enhance existing ones.

General and Administrative (in millions, except percentages):

| | Three Months Ended | | | Six Months Ended | | |
|-------------------------------------|--------------------|----------------|-------------|------------------|----------------|-------------|
| | October 26, | October 27, | % Change | October 26, | October 27, | % Change |
| General and administrative expenses | \$69 | \$ 69 | —% | \$142 | \$ 137 | 4 % |

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General and administrative expenses consist primarily of compensation costs, professional and corporate legal fees, outside services and allocated facilities and IT support costs. Changes in general and administrative expense consisted of the following:

| | Three Months Ended Fiscal 2019 to Fiscal 2018 Percentage Change Points | Six Months Ended Fiscal 2019 to Fiscal 2018 Percentage Change Points |
|--|---|---|
| Compensation costs | 1 | 1 |
| Professional and legal fees and outside services | (3) | (1) |
| Facilities and IT support costs | 2 | 2 |
| Other | — | 2 |
| Total change | — | 4 |

The increase in compensation costs for the second quarter and first six months of fiscal 2019 compared to the corresponding periods of the prior year was attributable to a slight increase in average headcount, while the increase in facilities and IT support costs was primarily due to higher spending levels on IT projects. The decrease in professional and legal fees and outside services expense in the second quarter and the first six months of fiscal 2019 was primarily due to the lower spending levels on projects.

Restructuring Charges (in millions, except percentages):

| | Three Months Ended October 26, 27, | % Change | Six Months Ended October 26, 27, | % Change |
|-----------------------|--|----------|--|----------|
| Restructuring charges | \$— | —NM | \$19 | —NM |

NM – Not Meaningful

In the first quarter of fiscal 2019, we announced a restructuring plan (the May 2018 Plan) to reduce costs and redirect resources to our highest return activities, which included a reduction in our global workforce of less than 2%. Charges related to the plan consisted primarily of employee severance-related costs. Substantially all activities under the plan have been completed. See Note 11 – Restructuring Charges of the Notes to Condensed Consolidated Financial Statements for more details.

Other Income, Net (in millions, except percentages)

The components of other income, net were as follows:

| | Three Months Ended | | | Six Months Ended | | |
|-------------------|--------------------|-------|-------|------------------|-------|-----|
| | October | | % | October | | % |
| | 2018 | 2017 | | 2018 | 2017 | |
| Interest income | \$21 | \$ 19 | 11 | \$46 | \$ 35 | 31 |
| Interest expense | (14) | (17) | (18) | (28) | (30) | (7) |
| Other income, net | — | 4 | (100) | 7 | 6 | 17 |
| Total | \$7 | \$ 6 | 17 | \$25 | \$ 11 | 127 |

Interest income increased in the second quarter and first six months of fiscal 2019 compared to the corresponding periods of the prior year, primarily due to a shift in our investment portfolio to higher-yielding investments, partially offset by a decrease in the size of the portfolio. Interest expense declined in the current year periods due to a reduction in the average amount of interest-bearing debt outstanding.

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

| | Three Months Ended | | | Six Months Ended | | |
|----------------------------|--------------------|-------|---|------------------|-------|------|
| | October | | % | October | | % |
| | 2018 | 2017 | | 2018 | 2017 | |
| Provision for income taxes | \$52 | \$ 48 | 8 | \$41 | \$ 62 | (34) |

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Our effective tax rate for the second quarter of fiscal 2019 was 17.7% compared to an effective tax rate of 21.6% for the second quarter of fiscal 2018. Our effective tax rate for the first six months of fiscal 2019 was 7.3% compared to an effective tax rate of 16.9% for the corresponding period of fiscal 2018. Our effective tax rates reflect the impact of a significant amount of our earnings, primarily income from our European operations which are headquartered in the Netherlands, being taxed in foreign jurisdictions at rates below the U.S. statutory tax rate. Our effective tax rate decreased for the second quarter of fiscal 2019 compared to the corresponding period in the prior year primarily due the reduction of the federal income tax rate under U.S. tax reform and discrete impacts related to stock-based compensation. Our effective tax rate decreased for the first six months of fiscal 2019 compared to the corresponding period in the prior year primarily due to the recognition of a \$34 million discrete tax benefit for adjustments to certain intercompany transactions resulting from the retrospective application of the new revenue standard, increased discrete benefits for stock-based compensation, and the reduction in the federal income tax rate.

On December 22, 2017, the Tax Cuts and Jobs Act (“TCJA”) was enacted into law. The TCJA made significant changes to the U.S. corporate income tax system including a reduction of the U.S. federal corporate income tax rate from 35% to 21%, the imposition of a one-time transition tax on deferred foreign earnings, and the creation of new taxes on certain foreign-sourced earnings. As of October 26, 2018, we have not fully completed the accounting for the tax impacts of the TCJA. No significant adjustments to prior period estimates or positions have been made in the current period. The provisional amounts recorded are based on reasonable estimates and our current interpretation and understanding of the TCJA. The final impacts of U.S. tax reform may differ, possibly materially, due to factors such as the issuance of further regulatory guidance, changes in interpretations, and the collection and analysis of additional information. The Company is also still evaluating the effects of the TCJA’s global minimum tax on intangible low-taxed income (“GILTI”) and has not yet made an accounting policy election to either account for the tax under a period cost method or a deferred method. For the first six months ended October 26, 2018, we have accounted for the GILTI tax under a period cost method as we continue to evaluate potential impacts. In accordance with Staff Accounting Bulletin 118, we will complete the accounting of the tax effects of the TCJA within the measurement period not to extend beyond one year from the enactment date.

As of October 26, 2018, we had \$356 million of gross unrecognized tax benefits. Inclusive of penalties, interest and certain income tax benefits, \$306 million would affect our provision for income taxes if recognized, and \$324 million has been recorded in other long-term liabilities.

We continue to monitor the progress of ongoing discussions with tax authorities and the impact, if any, of the expected expiration of the statute of limitations in various taxing jurisdictions. We believe that within the next 12 months, it is reasonably possible that either certain audits will conclude, certain statutes of limitations will lapse, or both. As a result of uncertainties regarding tax audits and their possible outcomes, an estimate of the range of possible impacts to unrecognized tax benefits in the next twelve months cannot be made at this time.

Liquidity, Capital Resources and Cash Requirements

| | October 26, | April 27, |
|---|----------------|--------------|
| (In millions, except percentages) | 2018 | 2018 |
| Cash, cash equivalents and short-term investments | \$ 4,299 | \$ 5,391 |
| Principal amount of debt | \$ 1,800 | \$ 1,935 |

The following is a summary of our cash flow activities:

| | Six Months Ended | |
|---|---------------------|----------------|
| | October 26, | October 27, |
| (In millions) | 2018 | 2017 |
| Net cash provided by operating activities | \$491 | \$ 564 |
| Net cash provided by (used in) investing activities | 381 | (92) |
| Net cash provided by (used in) financing activities | (1,429) | 601 |
| Effect of exchange rate changes on cash, cash equivalents and restricted cash | (25) | 13 |
| Net increase (decrease) in cash, cash equivalents and restricted cash | \$(582) | \$ 1,086 |

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Cash Flows

As of October 26, 2018, our cash, cash equivalents and short-term investments were \$4.3 billion, a decrease of \$1.1 billion from April 27, 2018. The decrease was primarily due to \$1.1 billion paid for the repurchase of our common stock, \$207 million used for the payment of dividends, \$135 million used for the net repayment of commercial paper notes, and \$107 million in purchases of property and equipment, partially offset by \$491 million of cash provided by operating activities. Working capital decreased by \$1.3 billion to \$2.2 billion as of October 26, 2018 compared to April 27, 2018 primarily due to the decreases in cash, cash equivalents and short-term investments discussed above, and the reclassification of \$400 million principal amount of our senior notes to current liabilities.

