

NetApp, Inc.
Form 10-Q
December 06, 2010
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended October 29, 2010

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 0-27130

NetApp, Inc.

(Exact name of registrant as specified in its charter)

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

Delaware
(State or other jurisdiction of
incorporation or organization)

77-0307520
(IRS Employer

Identification No.)

495 East Java Drive,

Sunnyvale, California 94089

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code:

(408) 822-6000

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

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

Class
Common Stock

Outstanding at November 12, 2010
361,423,011

Table of Contents**TABLE OF CONTENTS**

	Page No.
<u>PART I. FINANCIAL INFORMATION</u>	
Item 1. <u>Condensed Consolidated Financial Statements (Unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets as of October 29, 2010 and April 30, 2010 (Unaudited)</u>	3
<u>Condensed Consolidated Statements of Operations for the Three and Six Month Periods Ended October 29, 2010 and October 30, 2009 (Unaudited)</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the Six Month Periods Ended October 29, 2010 and October 30, 2009 (Unaudited)</u>	5
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	37
Item 4. <u>Controls and Procedures</u>	39
<u>PART II. OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	40
Item 1A. <u>Risk Factors</u>	40
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	59
Item 3. <u>Defaults upon Senior Securities</u>	59
Item 4. <u>Reserved</u>	60
Item 5. <u>Other Information</u>	60
Item 6. <u>Exhibits</u>	60
<u>SIGNATURE</u>	61

TRADEMARKS

© Copyright 2010 NetApp, Inc. All rights reserved. No portions of this document may be reproduced without prior written consent of NetApp, Inc. NetApp, the NetApp logo, Go further, faster, DataFabric, Data ONTAP, FAServer, FilerView, FlexCache, FlexClone, FlexShare, FlexVol, MultiStore, NearStore, Network Appliance, SecureShare, SnapDrive, SnapLock, SnapManager, SnapMirror, SnapRestore, Snapshot, SnapVault, and WAFL are trademarks or registered trademarks of NetApp, Inc. in the United States and/or other countries. Windows is a registered trademark of Microsoft Corporation. Linux is a registered trademark of Linus Torvalds. UNIX is a registered trademark of The Open Group. All other brands or products are trademarks or registered trademarks of their respective holders and should be treated as such.

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

	October 29, 2010	April 30, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,771.1	\$ 1,705.0
Short-term investments	2,610.4	2,019.0
Accounts receivable, net of allowances of \$1.8 and \$1.6 at October 29 and April 30, 2010, respectively	446.6	471.5
Inventories	84.7	112.9
Other current assets	218.3	228.7
Total current assets	5,131.1	4,537.1
Property and equipment, net	845.3	804.4
Goodwill	737.0	681.0
Other intangible assets, net	38.8	25.1
Long-term investments and restricted cash	69.8	72.8
Other non-current assets	415.8	374.0
Total assets	\$ 7,237.8	\$ 6,494.4
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 175.9	\$ 184.6
Accrued compensation and related benefits	277.6	379.1
Other current liabilities	245.4	212.2
Short-term deferred revenue	1,135.6	1,135.1
Total current liabilities	1,834.5	1,911.0
1.75% Convertible Senior Notes due 2013	1,125.4	1,101.5
Other long-term liabilities	204.1	171.9
Long-term deferred revenue	866.4	779.5
Total liabilities	4,030.4	3,963.9
Commitments and contingencies (Note 15)		
Stockholders' equity:		
Common stock (465.6 and 451.6 shares issued at October 29 and April 30, 2010)	0.5	0.5
Additional paid-in capital	3,816.0	3,453.7
Treasury stock at cost (104.3 shares at October 29 and April 30, 2010)	(2,927.4)	(2,927.4)

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

Retained earnings	2,307.3	2,000.9
Accumulated other comprehensive income	11.0	2.8
Total stockholders' equity	3,207.4	2,530.5
Total liabilities and stockholders' equity	\$ 7,237.8	\$ 6,494.4

See accompanying notes to condensed consolidated financial statements.

Table of Contents**NETAPP, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In millions, except per share amounts)****(Unaudited)**

	Three Months Ended		Six Months Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Revenues:				
Product	\$ 780.0	\$ 525.1	\$ 1,500.8	\$ 1,003.4
Software entitlements and maintenance	177.9	169.8	352.6	335.1
Service	249.5	215.1	491.8	409.5
Net revenues	1,207.4	910.0	2,345.2	1,748.0
Cost of revenues:				
Cost of product	296.1	199.1	603.8	411.7
Cost of software entitlements and maintenance	3.5	3.1	6.9	6.2
Cost of service	106.7	101.1	209.0	200.9
Total cost of revenues	406.3	303.3	819.7	618.8
Gross profit	801.1	606.7	1,525.5	1,129.2
Operating expenses:				
Sales and marketing	382.8	300.8	737.0	602.3
Research and development	156.6	132.4	306.1	262.7
General and administrative	64.2	56.9	120.4	116.4
Restructuring and other charges	0.1	1.2	0.1	2.7
Acquisition related (income) expense, net	0.0	0.0	0.3	(41.1)
Total operating expenses	603.7	491.3	1,163.9	943.0
Income from operations	197.4	115.4	361.6	186.2
Other expenses, net:				
Interest income	9.5	7.0	19.3	15.6
Interest expense	(18.6)	(17.9)	(37.2)	(37.1)
Other income (expense), net	(1.4)	1.5	0.8	0.4
Total other expenses, net	(10.5)	(9.4)	(17.1)	(21.1)
Income before income taxes	186.9	106.0	344.5	165.1
Provision for income taxes	22.3	10.3	38.1	17.8
Net income	\$ 164.6	\$ 95.7	\$ 306.4	\$ 147.3
Net income per share:				
Basic	\$ 0.46	\$ 0.28	\$ 0.86	\$ 0.44
Diluted	\$ 0.42	\$ 0.27	\$ 0.80	\$ 0.43

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

Shares used in net income per share calculations:				
Basic	359.1	336.7	355.8	335.6
Diluted	391.7	349.8	383.0	344.3

See accompanying notes to condensed consolidated financial statements.

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

	Six Months Ended	
	October 29, 2010	October 30, 2009
Cash flows from operating activities:		
Net income	\$ 306.4	\$ 147.3
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	82.3	85.2
Stock-based compensation	82.0	85.4
Accretion of discount and issuance costs on notes	25.9	25.3
Unrealized losses on derivative activities	6.7	0.0
Deferred income taxes	(29.6)	(1.9)
Tax benefit from stock-based compensation	40.9	14.4
Excess tax benefit from stock-based compensation	(32.7)	(1.4)
Other non-cash items, net	11.8	(2.2)
Changes in assets and liabilities, net of acquisition of business:		
Accounts receivable	27.3	131.7
Inventories	28.2	0.3
Other operating assets	6.0	(1.1)
Accounts payable	(18.6)	(16.9)
Accrued compensation and other current liabilities	(96.1)	(140.1)
Deferred revenue	81.6	(14.2)
Other operating liabilities	19.9	(6.3)
Net cash provided by operating activities	542.0	305.5
Cash flows from investing activities:		
Purchases of investments	(1,650.1)	(883.2)
Redemptions of investments	1,055.3	780.8
Purchases of property and equipment	(83.5)	(47.5)
Acquisition of business, net of cash acquired	(74.9)	0.0
Other investing activities, net	0.0	3.6
Net cash used in investing activities	(753.2)	(146.3)
Cash flows from financing activities:		
Issuance of common stock	236.1	60.1
Excess tax benefit from stock-based compensation	32.7	1.4
Payment on financing arrangements	(2.0)	0.0
Net cash provided by financing activities	266.8	61.5
Effect of exchange rate changes on cash and cash equivalents	10.5	13.9
Net increase in cash and cash equivalents	66.1	234.6
Cash and cash equivalents:		
Beginning of period	1,705.0	1,494.2
End of period	\$ 1,771.1	\$ 1,728.8

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NETAPP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. The Company

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

2. Condensed Consolidated Financial Statements

Fiscal Year We operate on a 52- or 53-week fiscal year ending on the last Friday in April. In a 52-week fiscal year, each quarter includes 13 weeks of operations; in a 53-week fiscal year, the first quarter includes 14 weeks of operations and the second, third and fourth quarter include 13 weeks of operations. Fiscal 2010 was a 53-week year and fiscal 2011 is a 52-week year. As a result, the six months ended October 30, 2009 included 27 weeks compared to 26 weeks for the six months ended October 29, 2010.