Cash Conversion Cycle

The following table presents the components of our cash conversion cycle:

| | Three Months Ended | | |
|---|--------------------|-------|---------|
| | October | April | October |
| | 26, | 27, | 27, |
| (In days) | 2018 | 2018 | 2017 |
| Days sales outstanding ⁽¹⁾ | 46 | 58 | 39 |
| Days inventory outstanding ⁽²⁾ | 14 | 18 | 18 |
| Days payables outstanding ⁽³⁾ | (79) | (90) | (67) |
| Cash conversion cycle ⁽⁴⁾ | (19) | (14) | (10) |

Days may not add due to rounding

- ⁽¹⁾ Days sales outstanding, referred to as DSO, calculates the average collection period of our receivables. DSO is based on ending accounts receivable and net revenue for each period. DSO is calculated by dividing accounts receivable by average net revenue per day for the current quarter (91 days for each of the quarters presented above). DSO for the second quarter of fiscal 2019 increased compared to the corresponding period of fiscal 2018 due to one of our major distributors choosing not to take advantage of an early payment discount in the current quarter, while it decreased compared to the fourth quarter of fiscal 2018 due to lower seasonal invoicing levels and more favorable shipping linearity.
- ⁽²⁾ Days inventory outstanding, referred to as DIO, measures the average number of days from procurement to sale of our products. DIO is based on ending inventory and cost of revenues for each period. DIO is calculated by dividing ending inventory by average cost of revenues per day for the current quarter. DIO for the second quarter of fiscal 2019 decreased compared to the corresponding period of fiscal 2018 and the fourth quarter of fiscal 2018, primarily due to lower levels of purchased components and finished goods, respectively, on hand at the end of the current quarter.
- ⁽³⁾ Days payables outstanding, referred to as DPO, calculates the average number of days our payables remain outstanding before payment. DPO is based on ending accounts payable and cost of revenues for each period. DPO is calculated by dividing accounts payable by average cost of revenues per day for the current quarter. DPO for the second quarter of fiscal 2019 increased compared to the corresponding period of fiscal 2018, due to differences in the timing of purchases from and payments to our suppliers. DPO for the second quarter of fiscal 2019 decreased compared to the fourth quarter of 2018, primarily due to the timing of purchases from contract manufacturers.
- ⁽⁴⁾ The cash conversion cycle is the sum of DSO and DIO less DPO. Items which may cause the cash conversion cycle in a particular period to differ include, but are not limited to, changes in business mix, changes in payment terms (including extended payment terms from suppliers), the extent of shipment linearity, seasonal trends and the timing

of revenue recognition and inventory purchases within the period.

Cash Flows from Operating Activities

During the first six months of fiscal 2019, we generated cash from operating activities of \$491 million, reflecting net income of \$524 million, adjusted by non-cash depreciation and amortization of \$98 million, and stock-based compensation of \$78 million, compared to \$564 million of cash generated from operating activities during the first six months of fiscal 2018.

Changes in assets and liabilities in the first six months of fiscal 2019 included the following:

- Accounts receivable decreased \$269 million, reflecting lower DSO.
- Accounts payable decreased \$127 million, reflecting lower DPO.
- Accrued expenses decreased \$162 million, primarily due to employee compensation payouts related to fiscal year 2018 commissions and incentive compensation plans.
- Deferred revenue and financed unearned services revenue decreased \$129 million, primarily due to a decrease in deferred software and hardware maintenance contract revenues reflecting the seasonality of maintenance contract renewal activities.
- Long-term taxes payable decreased \$63 million, primarily due to transition taxes associated with U.S. tax reform.

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

Cash Flows from Investing Activities

During the first six months of fiscal 2019, we generated \$489 million from maturities and sales of investments, net of purchases, and paid \$107 million for capital expenditures, compared to \$48 million and \$65 million, respectively, during the first six months of fiscal 2018.

Cash Flows from Financing Activities

During the first six months of fiscal 2019, we used \$1.1 billion for the repurchase of fourteen million shares of our common stock, \$207 million for the payment of dividends, and \$135 million for the repayment of commercial paper notes, net, compared to \$300 million used for the repurchase of seven million shares of common stock, \$108 million used for the payment of dividends, \$218 million generated from issuances of commercial paper notes, net, and \$795 million generated from the issuance of long-term debt during the first six months of fiscal 2018.

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, accounts payable and inventories, the timing and amount of stock repurchases and payment of cash dividends, the impact of foreign exchange rate changes, our ability to effectively integrate acquired products, businesses and technologies and the timing of repayments of our debt. Based on past performance and our current business outlook, we believe that our sources of liquidity, including potential future issuances of debt, equity or other securities, will satisfy our working capital needs, capital expenditures, investment requirements, stock repurchases, cash dividends, contractual obligations, commitments, principal and interest payments on our debt 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 or enter into new financing arrangements. 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.

Liquidity

Our principal sources of liquidity as of October 26, 2018 consisted of cash, cash equivalents and short-term investments, cash we expect to generate from operations, and our commercial paper program and related credit facility.

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

| | October 26, 2018 | April 27, 2018 |
|---------------------------|------------------------|----------------------|
| Cash and cash equivalents | \$ 2,359 | \$ 2,941 |
| Short-term investments | 1,940 | 2,450 |
| Total | \$ 4,299 | \$ 5,391 |

As of October 26, 2018 and April 27, 2018, \$3.9 billion and \$4.5 billion, respectively, of cash, cash equivalents and short-term investments were held by various foreign subsidiaries and were generally based in U.S. dollar-denominated holdings, while \$0.4 billion and \$0.9 billion, respectively, were available in the U.S. at the end of each period. The TCJA imposes a one-time transition tax on substantially all accumulated foreign earnings through December 31, 2017, and generally allows companies to make distributions of foreign earnings without incurring additional federal taxes. As a part of the provisional estimates recorded for the impacts of the TCJA, we have reviewed our projected global cash requirements and have determined that certain historical and future foreign earnings will no longer be

indefinitely reinvested.

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, service interest and principal payments on our debt, fund our stock repurchase program, and pay dividends, as and if declared.

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 October 26, 2018.

Our investment portfolio 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 the market risk of our investment portfolio. We routinely monitor our financial exposure to both sovereign and non-sovereign borrowers and counterparties. We utilize a variety of planning and financing strategies in an effort to ensure our worldwide cash is available when and where it is needed. Based on past performance and current expectations, we believe our cash and cash equivalents, investments, cash generated from operations, and ability to access capital markets and committed credit lines will satisfy, through at least the next 12 months, our liquidity requirements, both in total

and domestically, including the following: working capital needs, capital expenditures, stock repurchases, cash dividends, contractual obligations, commitments, principal and interest payments on debt, and other liquidity requirements associated with our operations. We also have an automatic shelf registration statement on file with the Securities and Exchange Commission (SEC). We may in the future offer an additional unspecified amount of debt, equity and other securities.

Senior Notes

The following table summarizes the principal amount of our Senior Notes as of October 26, 2018 (in millions):

| | |
|---------------------------------------|----------------|
| 2.00% Senior Notes Due September 2019 | \$400 |
| 3.375% Senior Notes Due June 2021 | 500 |
| 3.25% Senior Notes Due December 2022 | 250 |
| 3.30% Senior Notes Due September 2024 | 400 |
| Total | \$1,550 |

Interest on the Senior Notes is payable semi-annually. For further information on the underlying terms, see Note 8 – Financing Arrangements of the Notes to Condensed Consolidated Financial Statements.

Commercial Paper Program and Credit Facility

We have a commercial paper program (the Program), under which we may issue unsecured commercial paper notes. Amounts available under the Program may be borrowed, repaid and re-borrowed, with the aggregate face or principal amount of the notes outstanding under the Program at any time not to exceed \$1.0 billion. The maturities of the notes can vary, but may not exceed 397 days from the date of issue. The notes are sold under customary terms in the commercial paper market and may be issued at a discount from par or, alternatively, may be sold at par and bear interest at rates dictated by market conditions at the time of their issuance. The proceeds from the issuance of the notes are used for general corporate purposes. As of October 26, 2018, we had commercial paper notes outstanding with an aggregate principal amount of \$250 million, a weighted-average interest rate of 2.45% and maturities ranging from 4 days to 31 days.