Basis of Presentation The accompanying unaudited condensed consolidated financial statements have been prepared by the Company, and reflect all adjustments consisting only of normal recurring adjustments which are, in the opinion of management, necessary for a fair presentation of our financial position, results of operations, and cash flows for the interim periods presented. The statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all information and footnotes required by GAAP for annual consolidated financial statements, and should be read in conjunction with the Company's audited consolidated financial statements as of and for the fiscal year ended April 30, 2010 contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on June 18, 2010. The results of operations for the three and six month periods ended October 29, 2010 are not necessarily indicative of the operating results to be expected for the full fiscal year or future operating periods.

3. Significant Accounting Policies

There have been no significant changes in our significant accounting policies for the six month period ended October 29, 2010, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended April 30, 2010.

Recent Accounting Standards Not Yet Effective

In October 2009, the FASB amended the accounting standards for multiple deliverable revenue arrangements to:

- (i) provide updated guidance on how the deliverables in an arrangement should be separated, and how the consideration should be allocated;
- (ii) require an entity to allocate revenue in an arrangement using best estimate of selling prices (BESP) of deliverables if a vendor does not have vendor-specific objective evidence of selling price (VSOE) or third-party evidence of selling price (TPE);
- (iii) eliminate the use of the residual method and requires an entity to allocate revenue using the relative selling price method; and
- (iv) expand the disclosure requirements to provide both qualitative and quantitative information about the significant judgments made in applying the revised guidance and subsequent changes in those judgments that may significantly affect the timing or amount of

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

revenue recognition.

In addition, in October 2009, the FASB amended the accounting standards for revenue recognition to exclude tangible products containing software components and non-software components that function together to deliver the tangible product's essential functionality from the scope of the software revenue recognition guidance. The revised revenue recognition accounting standards are effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010 and shall be applied on a prospective basis. Earlier application is permitted. We are required to adopt this standard at the beginning of fiscal 2012, which begins on April 30, 2011. We are assessing the impact of the new accounting standards on our financial position and results of operations.

Table of Contents**NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

In July 2010, the FASB issued an accounting standard that is intended to improve the disclosures that an entity provides about the credit quality of its financing receivables and the related allowance for credit losses. As a result of these amendments, an entity is required to disaggregate by portfolio segment or class certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. We do not expect the new standard to have a material impact on our financial statements.

Use of Estimates The preparation of the 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 period. Such estimates include, but are not limited to, revenue recognition, reserve and allowances; inventory valuation and purchase order accruals; valuation of goodwill and intangibles; restructuring reserves; product warranties; self-insurance; stock-based compensation; loss contingencies; investment impairments; income taxes, and fair value measurements. Actual results could differ from those estimates.

4. Statements of Cash Flows

Supplemental cash flows and noncash investing and financing activities are as follows (in millions):

	Six Months Ended	
	October 29, 2010	October 30, 2009
Noncash Investing and Financing Activities:		
Acquisition of property and equipment on account	\$ 36.4	\$ 7.1
Acquisition of property and equipment through long-term financing	\$ 12.6	\$ 0.0
Supplemental Cash Flow Information:		
Income taxes paid, net of refunds	\$ 11.8	\$ 15.6
Interest paid	\$ 11.3	\$ 11.1

5. Business Combinations

We recognize identifiable assets acquired and the liabilities assumed at their acquisition date fair values. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net of the acquisition date fair values of the assets acquired and the liabilities assumed. While we use our best estimates and assumptions as a part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the acquisition date, our estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, we record adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill to the extent that we identify adjustments to the preliminary purchase price allocation. Upon the conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to our Consolidated Statements of Operations.

Bycast Acquisition

On May 13, 2010, NetApp completed its acquisition of Bycast Inc. (Bycast), a privately held company headquartered in Vancouver, Canada. Bycast develops and sells software designed to manage petabyte-scale, globally distributed repositories of images, video and records for enterprises and service providers. The acquisition extends our position in unified storage by adding an object-based storage software offering, which simplifies the task of large-scale storage and improves the ability to search and locate data objects.

We acquired 100% of the outstanding shares of Bycast for a purchase price of \$80.5 million in cash, including \$13.1 million which was placed in an escrow account to secure Bycast's obligations under certain indemnity provisions. Subject to any claims for indemnity, the escrow funds

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

will be released 18 months from the closing date of the acquisition. In addition, we assumed all of the then outstanding options to purchase Bycast common stock, and converted those into options to purchase approximately 0.2 million shares of our common stock. The results of operations of Bycast are included in our Condensed Consolidated Statements of Operations beginning May 13, 2010, the closing date of the acquisition.

Table of Contents**NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The following table summarizes the purchase price (in millions):

Cash	\$ 80.5
Fair value of vested options assumed	3.3
Total initial purchase price	\$ 83.8

The fair value of the assumed options was determined using a Black-Scholes valuation model.

The purchase price as shown in the table above was allocated to Bycast's net tangible and intangible assets based on various fair value estimates and analyses, including work performed by third-party valuation specialists (in millions):

Cash	\$ 5.7
Tangible assets	3.8
Deferred revenue and other liabilities	(1.4)
Identified intangible assets	23.6
Deferred income taxes	(3.9)
Goodwill	56.0
Total purchase price	\$ 83.8

Goodwill is not deductible for income tax purposes.

Adjustments may be made to the allocation of the purchase price during the measurement period to reflect adjustments to deferred taxes related to the acquisition. The identified intangible assets, which are amortized on a straight-line basis over their estimated useful lives, consisted of the following (in millions, except useful life):

		Useful Life (Years)
Developed technology	\$ 18.0	5
Customer relationships	4.7	3
Trademarks and trade names	0.7	5
Other	0.2	2
Total identified intangible assets	\$ 23.6	

Pro forma results of operations have not been presented because the acquisition was not material to our results of operations.

Termination of Proposed Merger with Data Domain, Inc.

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

In July 2009, a proposed merger between us and Data Domain, Inc. (Data Domain) was terminated by Data Domain's Board of Directors and, pursuant to the terms of the agreement, Data Domain paid us a \$57.0 million termination fee. We incurred \$15.9 million of incremental third-party costs relating to the terminated merger transaction during the same period, resulting in a net amount of \$41.1 million which is included in acquisition related (income) expense, net in the consolidated statement of operations.

6. Goodwill and Purchased Intangible Assets

Goodwill and identified intangible assets are summarized as follows (in millions):

	October 29, 2010			April 30, 2010		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Goodwill	\$ 737.0		\$ 737.0	\$ 681.0		\$ 681.0
Identified Intangible Assets:						
Existing technology	\$ 93.1	\$ (63.3)	\$ 29.8	\$ 75.1	\$ (55.5)	\$ 19.6
Trademarks/tradenames	7.1	(4.8)	2.3	6.4	(4.3)	2.1
Customer contracts/relationships	17.1	(10.4)	6.7	12.2	(8.8)	3.4
Total identified intangible assets	\$ 117.3	\$ (78.5)	\$ 38.8	\$ 93.7	\$ (68.6)	\$ 25.1

Table of Contents**NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

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

	Three Months Ended		Six Months Ended		Statement of Operations Classifications
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009	
Existing technology	\$ 3.3	\$ 4.3	\$ 7.7	\$ 9.0	Cost of product revenues
Trademarks/tradenames	0.3	0.3	0.6	0.6	Sales and marketing
Customer contracts/relationships	0.8	0.6	1.6	1.2	Sales and marketing
	\$ 4.4	\$ 5.2	\$ 9.9	\$ 10.8	

As of October 29, 2010, future amortization expense related to identifiable intangible assets was as follows (in millions):

Fiscal Year	Amount
Remainder of 2011	\$ 6.7
2012	12.6
2013	10.3
2014	4.4
2015 and thereafter	4.8
Total	\$ 38.8

7. Balance Sheet Detail*Cash and cash equivalents (in millions):*

	October 29, 2010	April 30, 2010
Cash	\$ 189.8	\$ 187.8
Cash equivalents	1,581.3	1,517.2
	\$ 1,771.1	\$ 1,705.0

Inventories (in millions):

	October 29, 2010	April 30, 2010
Purchased components	\$ 8.9	\$ 9.4
Work-in-process	0.1	0.2

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

Finished goods	75.7	103.3
Total	\$ 84.7	\$ 112.9

Other current assets (in millions):

	October 29, 2010	April 30, 2010
Deferred tax assets	\$ 65.8	\$ 69.6
Prepaid expenses and other current assets	149.2	157.0
Short-term restricted cash	3.3	2.1
	\$ 218.3	\$ 228.7

Table of Contents**NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Property and equipment (in millions):**

	October 29, 2010	April 30, 2010
Land	\$ 204.7	\$ 204.7
Buildings and building improvements	402.0	394.8
Leasehold improvements	76.0	73.7
Computer, production, engineering and other equipment and software	684.4	628.6
Furniture	55.7	63.2
Construction-in-process	62.1	37.0
	1,484.9	1,402.0
Accumulated depreciation and amortization	(639.6)	(597.6)
	\$ 845.3	\$ 804.4

Long-term investments and restricted cash (in millions):

	October 29, 2010	April 30, 2010
Auction rate securities	\$ 66.2	\$ 69.0
Nonmarketable securities	1.3	1.4
Restricted cash	2.3	2.4
	\$ 69.8	\$ 72.8

Other non-current liabilities (in millions):

	October 29, 2010	April 30, 2010
Liability for uncertain tax positions	\$ 126.0	122.4
Warranty	15.0	13.7
Other	63.1	35.8
	\$ 204.1	\$ 171.9

8. Financial Instruments and Fair Value

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

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

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

Level 2: Inputs reflect quoted prices for identical assets or liabilities in markets that are not active; quoted prices for similar assets or liabilities in active markets; inputs other than quoted prices that are observable for the assets or liabilities; or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3: Unobservable inputs reflecting our own assumptions incorporated in valuation techniques used to determine 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 view an inactive market as one in which there are 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 determining the fair values of liabilities and assets, respectively.

Table of Contents**NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Investments**

The following is a summary of investments at October 29, 2010 and April 30, 2010 (in millions):

	October 29, 2010 Gross Unrealized			Estimated Fair Value	April 30, 2010 Gross Unrealized			Estimated Fair Value
	Cost	Gains	Losses		Cost	Gains	Losses	
Corporate bonds	\$ 1,805.5	\$ 13.5	\$ (0.5)	\$ 1,818.5	\$ 1,128.1	\$ 3.4	\$ (1.8)	\$ 1,129.7
Auction rate securities	70.2	0.5	(4.5)	66.2	71.6	0.7	(3.3)	69.0
U.S. agency securities	664.6	0.9	(0.1)	665.4	775.4	1.7	(0.1)	777.0
U.S. treasuries	5.0	0.1	0.0	5.1	41.5	0.4	0.0	41.9
Commercial paper	474.6	0.0	(0.1)	474.5	215.9	0.0	0.0	215.9
Municipal bonds	1.5	0.0	0.0	1.5	1.5	0.0	0.0	1.5
Certificates of deposit	80.1	0.0	0.0	80.1	159.0	0.0	0.0	159.0
Money market funds	1,146.6	0.0	0.0	1,146.6	1,211.2	0.0	0.0	1,211.2
Equity funds	17.9	0.0	0.0	17.9	12.6	0.0	0.0	12.6
Investment in privately-held companies	1.3	0.0	0.0	1.3	1.4	0.0	0.0	1.4
Total investments	4,267.3	15.0	(5.2)	4,277.1	3,618.2	6.2	(5.2)	3,619.2

The following table presents the contractual maturities of our debt investments as of October 29, 2010 (in millions):

Debt Investment Maturities	Cost	Fair Value
Due in one year or less	\$ 1,131.7	\$ 1,133.2
Due in one through five years	1,899.6	1,911.9
Due in five through ten years	0.0	0.0
Due after ten years*	70.2	66.2
	\$ 3,101.5	\$ 3,111.3

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

Table of Contents**NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)***Fair Value of Financial Instruments*

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis as of October 29, 2010 (in millions):

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Corporate bonds	\$ 1,818.5	\$ 0.0	\$ 1,818.5	\$ 0.0
Auction rate securities	66.2	0.0	0.0	66.2
U.S. agency securities	665.4	0.0	665.4	0.0
U.S. treasuries	5.1	5.1	0.0	0.0
Commercial paper	474.5	0.0	474.5	0.0
Municipal bonds	1.5	0.0	1.5	0.0
Certificates of deposit	80.1	0.0	80.1	0.0
Money market funds	1,146.6	1,146.6	0.0	0.0
Equity funds	17.9	17.9	0.0	0.0
Investment in privately-held companies	1.3	0.0	0.0	1.3
Total	\$ 4,277.1	\$ 1,169.6	\$ 3,040.0	\$ 67.5
Liabilities				
Foreign currency contracts	\$ 7.7	\$ 0.0	\$ 7.7	\$ 0.0

Reported as (in millions):

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash equivalents	\$ 1,581.3	\$ 1,146.6	\$ 434.7	\$ 0.0
Short-term investments	2,610.4	5.1	2,605.3	0.0
Other current assets	2.3	2.3	0.0	0.0
Long-term investments	67.5	0.0	0.0	67.5
Other non-current assets	15.6	15.6	0.0	0.0

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

Total	\$ 4,277.1	\$ 1,169.6	\$ 3,040.0	\$ 67.5
Liabilities				
Other current liabilities	\$ 7.7	\$ 0.0	\$ 7.7	\$ 0.0

The unrealized losses on our available-for-sale investments in corporate bonds, U.S. agency securities and commercial paper were caused by market value declines as a result of the recent economic environment, as well as fluctuations in market interest rates. Because the decline in market value is attributable to changes in market conditions and not credit quality, and because we neither intend to sell nor are likely to be required to sell these investments prior to a recovery of par value, we do not consider these investments to be other-than temporarily impaired at October 29, 2010.

Table of Contents**NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

As of October 29, 2010 and April 30, 2010, we had auction rate securities (ARSs) with a par value of \$72.3 million and \$73.8 million, respectively, and an estimated fair value of \$66.2 million and \$69.0 million, respectively, which are classified as long-term investments. All of our ARSs are backed by pools of student loans guaranteed by the U.S. Department of Education. As of October 29, 2010, we recorded cumulative net temporary losses of \$4.0 million within Accumulated Other Comprehensive Income (AOCI). We estimated the fair value for each individual ARS using an income (discounted cash flow) approach that incorporates both observable and unobservable inputs to discount the expected future cash flows. Based on our ability to access our cash and other short-term investments, our expected operating cash flows, and our other sources of cash, we do not intend to sell these investments prior to recovery of value. We will continue to monitor our ARS investments in light of the current debt market environment and evaluate our accounting for these investments.

The table below provides a reconciliation of activities related to our Level 3 financial assets for the six months ended October 29, 2010 (in millions).