In connection with the Program, we have a senior unsecured credit agreement that expires on December 10, 2021. The credit agreement provides a \$1.0 billion revolving unsecured credit facility that serves as a back-up for the Program. Proceeds from the facility may also be used for general corporate purposes, providing another potential source of liquidity to the extent that the credit facility exceeds the outstanding debt issued under the Program. The credit agreement also includes options that allow us to request an increase in the facility of up to an additional \$300 million and to extend its maturity date for two additional one-year periods, both subject to certain conditions. As of October 26, 2018, we were in compliance with all associated covenants in this agreement. No amounts were drawn against this facility during any of the periods presented.

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 anticipate capital expenditures for the remainder of fiscal 2019 to be between \$100 million and \$150 million.

Dividends and Stock Repurchase Program

On November 14, 2018, we declared a cash dividend of \$0.40 per share of common stock, payable on January 23, 2019 to holders of record as of the close of business on January 4, 2019.

Our Board of Directors has authorized the repurchase of up to \$13.6 billion of our common stock under our stock repurchase program. Under this program, we may purchase shares of our outstanding common stock through solicited or unsolicited transactions in the open market, in privately negotiated transactions, through accelerated share repurchase programs, pursuant to a Rule 10b5-1 plan or in such other manner as deemed appropriate by our management. The stock repurchase program may be suspended or discontinued at any time. Since the May 13, 2003 inception of this program through October 26, 2018, we repurchased a total of 298 million shares of our common stock at an average price of \$35.87 per share, for an aggregate purchase price of \$10.7 billion. As of October 26, 2018, the remaining authorized amount for stock repurchases under this program was \$2.9 billion.

The timing and amount of stock repurchase transactions and future dividends will depend on market conditions, corporate business and financial considerations and regulatory requirements.

Contractual Obligations

Operating Lease Commitments

As of October 26, 2018, future annual minimum lease payments under non-cancelable operating leases with an initial term in excess of one year totaled \$172 million.

Purchase Orders and Other Commitments

In the ordinary 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. A significant portion of our reported purchase commitments arising from these agreements consists of firm, non-cancelable, and unconditional commitments. As of October 26, 2018, we had \$422 million in non-cancelable purchase commitments for inventory. We record a liability for firm, non-cancelable and unconditional purchase commitments for quantities in excess of our future demand forecasts consistent with the valuation of our excess and obsolete inventory. To the extent that such forecasts are not achieved, our commitments and associated accruals may change.

In addition to inventory commitments with contract manufacturers and component suppliers, we have open purchase orders and construction related obligations associated with our ordinary course of business for which we have not received goods or services. As of October 26, 2018, we had \$5 million in construction related obligations and \$187 million in other purchase obligations.

Unrecognized Tax Benefits

As of October 26, 2018, our liability for uncertain tax positions was \$324 million, including interest, penalties and certain income tax benefits. Due to uncertainties regarding tax audits and their possible outcomes, we are unable to make reasonably reliable estimates of the period of cash settlement with the taxing authorities.

Financing Guarantees

While most of our arrangements for sales include short-term payment terms, from time to time we provide long-term financing to creditworthy customers. We have generally sold receivables financed through these arrangements on a non-recourse basis to third party financing institutions within 10 days of the contracts' dates of execution, and we classify the proceeds from these sales as cash flows from operating activities in our condensed consolidated statements of cash flows. We account for the sales of these receivables as "true sales" as defined in the accounting standards on transfers of financial assets, as we are considered to have surrendered control of these financing receivables. Provided all other revenue recognition criteria have been met, we recognize product revenues for these arrangements, net of any payment discounts from financing transactions, upon product acceptance. We sold \$43 million and \$49 million of receivables during the six months ended October 26, 2018 and October 27, 2017, respectively.

In addition, we enter into arrangements with leasing companies for the sale of our hardware systems products. These leasing companies, in turn, lease our products to end-users. The leasing companies generally have no recourse to us in the event of default by the end-user and we recognize revenue upon delivery to the end-user customer, if all other revenue recognition criteria have been met.

Some of the leasing arrangements described above have been financed on a recourse basis through third-party financing institutions. Under the terms of recourse leases, which are generally three years or less, we remain liable for the aggregate unpaid remaining lease payments to the third-party leasing 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 for recourse leases, we recognize revenues in accordance with our revenue recognition policy, as updated to reflect the adoption of ASC 606. In connection with certain recourse financing arrangements, we receive advance payments associated with undelivered elements that are subject to customer refund rights. As of October 26, 2018 and April 28, 2017, the aggregate amount by which such contingencies exceeded the associated liabilities was not significant. To date, we have not experienced significant losses under our lease financing programs or other financing arrangements.

We have entered into service contracts with certain of our end-user customers that are supported by third-party financing arrangements. If a service contract is terminated as a result of our non-performance under the contract or our failure to comply with the terms of the financing arrangement, we could, under certain circumstances, be required to acquire certain assets related to the service contract or to pay the aggregate unpaid payments under such arrangements. As of October 26, 2018, we have not been required to make any payments under these arrangements, and we believe the likelihood of having to acquire a material amount of assets or make payments under these arrangements is remote. The portion of the financial arrangement that represents unearned services revenue is included in deferred revenue and financed unearned services revenue in our condensed consolidated balance sheets.

Indemnification Agreements

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.

Legal Contingencies

We are subject to various legal proceedings and claims which arise in the normal course of business. See further details on such matters in Note 15 – Commitments and Contingencies of the Notes to Condensed Consolidated Financial Statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

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

Interest Rate Risk

Fixed Income Investments — As of October 26, 2018, we had fixed income debt investments of \$2.0 billion. Our investment portfolio primarily consists of investments with original maturities greater than three months at the date of purchase, which are classified as available-for-sale investments. These investments, which consist primarily of corporate bonds, U.S. Treasury and government debt securities and certificates of deposit, are subject to interest rate and interest income risk and will decrease in value if market interest rates increase. Conversely, declines in interest rates, including the impact from lower credit spreads, could have a material adverse impact on interest income for our investment portfolio. A hypothetical 100 basis point increase in market interest rates from levels as of October 26, 2018 would have resulted in a decrease in the fair value of our fixed-income securities of approximately \$47 million. 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 monitor and evaluate our investment portfolio on a quarterly basis for any other-than-temporary impairments.

Debt — As of October 26, 2018, we have outstanding \$1.6 billion aggregate principal amount of Senior Notes. We carry these instruments at face value less unamortized discount on our condensed consolidated balance sheets. Since these instruments bear interest at fixed rates, we have no financial statement risk associated with changes in interest rates. However, the fair value of these instruments fluctuates when interest rates change. See Note 8 – Financing Arrangements of the Notes to Condensed Consolidated Financial Statements for more information.

Credit Facility — We are exposed to the impact of changes in interest rates in connection with our \$1.0 billion five-year revolving credit facility. Borrowings under the facility accrue interest at rates that vary based on certain market rates and our credit rating on our Senior Notes. Consequently, our interest expense would fluctuate with any changes in these market interest rates or in our credit rating if we were to borrow any amounts under the credit facility. As of October 26, 2018, no amounts were outstanding under the credit facility.

Foreign Currency Exchange Rate Risk

We hedge risks associated with certain foreign currency transactions to minimize the impact of changes in foreign currency exchange rates on earnings. We utilize foreign currency exchange forward and option contracts to hedge against the short-term impact of foreign currency fluctuations on certain foreign currency denominated monetary assets and liabilities. We also use foreign currency exchange forward contracts to hedge foreign currency exposures related to forecasted sales transactions denominated in certain foreign currencies. These derivatives are designated and qualify as cash flow hedges under accounting guidance for derivatives and hedging.

We do not enter into foreign currency exchange contracts for speculative or trading purposes. In entering into foreign currency exchange forward and option contracts, we have assumed the risk that might arise from the possible inability

of counterparties to meet the terms of the contracts. We attempt to limit our exposure to credit risk by executing foreign currency exchange contracts with creditworthy multinational commercial banks. All contracts have a maturity of less than six months. See Note 10 – Derivatives and Hedging Activities of the Notes to Condensed Consolidated Financial Statements for more information regarding our derivatives and hedging activities.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

The phrase “disclosure controls and procedures” refers to 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 rules and forms of the U.S. Securities and Exchange Commission (SEC). 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 October 26, 2018, 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 the information required to be disclosed in our 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.