	Six Months Ended October 29, 2010	
	Auction Rate Securities	Private Equity Fund
Beginning balance	\$ 69.0	\$ 1.4
Total unrealized losses included in other comprehensive income	(1.4)	0.0
Purchases, sales and settlements, net	(1.4)	(0.1)
Ending balance	\$ 66.2	\$ 1.3

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

On June 10, 2008, we issued \$1,265.0 million aggregate principal amount of 1.75% Convertible Senior Notes due 2013 (the Notes). The Notes are unsecured, unsubordinated obligations of the Company. Interest is payable in cash semi-annually at a rate of 1.75% per annum. The Notes will mature on June 1, 2013 unless repurchased or converted in accordance with their terms prior to such date. The Notes may be converted, under the conditions specified in the indenture governing the Notes, based on an initial conversion rate of approximately 31.40 shares of common stock per \$1,000 principal amount of Notes (which represents an initial effective conversion price of the Notes of approximately \$31.85 per share), subject to adjustment as described in the indenture governing the Notes. For at least 20 trading days during the 30 consecutive trading days ended September 30, 2010, our common stock price exceeded the conversion threshold price of \$41.41 per share set forth for these Notes. Accordingly, the notes are convertible at the holder's option through December 31, 2010. Upon conversion of any Notes, we will deliver cash up to the principal amount of the Notes and, with respect to any excess conversion value greater than the principal amount of the Notes, shares of our common stock.

As of October 29, 2010, we had not issued any shares related to the Notes. Based on the closing price of our common stock of \$53.25 on October 29, 2010, the if-converted value of our Notes exceeded their principal amount by approximately \$850.0 million.

The following table reflects the carrying value of our convertible debt (in millions):

October 29, 2010	April 30, 2010
-------------------------	-----------------------

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

1.75% Convertible Notes Due 2013	\$	1,265.0	\$	1,265.0
Less: Unamortized discount		(139.6)		(163.5)
Net carrying amount of Notes	\$	1,125.4	\$	1,101.5

Table of Contents**NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The following table presents the amount of interest expense recognized at an effective interest rate of 6.31% relating to both the contractual interest coupon and the amortization of the discount and issuance costs (in millions):

	Three Months Ended		Six Months Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Contractual coupon interest expense	\$ 5.5	\$ 5.5	\$ 11.0	\$ 11.4
Amortization of debt discount	12.0	11.2	23.9	23.3
Amortization of issuance costs	1.0	1.0	2.0	2.0
Total interest expense recognized	\$ 18.5	\$ 17.7	\$ 36.9	\$ 36.7

The following table reflects the remaining debt discount and issuance cost as of October 29, 2010 (in millions):

Remaining debt discount	\$ 139.6
Remaining issuance costs	\$ 12.1
Remaining life of the Notes (years)	2.6

Note Hedges and Warrants

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

Note Hedges. As of October 29, 2010 and April 30, 2010, we have transactions with counterparties to buy up to approximately 31.8 million shares, subject to anti-dilution adjustments, of our common stock at a price of \$31.85 per share, subject to adjustment. The Note hedge transactions will expire at the earlier of (1) the last day on which any Notes remain outstanding and (2) the scheduled trading day immediately preceding the maturity date of the Notes.

Warrants. As of October 29, 2010 and April 30, 2010, we have outstanding warrants for others to acquire, subject to anti-dilution adjustments, 39.7 million shares of our common stock at an exercise price of \$41.28 per share, subject to adjustment, on a series of days commencing on September 3, 2013. Upon exercise of the warrants, we have the option to deliver cash or shares of our common stock equal to the difference between the then market price and the strike price of the warrants.

As of October 29, 2010 we are subject to potential dilution on the approximately 20% unhedged portion of our Notes upon conversion, if on the date of conversion, the per-share market price of our common stock exceeds the conversion price of approximately \$31.85.

Fair Value of Notes

As of October 29, 2010, the approximate fair value of the principal amount of our Notes, which includes the debt and equity components, was approximately \$2.2 billion, or 174% of the face value of the Notes, based upon quoted market information.

Other Long-Term Financing Arrangements

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

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

	October 29, 2010	April 30, 2010
Current portion of other long-term financing arrangements	\$ 4.1	\$ 0.0
Non-current portion of long-term financing arrangements	6.5	0.0
	\$ 10.6	\$ 0.0

Table of Contents**NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****10. Stockholders Equity****Stock Options**

A summary of the combined activity under our stock option plans and agreements is as follows (in millions, except for per share information and term):

	Numbers of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at April 30, 2010	35.2	\$ 23.02		
Options granted	2.1	39.50		
Options assumed in acquisition	0.2	16.56		
Options exercised	(10.2)	21.86		
Option forfeitures and cancellations	(0.6)	35.93		
Outstanding at October 29, 2010	26.7	24.42	4.52	\$ 770.1
Vested and expected to vest as of October 29, 2010	25.3	\$ 24.25	4.45	\$ 732.8
Exercisable at October 29, 2010	14.8	\$ 23.21	3.67	\$ 443.7

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

	Three Months Ended		Six Months Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Weighted-average fair value per share granted	\$ 15.21	\$ 9.70	\$ 13.70	\$ 8.14
Weighted-average fair value per share of options assumed in acquisition	N/A	N/A	\$ 21.15	N/A
Intrinsic value of options exercised	\$ 104.1	\$ 12.4	\$ 214.6	\$ 16.5
Proceeds received from the exercise of stock options	\$ 97.3	\$ 27.4	\$ 224.9	\$ 40.3
Fair value of options vested	\$ 26.5	\$ 35.9	\$ 54.5	\$ 81.9

There was \$94.2 million of total unrecognized compensation expense as of October 29, 2010 related to options. The unrecognized compensation expense will be amortized on a straight-line basis over a weighted-average remaining period of 2.5 years.

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

	Numbers of Shares	Weighted Average Grant Date Fair Value
Outstanding at April 30, 2010	9.0	\$ 23.93

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

RSUs granted	1.5	41.64
RSUs vested	(1.4)	19.23
RSU forfeitures and cancellations	(0.4)	24.87
Outstanding at October 29, 2010	8.7	27.82

RSUs are converted into common stock upon the release to the employees or directors upon vesting. Upon the vesting of restricted stock, we primarily require the use of the net share settlement approach and withhold a portion of the shares to cover the applicable taxes and decrease the shares issued to the employee by a corresponding value. The number and the value of the shares netted for employee taxes are summarized in the table below (in millions):

	Three Months Ended		Six Months Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Shares withheld for taxes	0.0	0.0	0.5	0.3
Fair value of shares withheld	\$ 1.1	\$ 0.5	\$ 19.6	\$ 5.7

Table of Contents**NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

As of October 29, 2010, there was \$161.7 million of total unrecognized compensation expense related to RSUs. The unrecognized compensation expense will be amortized on a straight-line basis over a weighted-average remaining vesting period of 2.6 years.

Employee Stock Purchase Plan Under the Employee Stock Purchase Plan (ESPP), employees are entitled to purchase shares of our common stock at 85% of the fair market value at certain specified dates over a two-year period. Additional information related to our purchase rights issued under the ESPP is summarized below (in millions, except per share information):

	Three and Six Months Ended	
	October 29, 2010	October 30, 2009
Weighted-average fair value per right granted	\$ 11.79	\$ 7.07
Shares issued under the ESPP	2.8	2.5
Weighted average price of shares issued	\$ 11.08	\$ 10.38

Stock-Based Compensation Expense

Stock-based compensation expense included in the condensed consolidated statements of operations for the three and six month periods ended October 29, 2010 and October 30, 2009, respectively, are as follows (in millions):

	Three Months Ended		Six Months Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Cost of product revenues	\$ 0.8	\$ 0.5	\$ 1.7	\$ 1.7
Cost of service revenues	3.1	2.9	7.0	7.4
Sales and marketing	17.3	15.7	37.9	39.7
Research and development	9.2	7.9	20.3	20.6
General and administrative	7.3	6.2	15.1	16.0
Total stock-based compensation expense	\$ 37.7	\$ 33.2	\$ 82.0	\$ 85.4

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

	Three Months Ended		Six Months Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Employee stock options	\$ 13.0	\$ 11.1	\$ 25.9	\$ 40.5
RSUs and restricted stock awards	18.0	13.7	37.8	30.5
ESPP	6.7	8.7	18.3	14.8
Change in amounts capitalized in inventory	0.0	(0.3)	0.0	(0.4)
Total stock-based compensation expense	\$ 37.7	\$ 33.2	\$ 82.0	\$ 85.4

For the six month periods ended October 29, 2010 and October 30, 2009, total income tax benefits associated with employee stock transactions and recognized in stockholders' equity were \$40.9 million and \$14.4 million, respectively.

Valuation Assumptions

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

	Stock Options			
	Three Months Ended		Six Months Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Expected term in years	4.8	4.7	4.8	4.2
Risk-free interest rate	1.40%	2.39%	1.95%	2.27%
Volatility	37%	41%	37%	43%

Table of Contents**NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

	ESPP			
	Three Months Ended		Six Months Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Expected term in years	N/A	N/A	1.2	1.3
Risk-free interest rate	N/A	N/A	0.46%	0.63%
Volatility	N/A	N/A	39%	45%

N/A No new employee purchase rights were granted under the ESPP during the three month periods ended October 29, 2010 and October 30, 2009.

Stock Repurchase Program

Since the May 13, 2003 inception of our stock repurchase program through October 29, 2010, we have repurchased a total of 104.3 million shares of our common stock at an average price of \$28.06 per share, for an aggregate purchase price of \$2.9 billion. As of October 29, 2010, our Board of Directors had authorized the repurchase of up to \$4.0 billion of common stock under this stock repurchase program, and \$1.1 billion remains available under these authorizations. The stock repurchase programs may be suspended or discontinued at any time.

During the six month period ended October 29, 2010, we did not repurchase any shares of our common stock under the stock repurchase program.

Comprehensive Income

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

	October 29, 2010	April 30, 2010
Accumulated translation adjustments	\$ 5.4	\$ 1.2
Accumulated unrealized gain on available-for-sale investments	7.3	0.9
Accumulated unrealized gain (loss) on derivatives qualifying as cash flow hedges	(1.7)	0.7
Total accumulated other comprehensive income	\$ 11.0	\$ 2.8

The components of comprehensive income were as follows:

	Three Months Ended		Six Months Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Net income	\$ 164.6	\$ 95.7	\$ 306.4	\$ 147.3
Change in currency translation adjustments	3.7	0.4	4.2	2.8
Change in unrealized gain on available-for-sale investments, net of related tax effect	4.3	1.7	6.4	8.6

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

Change in unrealized gain (loss) on derivatives qualifying as cash flow hedges	(1.9)	0.8	(2.4)	0.2
Comprehensive income	\$ 170.7	\$ 98.6	\$ 314.6	\$ 158.9

Table of Contents**NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****11. Derivatives and Hedging Activities**

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

	October 29, 2010	April 30, 2010
Cash Flow Hedges		
Euro	\$ 123.7	\$ 81.0
British Pound Sterling	25.1	18.9
Balance Sheet Contracts		
Euro	186.7	232.6
British Pound Sterling	68.8	57.0
Canadian Dollar	19.3	28.1
Australian Dollar	30.1	23.0
Other	50.3	43.6
Put Option (Euro)	14.8	0.0

As of October 29, 2010 and April 30, 2010, the fair value of our short-term foreign currency contracts was not material. Certain of these contracts are designed to hedge our exposure to foreign monetary assets and liabilities and are not accounted for as a hedging activity. Accordingly, changes in fair value of these instruments are recognized in earnings during the period of change. Net deferred gains and losses relating to changes in fair value of our foreign currency contracts that are accounted for as cash flow hedges were not material for any period presented. We did not recognize any gains and losses in earnings due to hedge ineffectiveness for any period presented. The amount of net losses recorded in AOCI as of October 29, 2010 was not material.

12. Income Taxes

Our effective tax rate for the periods presented was as follows:

	Six Months Ended	
	October 29, 2010	October 30, 2009
Effective tax rate	11.1%	10.8%

Our effective tax rate reflects the impact of a significant amount of our earnings being taxed in foreign jurisdictions at rates below the U.S. statutory tax rate. As of October 29, 2010, we had \$139.5 million of unrecognized tax benefits. We have recorded \$126.0 million in other long-term liabilities, of which \$113.4 million, if recognized, would affect our provision for income taxes.

We are currently undergoing federal income tax audits in the United States and several foreign tax jurisdictions. The rights to some of our intellectual property (IP) are owned by certain of our foreign subsidiaries, and payments are made between U.S. and foreign tax jurisdictions relating to the use of this IP in a qualified cost sharing arrangement. In recent years, several other U.S. companies have had their foreign IP arrangements challenged as part of IRS examinations, which has resulted in material proposed assessments and/or litigation with respect to those companies. Effective September 27, 2007, the IRS's Large and Mid-Sized Business Division (LMSB) released a Coordinated Issues Paper (CIP) with respect to qualified cost sharing arrangements (CSAs). Specifically, this CIP provides guidance to IRS personnel concerning methods that may be applied to evaluate the arm's length charge (buy-in payment) for internally developed (pre-existing), as well as acquisition-related, intangible property that is made available to a qualified CSA.

Table of Contents**NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

During fiscal year 2009, we received Notices of Proposed Adjustments from the IRS in connection with a federal income tax audit of our fiscal 2003 and 2004 tax returns. We filed a protest with the IRS in response to the Notices of Proposed Adjustments and subsequently received a rebuttal from the IRS examination team in response to our protest. We are currently in discussions with the IRS Appeals office for further administrative review. The Notices of Proposed Adjustments in this audit focus primarily on issues of the timing and the amount of income recognized and deductions taken during the audit years and on the level of cost allocations made to foreign operations during the audit years.

The IRS recently commenced the examination of our fiscal 2005 through 2007 federal income tax returns, and the California Franchise Tax Board has begun the examination of our fiscal 2007 and 2008 California income tax returns. The scope of each of the IRS and California Franchise Tax Board examinations is unclear at this time.

If upon the conclusion of these audits, the ultimate determination of taxes owed in the U.S. is for an amount in excess of the tax provision we have recorded in the applicable period or subsequently reserved for, the overall tax expense and effective tax rate could be adversely impacted in the period of adjustment. It is reasonably possible the Company will reach a final settlement with the IRS on the 2003-2004 audit within the next six months.

On September 17, 2010, the Danish tax authorities issued a decision concluding that distributions declared in 2005 and 2006 from the Company's indirect Danish subsidiary to the subsidiary's immediate parent affiliate, for which the Company has not paid or accrued any taxes, are subject to Danish at-source dividend withholding tax. The Company does not believe that the Danish subsidiary was liable to withhold tax at source on the distributions and has appealed this assessment decision with the Danish National Tax Tribunal.