Changes in Internal Control Over Financial Reporting

There has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) identified in connection with our evaluation that occurred during the second quarter of fiscal 2019 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings.

For a discussion of legal proceedings, see Note 15 – Commitments and Contingencies of the Notes to Condensed Consolidated Financial Statements.

Item 1A. Risk Factors.

The following descriptions of risk factors includes any material changes to, and supersedes the description of risk factors associated with, the Company's business previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended April 27, 2018 (the "2018 Form 10-K") filed with the U.S. Securities and Exchange Commission (the "SEC") under the heading "Risk Factors." Our business, financial condition and operating results can be affected by a number of factors, whether currently known or unknown, including but not limited to those described below, any one or more of which could, directly or indirectly cause our actual results of operations and financial condition to vary materially from the past, or from anticipated future, results of operations and financial condition. Any of these factors, in whole or in part, could materially and adversely affect our business, financial condition, results of operations and common stock price.

The following discussion of risk factors contains forward-looking statements. These risk factors may be important to understanding any statement in this Form 10-Q or elsewhere. The following information should be read in conjunction with the condensed consolidated financial statements and the related notes in Part I, Item 1 – Financial Statements and Part I, Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-Q.

The following discussion reflects our current judgment regarding the most significant risks we face. These risks can and will change in the future.

Our business may be harmed by trends in the networked storage hardware market or if we are unable to keep pace with rapid industry, technological and market changes.

Our industry and the markets in which we compete have historically experienced significant growth due to the increase in the demand for storage and data management solutions by consumers, enterprises and government bodies around the world, and the resultant purchases of storage and data management solutions to address this demand. However, despite continued data growth, the networked storage hardware market experienced a decline in each of the last three calendar years due to a combination of customers delaying purchases in the face of technology transitions, increasing adoption of cloud environments built on commodity hardware, increased storage efficiency, and changing economic and business environments. While customers are navigating through their information technology (IT) transformations, which leverage modern architectures and hybrid cloud environments, they are also reducing IT budgets, looking for simpler solutions, and rethinking how they consume IT. This evolution is diverting spending towards transformational projects and architectures like flash, hybrid cloud, IT as a service, converged infrastructure,

and software defined storage. Our business may be adversely impacted if we are unable to keep pace with rapid industry, technological or market changes or if our Data Fabric strategy is not accepted in the marketplace. As a result of these and other factors discussed in the report, our revenue may decline as it did in fiscal years 2015, 2016 and 2017, on a year-over-year basis. The future impact of these trends on both short-term and long-term growth patterns is uncertain. If the general historical rate of industry growth declines, if the growth rates of the specific markets in which we compete decline, and/or if the consumption model of storage changes and our new and existing products, services and solutions do not receive customer acceptance, our business, operating results and financial condition could suffer.

If we are unable to develop, introduce and gain market acceptance for new products while managing the transition from older products, or if we cannot provide the expected level of quality, service and support for our new products, our business, operating results and financial condition could be harmed.

Our future growth depends upon the successful development and introduction of new hardware and software products and related services. Due to the complexity of storage software, subsystems and appliances and the difficulty in gauging the engineering effort required to produce new products and services, such products and services are subject to significant technical and quality control risks.

If we are unable, for technological, customer reluctance or other reasons, to develop, introduce and gain market acceptance for new products and services, as and when required by the market and our customers, our business, operating results and financial condition could be materially and adversely affected.

New or additional product introductions, including new hardware and software offerings, such as NetApp HCI, Cloud Volumes ONTAP, and new all flash storage products, subject us to additional financial and operational risks, including our ability to forecast customer preferences and/or demand, our ability to successfully manage the transition from older products and solutions, our ability to forecast the impact of customers' demand for new products and solutions or the products being replaced, and our ability to manage production capacity to meet the demand for new products. In addition, as new or enhanced products are introduced, we must also

avoid excessive levels of older product inventories and related components and ensure that enough supplies of new products can be delivered to meet customers' demands. Further risks inherent in new product and solutions introductions include the uncertainty of price-performance relative to products of competitors, competitors' responses to the introductions, delays in sales caused by the desire of customers to evaluate new products for extended periods of time and our partners' investment in selling our new products and solutions. If these risks are not managed effectively, we could experience material risks to our operations, financial condition and business model.

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.

Our new consumption-based business models may adversely affect our revenues and profitability.

We offer customers a full range of consumption models, including the deployment of our software through our subscription and cloud-based Software as a Service (SaaS), and utility pricing and managed services offerings for our hardware and software systems. These business models continue to evolve, and we may not be able to compete effectively, generate significant revenues or maintain the profitability of our consumption-based offerings. Additionally, the increasing prevalence of cloud and SaaS delivery models offered by us and our competitors may unfavorably impact the pricing of our on-premise hardware and software offerings and could have a dampening impact on overall demand for our on-premise hardware and software product and service offerings, which could reduce our revenues and profitability, at least in the near term. If we do not successfully execute our consumption model strategy or anticipate the needs of our customers, our revenues and profitability could decline.

As customer demand for our consumption model offerings increases, we will experience differences in the timing of revenue recognition between our traditional hardware and software license arrangements, including for the software license components of enterprise software license agreements, (for which revenue is generally recognized in full at the time of delivery), relative to our consumption model offerings, (for which revenue is generally recognized ratably over the term of the arrangement). We incur certain expenses associated with the infrastructure and marketing of our consumption model offerings in advance of our ability to recognize the revenues associated with these offerings.

Our sales and distribution structure makes forecasting revenues difficult and, if disrupted, could harm our operating results.

Our business and sales models make revenues difficult to forecast. We sell to a variety of customers directly and through various channels, with a corresponding variety of sales cycles, and we recently reorganized our sales resources to improve the alignment of those resources with customer and market opportunities. The reorganization of our sales resources could result in short or long-term disruption of our sales cycles and harm our operating results. The majority of our sales are made and/or fulfilled indirectly through channel partners, including value-added resellers, systems integrators, distributors, original equipment manufacturers (OEMs) and strategic business partners, which now include hyperscalers. This structure significantly complicates our ability to forecast future revenue, especially within any particular fiscal quarter or year. Moreover, our relationships with our indirect channel partners and strategic business partners are critical to our success. The loss of one or more of our key indirect channel partners in a given geographic area or the failure of our channel or strategic partners to promote our products could harm our operating results. Qualifying and developing new indirect channel partners typically require a significant investment of time and resources before acceptable levels of productivity are met. If we fail to maintain our relationships with our indirect channel partners and strategic partners, if their financial condition, business or customer relationships were to weaken, if they fail to comply with legal or regulatory requirements, or if we were to cease to do business with them for these or other reasons, our business, operating results and financial condition could be harmed.

Increasing competition and industry consolidation could harm our business and operating results.

The storage and data management markets are intensely competitive and are characterized by rapidly changing technology and fragmentation. We compete with many companies in the markets we serve, including established public companies, newly public companies with a strong flash focus, and new market entrants addressing the growing opportunity for hyper-converged systems. Some offer a broad spectrum of IT products and services (full-stack vendors) and others offer a more limited set of storage and data management products or services. Technology trends, such as the emergence of hosted or public cloud storage, SaaS and flash storage are driving significant changes in storage architectures and solution requirements. Cloud service providers provide customers storage for their data centers on demand, without requiring a capital expenditure, which meets rapidly evolving business needs and has changed the competitive landscape.

Competitors may develop new technologies or products in advance of us or establish business models or technologies disruptive to us. By extending our flash, converged infrastructure and cloud storage offerings, we are competing in new segments with both traditional competitors and new competitors, particularly smaller emerging storage vendors. The longer-term potential and competitiveness of these emerging vendors remains to be determined. In cloud and converged infrastructure, we also compete with large well-established competitors.