13. Net Income per Share

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

	Three Months Ended		Six Months Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Numerator:				
Net income	\$ 164.6	\$ 95.7	\$ 306.4	\$ 147.3
Denominator:				
Weighted average common shares outstanding	359.1	336.7	355.8	335.7
Weighted average common shares outstanding subject to repurchase	0.0	0.0	0.0	(0.1)
Shares used in basic computation	359.1	336.7	355.8	335.6
Weighted average common shares outstanding subject to repurchase	0.0	0.0	0.0	0.1
Dilutive potential shares related to employee equity award plans	15.9	13.1	15.7	8.6
Dilutive impact of assumed conversion of Notes	12.4	0.0	9.4	0.0
Dilutive impact of warrants	4.3	0.0	2.1	0.0
Shares used in diluted computation	391.7	349.8	383.0	344.3
Net Income per Share:				
Basic	\$ 0.46	\$ 0.28	\$ 0.86	\$ 0.44

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

Diluted \$ 0.42 \$ 0.27 \$ 0.80 \$ 0.43

The following employee equity awards have been excluded from the diluted net income per share calculations, as their effect would have been antidilutive (in millions):

	Three Months Ended		Six Months Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Options and RSUs	2.1	20.3	3.7	31.0

Table of Contents**NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

Dilutive shares outstanding during the three and six month periods ended October 30, 2009 do not include any effect resulting from warrants or any effect resulting from assumed conversion of the Notes, as their impact would have been anti-dilutive. The Note hedges (as described in Note 9) are not included for purposes of calculating earnings per share as their effect would be anti-dilutive. The Note hedges, if exercised upon conversion of the Notes, are expected to reduce approximately 80% of the dilutive effect of the Notes when our stock price is above \$31.85 per share.

14. Segment, Geographic, and Significant Customer Information

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

Summarized revenues by geographic region for the three and six month periods ended October 29, 2010 and October 30, 2009, based on the our internal management system and as utilized by our Chief Executive Officer, who is considered our Chief Operating Decision Maker (CODM), is as follows (in millions):

	Three Month Ended		Six Month Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Americas (United States, Canada and Latin America)*	\$ 741.1	\$ 510.5	\$ 1,375.0	\$ 993.3
Europe, Middle East and Africa	349.9	306.1	733.2	573.0
Asia Pacific and Japan	116.4	93.4	237.0	181.7
Net revenues	\$ 1,207.4	\$ 910.0	\$ 2,345.2	\$ 1,748.0

* Sales to the United States accounted for \$668.3 million and \$460.8 million, respectively, in the three month periods ended October 29, 2010 and October 30, 2009, and \$1,233.5 million and \$899.8 million, respectively, of Americas revenues in the six month periods ended October 29, 2010 and October 30, 2009.

The majority of our assets, excluding cash, cash equivalents and investments and accounts receivable, as of October 29, 2010 and April 30, 2010 were attributable to our U.S. operations. Our total cash, cash equivalents and investments held outside of the United States in various foreign subsidiaries was \$2.0 billion and \$1.7 billion as of October 29, 2010 and April 30, 2010, respectively, and the remaining \$2.5 billion and \$2.1 billion at the respective period ends was held in the United States.

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 29, 2010

April 30, 2010

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

United States	\$	777.7	\$	735.0
International		67.6		69.4
Total property and equipment	\$	845.3	\$	804.4

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

International sales to single foreign countries which accounted for ten percent or more of net revenues were as follows (in millions):

	Three Months Ended		Six Months Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Germany	\$ 127.7	\$ 105.5	\$ 261.8	\$ 184.8

Table of Contents**NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

Sales to customers, who are our distributors, which accounted for ten percent or more of net revenues were as follows (in millions):

	Three Months Ended		Six Months Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Arrow Electronics, Inc.	\$ 211.7	\$ 107.4	\$ 392.0	\$ 200.9
Avnet, Inc.	186.2	100.7	310.2	195.5

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

	October 29, 2010	April 30, 2010
Arrow Electronics, Inc.	\$ 42.5	\$ 48.7

15. Commitments and Contingencies*Lease Commitments*

Future annual minimum lease payments under all noncancelable facilities and equipment operating leases with an initial term in excess of one year as of October 29, 2010 totaled \$254.3 million.

Purchase Orders and Other Commitments

In the normal course of business we make commitments to our third party contract manufacturers, to manage manufacturer lead times and meet product forecasts, and to other parties, to purchase various key components used in the manufacture of our products. We establish accruals for estimated losses on purchased components for which we believe it is probable that they will not be utilized in future operations. To the extent that such forecasts are not achieved, our commitments and associated accruals may change. We had \$126.2 million in non-cancelable purchase commitments with our contract manufacturers as of October 29, 2010. In addition, we recorded a liability for firm non-cancelable and unconditional purchase commitments with contract manufacturers for quantities in excess of our future demand forecasts through a charge to product cost of sales. As of October 29, 2010 and April 30, 2010, such liability amounted to \$3.5 million and \$3.8 million, respectively, and is included in other current liabilities in the consolidated balance sheets.

In addition to commitments with contract manufacturers and component suppliers, we have open purchase orders and contractual obligations associated with our ordinary course business for which we have not received goods or services. We had \$30.1 million in capital purchase commitments and \$337.1 million in other purchase commitments as of October 29, 2010.

Product Warranties

We provide customers a warranty on software of ninety days and a warranty on hardware of three years. Following is an analysis of our warranty reserves (in millions):

	Three Months Ended		Six Months Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Beginning balance	\$ 32.1	\$ 40.3	\$ 31.9	\$ 42.3

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

Expense accrued during the period	7.0	2.3	12.9	7.6
Warranty costs incurred	(5.6)	(6.7)	(11.3)	(14.0)
Ending balance	\$ 33.5	\$ 35.9	\$ 33.5	\$ 35.9

Table of Contents

NETAPP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Financing Guarantees

We have both nonrecourse and recourse lease financing arrangements with third-party leasing companies through new and preexisting relationships with customers. In addition, from time to time we provide guarantees for a portion of other financing arrangements under which we could be called upon to make payments to our third-party funding companies in the event of nonpayment by end-user customers. Under the terms of the nonrecourse leases, we do not have any continuing obligations or liabilities to the third-party leasing companies. Under the terms of the recourse leases, which are generally three years or less, we remain liable for the aggregate unpaid remaining lease payments to the third-party 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, we defer the revenues associated with the end-user financing arrangement in accordance with our revenue recognition policies. As of October 29, 2010, the maximum guaranteed payment contingencies under our financing arrangements totaled approximately \$75.8 million; and the related deferred revenue and cost of revenues totaled approximately \$78.7 million and \$9.1 million, respectively. To date, we have not experienced material losses under our lease financing programs or other financing arrangements.

Legal Contingencies

We are subject to various legal proceedings and claims which may arise in the normal course of business. No accrual has been recorded as of October 29, 2010, as the outcome of these legal matters is currently not determinable.

On September 5, 2007, we filed a patent infringement lawsuit in the Eastern District of Texas seeking compensatory damages and a permanent injunction against Sun Microsystems (Sun). On October 25, 2007, Sun filed a counter claim against us in the Eastern District of Texas seeking compensatory damages and a permanent injunction. On October 29, 2007, Sun filed a second lawsuit against us in the Northern District of California asserting additional patents against us. The Texas court granted a joint motion to transfer the Texas lawsuit to the Northern District of California on November 26, 2007. On March 26, 2008, Sun filed a third lawsuit in federal court that extends the patent infringement charges to storage management technology we acquired in January 2008. In January 2010, Oracle Corporation acquired Sun. In September 2010, the lawsuits were dismissed without prejudice.

On October 13, 2010, Amalgamated Bank (as trustee of the Longview Largecap 500 Index Fund and the Longview Largecap 500 Index Veba Fund) filed a derivative lawsuit on behalf of NetApp, Inc. and NetApp U.S. Public Sector, Inc. in the Superior Court of the State of California, Santa Clara County. The lawsuit names 15 current and former NetApp directors as defendants, alleging breach of fiduciary duty and wasting of corporate assets. The lawsuit alleges that the defendants failed to implement and oversee internal controls to ensure that we complied with legal requirements in its General Services Administration (GSA) contracting activities, and that this purported failure of oversight required us to incur significant costs in defending and settling a dispute with the United States of America regarding these past GSA contracting activities. The complaint seeks disgorgement of salaries and other compensation from the defendants and seeks additional unspecified damages. We and the defendants have filed demurrers seeking to have the lawsuit dismissed.