For additional information regarding our competitors, see the section entitled “Competition” contained in Item 1 – Business of Part I of the 2018 Form 10-K. It is possible that new competitors or alliances among competitors might emerge and rapidly acquire significant market share or buying power. An increase in industry consolidation might result in stronger competitors that are better able to compete as full-stack vendors for customers and achieve increased economies of scale in the supply chain. For example, in October 2016, Dell Inc. and EMC Corp. consummated their agreement to merge. Also, in April 2017, HP Enterprise completed their acquisition of Nimble Storage. In addition, current and potential competitors have established or might establish cooperative relationships among themselves or with third parties, including some of our partners or suppliers.

Continuing uncertain economic and political conditions restrict our visibility and may harm our operating results, including our revenue growth and profitability.

Continuing global economic uncertainty, political conditions and fiscal challenges in the United States (U.S.) and abroad have, among other things, limited our ability to forecast future demand for our products, contributed to increased periodic volatility in the computer, storage and networking industries at large, as well as the IT market, and could constrain future access to capital for our suppliers, customers and partners. The impacts of these circumstances are global and pervasive, and the timing and nature of any ultimate resolution of these matters remain highly uncertain. Consequently, we expect these concerns to challenge our business for the foreseeable future, which could cause harm to our operating results. Such conditions have resulted, and may in the future again result, in failure to meet our forecasted financial expectations and to achieve historical levels of revenue growth.

Our quarterly operating results may fluctuate materially, which could harm our common stock price.

Our operating results have fluctuated in the past and will continue to do so, sometimes materially. All of the matters discussed in this Risk Factors section could impact our operating results in any fiscal quarter or year. In addition to those matters, we face the following issues, which could impact our quarterly results:

• 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; and

• 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.

If our operating results fall below our forecasts and the expectations of public market analysts and investors, the trading price of our common stock may decline.

Our gross margins vary.

Our gross margins reflect a variety of factors, including competitive pricing, component and product design, and the volume and relative mix of revenues from product, software maintenance, hardware maintenance and other services. Increased component costs, increased pricing and discounting pressures, the relative and varying rates of increases or decreases in component costs and product prices, or changes in the mix of revenue or decreased volume from product, software maintenance, hardware maintenance and other services could harm our revenues, gross margins or earnings. Our gross margins are also impacted by the cost of any materials that are of poor quality and our sales and distribution activities, including, without limitation, pricing actions, rebates, sales initiatives and discount levels, and the timing of service contract renewals.

The costs of third-party components comprise a significant portion of our product costs. While we generally have been able to manage our component and product design costs, we may have difficulty managing these costs if supplies of certain components become limited or component prices increase. Any such limitation could result in an increase in

our product costs. An increase in component or design costs relative to our product prices could harm our gross margins and earnings.

We often incur expenses before we receive related benefits, and expenses may be difficult to reduce quickly if demand declines.

We base our expense levels in part on future revenue expectations and a significant percentage of our expenses are fixed. It is difficult to reduce our fixed costs quickly, and if revenue levels are below our expectations, operating results could be adversely impacted. During periods of uneven growth or decline, we may incur costs before we realize the anticipated related benefits, which could also harm our operating results. We have made, and will continue to make, significant investments in engineering, sales, service and support, marketing 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, such as 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.

If we are unable to maintain and develop relationships with strategic partners, our revenues may be harmed.

Our growth strategy includes developing and maintaining strategic partnerships with major third-party software and hardware vendors to integrate our products into their products and also co-market our products with them. A number of our strategic partners are industry leaders that offer us expanded access to segments of the storage and data management markets. In particular, strategic

partnerships with hyperscalers and cloud service vendors are critical to the success of our cloud-based business. However, there is intense competition for attractive strategic partners, and these relationships may not be exclusive, may not generate significant revenues and may be terminated on short notice. For instance, some of our partners are also partnering with our competitors, which may increase the availability of competing solutions and harm our ability to grow our relationships with those partners. Moreover, some of our partners, particularly large, more diversified technology companies, are also competitors, thereby complicating our relationships. If we are unable to establish new partnerships or maintain existing partnerships, if our strategic partners favor their relationships with other vendors in the storage industry or if our strategic partners increasingly compete with us, we could experience lower than expected revenues, suffer delays in product development, or experience other harm to our business, operating results and financial condition.

If we do not achieve forecasted bookings in any quarter, our financial results could be harmed.

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 the level, timing and mix of bookings consistent with our quarterly targets and historical patterns, or if we experience cancellations of significant orders, our financial results 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 negatively affected us in the past, and could negatively affect our revenues in the future.

A significant portion of our net revenues are generated through sales to a limited number of distributors. We generally do not enter into binding purchase commitments with our customers, resellers and distributors for extended periods of time, and thus there is no guarantee we will 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. In addition, unfavorable economic conditions may negatively impact the solvency of our customers, resellers and distributors or the ability of such customers, resellers and distributors to obtain credit to finance purchases of our products. If any of our key customers, resellers or distributors changes its pricing practices, reduces the size or frequency of its orders for our products, or stops purchasing our products altogether, our operating results and financial condition could be materially adversely impacted.

We rely on a limited number of suppliers for critical product components.

We rely on a limited number of suppliers for drives and other components utilized in the assembly of our products, including certain single source suppliers, which has subjected us, and could in the future subject us, to price rigidity, periodic supply constraints, and the inability to produce our products with the quality and in the quantities demanded. Consolidation among suppliers, particularly within the semiconductor and disk drive industries, has contributed to price rigidity and may in the future create supply constraints. When industry supply is constrained, our suppliers may allocate volumes away from us and to our competitors, all of which rely on many of the same suppliers as we do. Accordingly, our operating results may be harmed.

Any disruption to our supply chain could materially harm our business, operating results and financial condition.

We do not manufacture our products or their components. Instead, we rely on third parties to make our products and critical components, such as disk drives, as well as for associated logistics. Our lack of direct responsibility for, and control over, these elements of our business, as well as the diverse international geographic locations of our manufacturing partners and suppliers, creates significant risks for us, including, among other things:

- Limited ability to control the quality, quantity and cost of our products or of their components;

- The potential for binding price or purchase commitments with our suppliers at higher than market rates;

- Limited ability to adjust production volumes in response to our customers' demand fluctuations;

- Labor and political unrest at facilities we do not operate or own;

- Geopolitical disputes disrupting our supply chain;

- Business, legal compliance, litigation and financial concerns affecting our suppliers or their ability to manufacture and ship our products in the quantities, quality and manner we require; and

- Disruptions due to floods, earthquakes, storms and other natural disasters, particularly in countries with limited infrastructure and disaster recovery resources.

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Such risks have subjected us, and could in the future subject us, to supply constraints, price increases and minimum purchase requirements and our business, operating results and financial condition could be harmed. The risks associated with our outsourced manufacturing model are particularly acute when we transition products to new facilities or manufacturers, introduce and increase volumes of new products or qualify new contract manufacturers or suppliers, at which times our ability to manage the relationships among us, our manufacturing partners and our component suppliers, becomes critical. New manufacturers, products, components or facilities create increased costs and risk that we will fail to deliver high quality products in the required volumes to our customers. Any failure of a manufacturer or component supplier to meet our quality, quantity or delivery requirements in a cost-effective manner will harm our business, operating results and customer relationships.

Due to the global nature of our business, risks inherent in our international operations could materially harm our business.

A significant portion of our operations are located, and a significant portion of our revenues are derived, outside of the U.S. In addition, most of our products are manufactured outside of the U.S., and we have research and development, sales and service centers overseas. Accordingly, our business and our future operating results could be adversely impacted by factors affecting our international operations including, among other things, local political or economic conditions, trade protection and export and import requirements, tariffs, local labor conditions, transportation costs, government spending patterns, acts of terrorism, international conflicts and natural disasters in areas with limited infrastructure. In particular, the current trade tensions with China could impact our business and operating results. 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 condition.

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. We utilize forward and option contracts in an attempt to reduce the adverse earnings impact from the effect of exchange rate fluctuations on certain assets and liabilities. Our hedging strategies may not be successful, and currency exchange rate fluctuations could have a material adverse effect on our operating results and cash flows. In addition, our foreign currency exposure on assets, liabilities and cash flows that we do not hedge could have a material impact on our financial results in periods when the U.S. dollar significantly fluctuates in relation to foreign currencies.

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

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 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, operating results and financial condition.

We could be subject to additional income tax liabilities.

Our effective tax rate is influenced by a variety of factors, many of which are outside of our control. These factors include among other things, fluctuations in our earnings and financial results in the various countries and states in which we do business, the outcome of income tax audits and changes to the tax laws in such jurisdictions. Changes to

any of these factors could materially impact our operating results.

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 or a change in how we manage our international operations could adversely affect our ability to continue realizing these tax benefits.

Many countries around the world are beginning to implement legislation and other guidance to align their international tax rules with the Organisation for Economic Co-operation's Base Erosion and Profit Shifting recommendations and related action plans that aim to standardize and modernize global corporate tax policy, including changes to cross-border tax, transfer-pricing documentation rules and nexus-based tax incentive practices. As a result, many of these changes, if enacted, could increase our worldwide effective tax rate and harm our financial position and results of operations.

We are routinely subject to income tax audits in the U.S. and several foreign tax jurisdictions. If the ultimate determination of income taxes or at-source withholding taxes assessed under these audits results in amounts 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 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. Additionally, our effective tax rate could also be adversely affected if there is a change in international operations, our tax structure and how our operations are managed and structured, and as a result, we could experience harm to our operating results and financial condition. The recent U.S. tax law changes enacted through the Tax Cuts and Jobs Act are subject to further interpretations from the U.S. federal and state governments and regulatory organizations, such as the Treasury Department and/or Internal Revenue Service. Changes to interpretations of the law could change the provisional tax expense or accounting treatment of the \$732 million expense we have recorded in relation to the transition tax. We have elected to pay the transition tax over a period of eight years. As result, our cash flows from operating activities will be adversely impacted until the additional tax provisions are paid in full.

Our success depends upon our ability to effectively plan and manage our resources and restructure our business in response to changing market conditions and market demand for our products, and such actions may have an adverse effect on our financial and operating results.

Our ability to successfully offer our products and services in a rapidly evolving market requires an effective planning, forecasting, and management process to enable us to effectively scale and adjust our business in response to fluctuating market opportunities and conditions.

In response to changes in market conditions and market demand for our products, we have in the past undertaken cost savings initiatives. For example, in May 2015, March 2016, November 2016 and May 2018, we executed restructuring events designed to streamline our business, reduce our cost structure and focus our resources on key strategic opportunities. As a result, we have recognized substantial restructuring charges. In fiscal 2018, we created the Storage Systems and Software, Cloud Data Services, and Cloud Infrastructure business units to enable us to develop the organization and systems to successfully execute a multi-product business. We also reorganized our sales resources to better align with customer and market opportunities. We may in the future undertake initiatives that could include reorganizing our workforce, restructuring, disposing of, and/or otherwise discontinuing certain products, or a combination of these actions. Rapid changes in the size, alignment or organization of our workforce, including our new business unit structure and sales account coverage, could adversely affect our ability to develop, sell and deliver products and services as planned or impair our ability to realize our current or future business and financial objectives. Any decision to take these actions may result in charges to earnings associated with, among other things, inventory or other fixed, intangible or goodwill asset reductions (including, without limitation, impairment charges), workforce and facility reductions and penalties and claims from third-party resellers or users of discontinued products. Charges associated with these activities would harm our operating results. In addition to the costs associated with these activities, we may not realize any of the anticipated benefits of the underlying restructuring activities.

If our products are defective, or are perceived to be defective as a result of improper use or maintenance, our gross margins, operating results and customer relationships may be harmed.

Our hardware and software products are complex. We have experienced in the past, and expect to experience in the future, quality issues. Such quality issues may be due to, for example, our own designs or processes, the designs or processes of our suppliers, and/or flaws in third-party software used in our products. Quality risk is most acute when we are introducing new products. We have also increased the cadence of our product release cycle, which could impact product and service quality. Quality issues have and could again in the future cause customers to experience outages or disruptions in service, data loss or data corruption. 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, loss of revenue, inventory costs or product reengineering expenses and higher ongoing warranty and service costs, and these occurrences could have a material impact on our gross margins, business and operating results. In addition, we exercise little control over how our customers use or maintain our products, and in some cases improper usage or maintenance could impair the performance of our products, which could lead to a perception of a quality issue. Customers and we may experience 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.

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 could be attributed to the quality of our products, thereby causing financial or reputational harm to our business.

Our clients, including data centers, SaaS, cloud computing and internet infrastructure and bandwidth providers, rely on our products for their data storage needs. Our clients may authorize third-party technology providers to access their data on our systems. Because we do not control the transmissions between our clients, their customers, and third-party technology providers, or the processing of such data by third-party technology providers, we cannot ensure the complete integrity or security of such transmissions or processing. Errors or wrongdoing by clients, their customers, or third-party technology providers resulting in security breaches may be attributed to us.

A failure or inability to meet our clients' expectations with respect to security and confidentiality through 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. This may affect our ability to retain clients and attract new business.

If a cybersecurity or other security breach occurs on our systems or on our end-user customer systems, or if stored data is improperly accessed, customers may reduce or cease using our solutions, our reputation may be harmed and we may incur significant liabilities.

We store and transmit personal, sensitive and proprietary data related to our products, our employees, customers, clients and partners (including third-party vendors such as data centers and providers of SaaS, cloud computing, and internet infrastructure and bandwidth), and their respective customers, including intellectual property, books of record and personal information. It is critical to our business strategy that our infrastructure, products and services remain secure and are perceived by customers, clients and partners to be secure. There are numerous and evolving risks to cybersecurity and privacy, including criminal hackers, state-sponsored intrusions, industrial espionage, human error and technological vulnerabilities. Cybersecurity incidents or other security breaches could result in (1) unauthorized access to, or loss or unauthorized disclosure of, such information; (2) litigation, indemnity obligations, government investigations and other possible liabilities; (3) negative publicity; and (4) disruptions to our internal and external operations. Any of these could damage our reputation and public perception of the security and reliability of our products, as well as harm our business and cause us to incur significant liabilities. In addition, a cybersecurity incident or other security breach could result in other negative consequences, including remediation costs, disruption of internal operations, increased cybersecurity protection costs and lost revenues.

Our clients and customers use our platforms for the transmission and storage of sensitive data. We do not review the information or content that our clients and their customers upload and store, and, therefore, we have no direct control over the substance of the information or content stored within our platforms. If our employees, or our clients, partners or their respective customers use our platforms for the transmission or storage of personal or other sensitive information and our security measures are breached as a result of third-party action, employee error, malfeasance, stolen or fraudulently obtained log-in credentials or otherwise, our reputation could be damaged, our business may be harmed and we could incur significant liabilities.

High-profile cyberattacks and security breaches have increased in recent years, and security industry experts and government officials have warned about the risks of hackers and cyberattacks targeting IT products and businesses. Because techniques used to obtain unauthorized access or to sabotage systems change frequently and often are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. As we continue to increase our client base and expand our brand, we may become more of a target for third parties seeking to compromise our security systems and we anticipate that hacking attempts and cyberattacks will increase in the future. We cannot give assurance that we will always be successful in preventing or repelling unauthorized access to our systems.

Many jurisdictions have enacted or are enacting laws requiring companies to notify regulators or individuals of data security incidents involving certain types of personal data. These mandatory disclosures regarding security incidents often lead to widespread negative publicity. 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. Any security incident, whether actual or perceived, could harm our reputation, erode customer confidence in the effectiveness of our data security measures, negatively impact our ability to attract new customers, cause existing customers to elect not to renew their support contracts or their SaaS subscriptions, or subject us to third-party lawsuits, regulatory fines or other action or liability, which could materially and adversely affect our business and operating results. In addition, a security incident or loss of personal information could result in other negative consequences, including remediation costs, disruption of internal operations, increased cybersecurity protection costs and lost revenues. Our business could be subject to stricter obligations and greater fines under the enactment of new data privacy laws, including but not limited to, the European Union General Data Protection Regulation enacted on May 25, 2018.