Table of Contents

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

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

our future financial and operating results;

our business strategies;

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

economic and industry trends or trend analyses;

product introductions, development, enhancements and acceptance;

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

competitive positions;

future cash flows and cash deployment strategies;

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

our anticipated tax rate;

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

the conversion, maturation or repurchase of the convertible notes;

compliance with laws, regulations and debt covenants;

the continuation of our stock repurchase program; and

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

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

acceptance of, and demand for, our products, including our recently announced new product introductions;

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

the general economic environment and the growth of the storage markets;

the amount of orders received in future periods;

our ability to ship our products in a timely manner;

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

our ability to successfully manage our backlog and increase revenue;

our ability to successfully execute on our strategy;

Table of Contents

our ability to successfully introduce new products;

our ability to maintain the quality of our hardware, software and services offerings;

our ability to adapt to changes in market demand;

demand for our services and support;

our ability to identify and respond to significant market trends and emerging standards;

the impact of industry consolidation;

our ability to successfully manage our investment in people, process, and systems;

our ability to maintain our partner, supplier and contract manufacturer relationships;

the ability of our suppliers and contract manufacturers to meet our requirements;

the ability of our competitors to introduce new products that compete successfully with our products;

our ability to grow direct and indirect sales and to efficiently utilize global service and support;

variability in our gross margins;

our ability to sustain and/or improve our cash and overall financial position;

our cash requirements and terms and availability of financing;

valuation and liquidity of our investment portfolio;

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

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

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

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

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof and are based upon information available to us at this time. These statements are not guarantees of future performance. We disclaim any obligation to update information in any forward-looking statement. Actual results could vary from our forward looking statements due to foregoing factors as well as other important factors, including those described in the Risk Factors included on page 40.

Overview

Net revenues for the three month period ended October 29, 2010 were \$1,207.4 million, up \$297.4 million, or 33%, from the comparable period in the prior year. Net revenues for the six month periods ended October 29, 2010 were \$2,345.2 million, up \$597.2 million, or 34%, from the comparable period in the prior year. Improved revenue performance in the first three and six months of fiscal 2011 was the result of strong demand for our storage efficiency and data management solutions, with increases in revenues across all geographies. Gross margin percentages remained relatively flat during the three and six month periods ended October 29, 2010, respectively, compared to the same periods in the prior year.

Sales and marketing, research and development, and general and administrative expenses for the three month period ended October 29, 2010 totaled \$603.6 million, up 23% from the prior year and for the six month period ended October 29, 2010 totaled \$1,163.5 million, up 19% from the prior year. The increase is primarily due to an 18% and 14% increase in average headcount, respectively, and higher levels of incentive compensation and commission expense. Salary and related expenses for the six months ended October 29, 2010 were favorably impacted by having 26 weeks in that period compared to 27 weeks in the same period of the prior year.

Table of Contents***Critical Accounting Estimates and Policies***

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

We believe the accounting policies discussed under Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended April 30, 2010 are significantly affected by critical accounting estimates and that they are both highly important to the portrayal of our financial condition and results and require difficult management judgments and assumptions about matters that are inherently uncertain. There have been no material changes to the critical accounting policies and estimates as filed in such report.

New Accounting Standards

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

Results of Operations

The following table sets forth certain condensed consolidated statements of operations data as a percentage of net revenues for the periods indicated:

	Three Months Ended		Six Months Ended	
	October 29, 2010	October 30, 2009	October 29, 2010	October 30, 2009
Revenues:				
Product	64.6%	57.7%	64.0%	57.4%
Software entitlements and maintenance	14.7	18.7	15.0	19.2
Service	20.7	23.6	21.0	23.4
Net revenues	100.0	100.0	100.0	100.0
Cost of revenues:				
Cost of product	24.5	21.9	25.7	23.5
Cost of software entitlements and maintenance	0.3	0.3	0.3	0.4
Cost of service	8.9	11.1	9.0	11.5
Gross profit	66.3	66.7	65.0	64.6
Operating expenses:				
Sales and marketing	31.7	33.1	31.4	34.5
Research and development	13.0	14.5	13.1	15.0
General and administrative	5.3	6.3	5.1	6.7
Restructuring and other charges		0.1		0.2
Acquisition related (income) expense, net				(2.4)
Total operating expenses	50.0	54.0	49.6	54.0
Income from operations	16.3	12.7	15.4	10.6
Other expenses, net:				
Interest income	0.7	0.7	0.8	0.8
Interest expense	(1.5)	(2.0)	(1.5)	(2.1)

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

Other income (expense), net	(0.1)	0.2		0.1
Total other expenses, net	(0.9)	(1.1)	(0.7)	(1.2)
Income before income taxes	15.4	11.6	14.7	9.4
Provision for income taxes	1.8	1.1	1.6	1.0
Net income	13.6%	10.5%	13.1%	8.4%

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

Net Revenues Our net revenues for the three and six month periods ended October 29, 2010 and October 30, 2009 were as follows (in millions, except percentages):

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
Net revenues	\$ 1,207.4	\$ 910.0	33%	\$ 2,345.2	\$ 1,748.0	34%

Net revenues increased by \$297.4 million, or 33%, for the three month period ended October 29, 2010 from the comparable period in the prior year, and for the six month period ended October 29, 2010, increased \$597.2 million, or 34%, from the comparable period in the prior year. The increase in our net revenues for both periods was primarily related to an increase in product revenues, which comprised 65% and 64% of net revenues in the three and six month periods ended October 29, 2010, respectively, compared to 58% and 57% in the three and six month periods ended October 30, 2009, respectively.

Sales through our indirect channels represented 72% and 70% of net revenues for the three and six month periods ended October 29, 2010, respectively, and represented 67% and 68% of net revenues for the three and six month periods ended October 30, 2009, respectively.

The following table sets forth sales to customers, who are distributors, who accounted for 10% or more of revenues (in millions, except percentages):

	Three Months Ended				Six Months Ended			
	October 29, 2010	% of Revenues	October 30, 2009	% of Revenues	October 29, 2010	% of Revenues	October 30, 2009	% of Revenues
Arrow Electronics, Inc.	\$ 211.7	18%	\$ 107.4	12%	\$ 392.0	17%	\$ 200.9	11%
Avnet, Inc.	186.2	15%	100.7	11%	310.2	13%	195.5	11%

Product Revenues (in millions, except percentages):

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
Product revenues	\$ 780.0	\$ 525.1	49%	\$ 1,500.8	\$ 1,003.4	50%

Product revenues increased by \$254.9 million, or 49%, for the three month period ended October 29, 2010, and increased by \$497.4 million, or 50%, for the six month period ended October 29, 2010, from the comparable periods in the prior year. Our configured systems are comprised of bundled hardware and software products. Configured systems unit volume increased by 77% for each of the three and six month periods ended October 29, 2010 compared to the prior year, with the largest increase in smaller systems. Total configured system revenue increased by \$182.7 million and \$376.0 million for the three and six month periods ended October 29, 2010, respectively, compared to the prior year, with the largest increase in medium-sized systems.

Table of Contents

During the three month period ended October 29, 2010, large, medium-sized and smaller systems generated approximately 18%, 59% and 23% of configured systems revenues, respectively, compared to approximately 23%, 58% and 19%, respectively in the prior year. Average selling prices (ASPs) declined during the three month period ended October 29, 2010 due primarily to lower ASPs per unit in smaller systems, as well as a shift in unit mix towards smaller systems. During the six month period ended October 29, 2010, large, medium-sized and smaller systems generated approximately 22%, 55% and 23% of configured systems revenues, respectively, compared to approximately 22%, 58% and 20%, respectively in the prior year. During the six months ended October 29, 2010, ASP declined due primarily to lower ASPs per unit in smaller systems, partially offset by an increase in ASPs per unit in medium-sized systems as well as a shift in unit mix towards medium-sized systems.