There can be no assurance that the limitations of liability in our contracts would be enforceable or adequate or would otherwise protect us from any such liabilities or damages with respect to any particular claim. Our existing general liability insurance coverage and coverage for errors and omissions may not continue to be available on acceptable terms or may not be available in sufficient amounts to cover one or more large claims, or our insurers may deny coverage as to any future claim. The successful assertion of one or more large claims against us that exceeds available insurance coverage, or the occurrence of changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, could have a material adverse effect on our business, operating results and financial condition.

If we are unable to attract and retain qualified personnel, our business, operating results and financial condition could be harmed.

Our continued success depends, in part, on our ability to hire and retain qualified personnel and to preserve the key aspects of our corporate culture. 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 hire and retain qualified engineers, including in emerging areas of technology such as artificial intelligence and machine learning. In addition, to increase revenues, we will be required to increase the productivity of our sales force and support infrastructure to achieve adequate customer coverage. Competition for qualified employees, particularly in Silicon Valley,

is intense. We have periodically reduced our workforce, including an 11% reduction announced in March 2016 and a 6% reduction announced in November 2016, and these actions may make it more difficult to attract and retain qualified employees. Our inability to hire and retain qualified management and skilled personnel, particularly engineers, salespeople and key executive management, could be disruptive to our development efforts, sales results, business relationships and/or our ability to execute our business plan and strategy on a timely basis and could materially and adversely affect our operating results.

Equity grants are a critical component of our current compensation programs. If we reduce, modify or eliminate our equity programs, we may have difficulty attracting and retaining critical employees.

In addition, because of the structure of our cash and equity incentive compensation plans, we may be at increased risk of losing employees at certain times. For example, the retention value of our compensation plans decreases after the payment of annual bonuses or the vesting of equity awards.

We are continually seeking ways to make our cost structure, business processes and systems more efficient, including by moving activities from higher-cost to lower-cost locations, outsourcing certain business processes and functions, and implementing new business information systems. Problems with the execution of these activities could have an adverse effect on our business, operating results and financial condition. In addition, we may not achieve the expected benefits of these initiatives.

We continuously seek to make our cost structure and business processes more efficient, including by moving our business activities from higher-cost to lower-cost locations, outsourcing certain business processes and functions, and implementing changes to our business information systems. These efforts involve a significant investment of financial and human resources and significant changes to our current operating processes. In addition, as we move operations into lower-cost jurisdictions and outsource certain business processes, we become subject to new regulatory regimes and lose control of certain aspects of our operations and, as a consequence, become more dependent upon the systems and business processes of third-parties. If we are unable to move our operations, outsource business processes and implement new business information systems in a manner that complies with local law and maintains adequate standards, controls and procedures, the quality of our products and services may suffer and we may be subject to increased litigation risk, either of which could have an adverse effect on our business, operating results and financial condition. Additionally, we may not achieve the expected benefits of these and other transformational initiatives, which could harm our business, operating results and financial condition.

Our acquisitions may not achieve expected benefits, and may increase our liabilities, disrupt our existing business and harm our operating results.

As part of our strategy, we seek to acquire other businesses and technologies to complement our current products, expand the breadth of our markets, or enhance our technical capabilities. For example, in fiscal 2018 we acquired two privately held companies, and in fiscal 2016 we acquired SolidFire, Inc. The benefits we have received, and expect to receive, from these and other acquisitions depend on our ability to successfully conduct due diligence, negotiate the terms of the acquisition and integrate the acquired business into our systems, procedures and organizational structure. Any inaccuracy in our acquisition assumptions or any failure to uncover liabilities or risks associated with the acquisition, make the acquisition on favorable terms, integrate the acquired business or assets as and when expected or retain key employees of the acquired company may reduce or eliminate the expected benefits of the acquisition to us, increase our costs, disrupt our operations, result in additional liabilities, investigations and litigation, and may also harm our strategy, our business and our operating results. The failure to achieve expected acquisition benefits may also result in impairment charges for goodwill and purchased intangible assets.

Reduced U.S. government demand could materially harm our business and operating results. In addition, we could be harmed by claims that we have or a channel partner has failed to comply with regulatory and contractual requirements applicable to sales to the U.S. government.

The U.S. government is an important customer for us. However, government demand is uncertain, as it is subject to political and budgetary fluctuations and constraints. Events such as the U.S. federal government shutdown in October 2013 and continued uncertainty regarding the U.S. budget and debt levels have increased demand uncertainty for our products, and in our fiscal 2016 resulted in lower sales to these customers. In addition, like other customers, the U.S. government may evaluate competing products and delay purchasing in the face of the technology transitions taking place in the storage industry. If the U.S. government or an individual agency or multiple agencies within the U.S. government continue to reduce or shift their IT spending patterns, our revenues and operating results may be harmed.

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 materially harm our operating results and financial condition. 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. Although the DOJ and GSA currently have no claims pending against us, we could face claims in the future.

Violations of certain regulatory and contractual requirements, including with respect to data security, 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 business, operating results and financial condition.

We are exposed to credit risks and fluctuations in the market values of our investment portfolio.

We maintain an investment portfolio of various holdings, types, and maturities. Credit ratings and pricing of our investments can be negatively affected by liquidity, credit deterioration, financial results, economic risk, political risk, sovereign risk or other factors. As a result, the value and liquidity of our investments may fluctuate substantially. Therefore, although we have not recently realized any significant losses on our investments, future fluctuations in their value could result in a significant realized loss.

There are risks associated with our outstanding and future indebtedness.

As of October 26, 2018, we had \$1.6 billion aggregate principal amount of outstanding indebtedness for our senior notes that mature at specific dates in calendar years 2019, 2021, 2022 and 2024, and we had an aggregate of \$250 million of commercial paper notes outstanding with maturities ranging from 4 to 31 days. We may incur additional indebtedness in the future under existing credit facilities and/or enter into new financing arrangements. We may fail to pay these or additional future obligations, as and when required. Specifically, if we are unable to generate sufficient cash flows from operations or to borrow sufficient funds in the future to service or refinance our debt, our business, operating results and financial condition will be harmed. Any downgrades from credit rating agencies such as Moody's Investors Service or Standard & Poor's Rating Services may adversely impact our ability to obtain additional financing or the terms of such financing and reduce the market capacity for our commercial paper. Furthermore, if prevailing interest rates or other factors result in higher interest upon any potential future financing, then interest expense related to the refinance indebtedness would increase.

In addition, all our debt and credit facility arrangements subject us to continued compliance with restrictive and financial covenants. If we do not comply with these covenants or otherwise default under the arrangements, we may be required to repay any outstanding amounts borrowed under these agreements. Moreover, compliance with these covenants may restrict our strategic or operational flexibility in the future, which could harm our business, operating results and financial condition.

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. We may experience losses due to a customer's inability to pay. Beyond our open credit arrangements, some of our customers have entered into recourse and non-recourse financing leasing arrangements using third-party leasing companies. Under the terms of recourse leases, which are generally three years or less, we remain liable for the aggregate unpaid remaining lease payments to the third-party leasing companies in the event of end-user customer default. 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.

Our failure to adjust to emerging standards in the storage and data management industry may harm our business.

Emerging standards in the storage and data management markets may adversely affect the UNIX®, Windows® and 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 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 may not be able to expand our product offerings in these market and geographical segments at the rates which we have forecasted.

Some of our products are subject to U.S. export control laws and other laws affecting the countries in which our products and services may be sold, distributed, or delivered, and any violation of these laws could have a material and adverse effect on our business, operating results and financial condition.

Due to the global nature of our business, we are subject to import and export restrictions and regulations, including the Export Administration Regulations 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. Violators of these export control and sanctions laws may be subject to significant penalties, which may include significant monetary fines, criminal proceedings against them and their officers and employees, a denial of export privileges, and suspension or debarment from selling products to the federal government. Our products could be shipped to those targets by third parties, including potentially our channel partners, despite our precautions.

If we were ever 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 condition. Even if we were not found to have violated such laws, the political and media scrutiny surrounding any governmental investigation of us could cause us significant expense and reputational harm. Such collateral consequences could have a material adverse impact on our business, operating results and financial condition.

Changes in regulations relating to our products or their components, or the manufacture, sourcing, distribution or use thereof, may harm our business and operating results.

The laws and regulations governing the manufacturing, sourcing, distribution and use of our products have become more complex and stringent over time. For example, in addition to various environmental laws relating to carbon emissions and the use and discharge of hazardous materials, the SEC adopted regulations concerning the supply of certain minerals originating from the conflict zones of the Democratic Republic of Congo or adjoining countries. We incur costs to comply with the disclosure requirements of this law and may realize other costs relating to the sourcing and availability of minerals used in our products. Further, since our supply chain is complex, we may face reputational harm if our customers or other stakeholders conclude that we are unable to verify sufficiently the origins of the minerals used in the products we sell. As the laws and regulations governing our products continue to expand and change, our costs are likely to rise, and the failure to comply with any such laws and regulations could subject us to business interruptions, litigation risks and reputational harm.

Our failure to protect our intellectual property could harm our business, operating results and financial condition.

Our success depends significantly upon developing, maintaining and protecting our proprietary technology. We rely on a combination of patents, copyrights, trademarks, trade secrets, confidentiality procedures and contractual provisions with employees, resellers, strategic partners and customers, to protect our proprietary rights. We currently have multiple U.S. and international patent applications pending and multiple U.S. and international 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 condition. 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. In addition, while we train employees in confidentiality practices and include terms in our employee and consultant agreements to protect our intellectual property, there is persistent risk that some individuals will improperly take our intellectual property after terminating their employment or other engagements with us, which could lead to intellectual property leakage to competitors and a loss of our competitive advantages.

We may be found to infringe on intellectual property rights of others.

We compete in markets in which intellectual property infringement claims arise in the normal course of business. Third parties have, from time to time, asserted intellectual property-related claims against us, including claims for alleged patent infringement brought by non-practicing entities. Such claims may be made against our products and services, our customers' use of our products and services, or a combination of our products and third-party products. We also may be subject to claims and indemnification obligations from customers and resellers with respect to third-party intellectual property rights pursuant to our agreements with them. If we refuse to indemnify or defend such claims, even in situations in which the third party's allegations are meritless, then customers and resellers may refuse

to do business with us.

Patent litigation is particularly common in our industry. We have been, and continue to be, in active patent litigations with non-practicing entities. While we vigorously defend our ability to compete in the marketplace, there is no guarantee that, in patent or other types of intellectual property litigation, we will prevail at trial or be able to settle at a reasonable cost. If a judge or jury were to find that our products infringe, we could be required to pay significant monetary damages and be subject to an injunction that could cause product shipment delays, require us to redesign our products, affect our ability to supply or service our customers, and/or require us to enter into compulsory royalty or licensing agreements.

We expect that companies in the network storage and data management markets 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, and any such infringement claims discussed above, could be time consuming, result in costly litigation, cause product shipment delays, require us to redesign our products, or require us to 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.

We rely on software from third parties, and a failure to properly manage our use of third-party software could result in increased costs or loss of revenue.

Many of our products are designed to include software licensed from third parties. Such third-party software includes software licensed from commercial suppliers and software licensed under public open source licenses. We have internal processes to manage our use of such third-party software. However, if we fail to adequately manage our use of third-party software, then we may be subject to copyright infringement or other third-party claims. If we are non-compliant with a license for commercial software, then we may be required to pay penalties or undergo costly audits pursuant to the license agreement. In the case of open-source software licensed under certain “copyleft” licenses, the license itself may require, or a court-imposed remedy for non-compliant use of the open source software may require, that proprietary portions of our own software be publicly disclosed or licensed. This could result in a loss of intellectual property rights, increased costs, damage to our reputation and/or a loss of revenue.

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

We depend on the ability of our personnel, inventories, 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 economic failure or other material disruption caused by natural disasters, including fires, floods, hurricanes, earthquakes, and volcanoes; power loss or shortages; environmental disasters; telecommunications or business information systems failures or break-ins and similar events 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 IT, or directly impact our marketing, manufacturing, financial and logistics functions, or impair our ability to meet our customer demands, our operating results and financial condition could be materially adversely affected. In addition, our headquarters is located in Northern California, an area susceptible to earthquakes and wildfires. If any significant disaster were to occur, our ability to operate our business and our financial condition could be impaired.

Our stock price is subject to volatility.

Our stock price is subject to changes in recommendations or earnings estimates by financial analysts, changes in investors' or analysts' valuation measures for our stock, changes in our capital structure, including issuance of additional debt, changes in our credit ratings, our ability to pay dividends and to continue to execute our stock repurchase program as planned and market trends unrelated to our performance.

Our ability to pay quarterly dividends and to continue to execute our stock repurchase program as planned will be subject to, among other things, our financial condition and operating results, available cash and cash flows in the U.S., capital requirements, and other factors. Future dividends are subject to declaration by our Board of Directors, and our stock repurchase program does not obligate us to acquire any specific number of shares. If we fail to meet any expectations related to dividends and/or stock repurchases, the market price of our stock could decline significantly, and could have a material adverse impact on investor confidence. Additionally, price volatility of our stock over a given period may cause the average price at which we repurchase our own stock to exceed the stock's market price at a given point in time.

Furthermore, speculation in the press or investment community about our strategic position, financial condition, results of operations or business can cause changes in our stock price. These factors, as well as general economic and political conditions and the timing of announcements in the public market regarding new products or services, product enhancements or technological advances by our competitors or us, and any announcements by us of acquisitions, major transactions, or management changes may adversely affect our stock price.

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

Purchases of equity securities

The following table provides information with respect to the shares of common stock repurchased by us during the three months ended October 26, 2018:

| Period | Total Number of Shares Purchased (Shares in thousands) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Program (Shares in thousands) | Approximate Dollar Value of Shares That May Yet Be Purchased Under The Repurchase Program (Dollars in millions) |
|--|---|---------------------------------------|--|--|
| July 28, 2018 - August 24, 2018 | 1,881 | \$ 80.97 | 292,871 | \$ 3,348 |
| August 25, 2018 - September 21, 2018 | 1,817 | \$ 84.84 | 294,688 | \$ 3,194 |
| September 22, 2018 - October 26, 2018 | 3,198 | \$ 79.72 | 297,886 | \$ 2,939 |
| Total | 6,896 | \$ 81.41 | | |

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In May 2003, our Board of Directors approved a stock repurchase program. As of October 26, 2018, our Board of Directors has authorized the repurchase of up to \$13.6 billion of our common stock. Since inception of the program through October 26, 2018, we repurchased a total of 298 million shares of our common stock for an aggregate purchase price of \$10.7 billion. Under this program, which we may suspend or discontinue at any time, we may purchase shares of our outstanding common stock through solicited or unsolicited transactions in the open market, in privately negotiated transactions, through accelerated share repurchase programs, pursuant to a Rule 10b5-1 plan or in such other manner as deemed appropriate by our management.

Item 3. Defaults upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not Applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

The following documents are filed as exhibits to this report.

| Exhibit No | Description | Incorporation by Reference | | |
|---------------|--|----------------------------|---------|-------------|
| | | File Form No. | Exhibit | Filing Date |
| 10.1* | <u>Outside Director Compensation Policy (effective September 1, 2018) of the Company.</u> | — | — | — |
| 10.2* | <u>Form of Restricted Stock Unit Agreement (Non-Employee Directors) approved for use under the Company's 1999 Stock Option Plan.</u> | — | — | — |
| 31.1 | <u>Certification of the Chief Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.</u> | — | — | — |
| 31.2 | <u>Certification of the Chief Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.</u> | — | — | — |
| 32.1 | <u>Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley</u> | — | — | — |

Act of 2002.

| | | | | |
|---------|---|---|---|---|
| 32.2 | <u>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.</u> | — | — | — |
| 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 | — | — | — |

‡Identifies management plan or compensatory plan or arrangement.

SIGNATURE

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

NETAPP, INC.
(Registrant)

/s/ RONALD J. PASEK
Ronald J. Pasek
Executive Vice President and

Chief Financial Officer
Date: November 19, 2018