In addition, our net add-on hardware, software and other product revenues accounted for a \$72.1 million and a \$121.5 million increase for the three and six month periods ended October 29, 2010 from the comparable periods in the prior year, primarily due to customers increasing the capacity and/or functionality of their storage systems.

Our systems are highly configurable to respond to customer requirements in the open systems storage markets that we serve. This wide variation in customer configurations can significantly impact revenues, cost of revenues, and gross profit performance. Price changes, foreign currency rates, unit volumes, customer mix and product configuration can also impact revenues, cost of revenues and gross profit performance. Disks are a significant component of our storage systems. Industry disk pricing continues to fall every year, and we pass along those price decreases to our customers while working to maintain relatively constant profit margins on our disk drives. While our sales price per terabyte continues to decline, improved system performance, increased capacity and software to manage this increased capacity have an offsetting impact on product revenues.

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

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
Software entitlements and maintenance revenues	\$ 177.9	\$ 169.8	5%	\$ 352.6	\$ 335.1	5%

Software entitlements and maintenance, or SEM, revenues increased by \$8.1 million, or 5%, and \$17.5 million, or 5%, for the three and six month periods ended October 29, 2010, respectively, from the comparable periods in the prior year. These increases were the result of an increase in the aggregate contract value of the installed base under SEM contracts, which is recognized as revenue ratably over the terms of the underlying contracts.

Service Revenues (in millions, except percentages):

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
Service revenues	\$ 249.5	\$ 215.1	16%	\$ 491.8	\$ 409.5	20%

Service revenues include hardware maintenance, professional services and educational and training services. Service revenues increased by \$34.4 million, or 16%, and \$82.3 million, or 20%, for the three and six month periods ended October 29, 2010, respectively, from the comparable periods in the prior year. Hardware maintenance contract revenues increased 22% for each of the three and six month periods ended October 29, 2010, respectively, from the comparable periods in the prior year, as a result of an increase in the installed base under service contracts and the timing of recognition of the related revenue. Professional services and educational and training services revenues increased 6% and 16% for the three and six month periods ended October 29, 2010, respectively, compared to the prior year.

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

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
Americas (primarily the United States)	\$ 741.1	\$ 510.5	45%	\$ 1,375.0	\$ 993.3	38%

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

Europe, Middle East and Africa (EMEA)	349.9	306.1	14%	733.2	573.0	28%
Asia Pacific and Japan (APAC)	116.4	93.4	25%	237.0	181.7	30%
Net revenues	\$ 1,207.4	\$ 910.0		\$ 2,345.2	\$ 1,748.0	

Table of Contents

Sales to the United States accounted for 90% of Americas revenues in each of the three month periods ended October 29, 2010 and October 30, 2009, and 90% and 91% of Americas revenues in the six month periods ended October 29, 2010 and October 30, 2009, respectively. Sales to Germany accounted for 11% and 12% of net revenues for the three month periods ended October 29, 2010 and October 30, 2009, respectively, and for 11% of net revenues for each of the six month periods ended October 29, 2010 and October 30, 2009, respectively.

Cost of Revenues

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

Our gross profits are impacted by a variety of factors including pricing and discount practices, product configuration, channel sales mix, revenue mix and product material costs. Service gross profit is also typically impacted by factors such as changes in the size of our installed base of products, as well as the timing of support service initiations and renewals, and incremental investments in our customer support infrastructure. If our shipment volumes, product and services mix, average selling prices and pricing actions that impact our gross profit are adversely affected, whether by economic uncertainties or for other reasons, our gross profit could decline.

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

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
Cost of product revenues	\$ 296.1	\$ 199.1	49%	\$ 603.8	\$ 411.7	47%

Cost of product revenues increased by \$97.0 million, or 49%, and by \$192.1 million, or 47%, for the three and six month periods ended October 29, 2010, respectively, from the comparable periods in the prior year. The change was comprised of the following elements (in percentage points of the total change):

	Three Months Ended Fiscal 2010 to Fiscal 2011 Percentage Points	Six Months Ended Fiscal 2010 to Fiscal 2011 Percentage Points
Materials costs	44	44
Excess and obsolete inventory	1	
Warranty	2	1
Manufacturing overhead	1	1
Other	1	1
Total change	49	47

In each of the three and six month periods ended October 29, 2010, the increase in materials cost reflects a 77% increase in configured systems unit volume and an increase in unit costs of large systems, partially offset by lower per unit costs in smaller systems due to favorable materials pricing, which we expect to continue. Average materials costs per unit were favorably impacted by a shift in mix to smaller systems in the three months ended October 29, 2009, but were unfavorably impacted by a shift towards medium-sized systems in the six months ended October 29, 2009. Our cost of product revenues was unfavorably impacted by:

- (i) an increase of \$57.8 million and \$123.5 million in material costs related to increased volumes in the three and six month periods ended October 29, 2010, respectively,

- (ii) an increase of \$4.7 million and \$5.3 million in warranty expenses in the three and six month period ended October 29, 2010, respectively,

- (iii) an increase of \$34.5 million and \$63.3 million in costs of hardware add-ons and other product costs in the three and six month period ended October 29, 2010, respectively,

Table of Contents

Cost of product revenues represented 38% of product revenue for each of the three month periods ended October 29, 2010 and October 30, 2009, respectively, and represented 40% and 41% of product revenue for the six month periods ended October 29, 2010 and October 30, 2009, respectively. The overall reduction of costs as a percentage of revenues for the six month periods ended October 29, 2010 was the result of per unit materials cost reductions outpacing sales price reductions.

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

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
Cost of software entitlements and maintenance revenues	\$ 3.5	\$ 3.1	13%	\$ 6.9	\$ 6.2	11%

Cost of SEM revenues increased by \$0.4 million, or 13%, and \$0.7 million, or 11%, for the three and six month periods ended October 29, 2010, respectively, from the comparable periods in the prior year due to an increase in field service engineering costs. Cost of SEM revenues represented 2% of SEM revenues for each of the three month periods ended October 29, 2010 and October 30, 2009, and for each of the six month periods ended October 29, 2010 and October 30, 2009.

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

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
Cost of service revenues	\$ 106.7	\$ 101.1	6%	\$ 209.0	\$ 200.9	4%

Cost of service revenues increased by \$5.6 million, or 6%, and increased by \$8.1 million, or 4%, for the three and six month periods ended October 29, 2010, respectively, from the comparable periods in the prior year primarily due to increased warranty costs associated with higher sales volumes. Costs represented 43% and 47% of service revenues for the three month periods ended October 29, 2010 and October 30, 2009, respectively, and represented 43% and 49% of service revenues for the six month periods ended October 29, 2010 and October 30, 2009, respectively.

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

Compensation costs comprise the largest component of operating expenses. Included in compensation costs are salaries and related benefits, stock-based compensation costs and employee incentive compensation plan costs. Compensation costs included in operating expenses increased approximately \$52.6 million, or 20%, and \$72.8 million, or 13%, during the three and six month periods ended October 29, 2010, respectively, compared to the comparable periods in the prior year, primarily due to:

- (i) an increase in salaries, benefits and other compensation related costs due to an increase in average headcount, primarily in sales, marketing and engineering functions, of \$42.7 million and \$62.0 million for the three and six month periods ended October 29, 2010, respectively,
- (ii) an increase in incentive compensation expense reflecting stronger operating performance and increased headcounts of \$5.9 million and \$13.7 million during the three and six month periods ended October 29, 2010, respectively, and
- (iii) an increase in stock based compensation of \$4.0 million for the three month periods ended October 29, 2010, and a decrease of \$2.9 million for the six month periods ended October 29, 2010.

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

In addition, sales and marketing expenses reflected an increase in commissions expense of \$6.0 million and \$17.8 million during the three and six month periods ended October 29, 2010, respectively, reflecting stronger sales performance compared to the same periods of the prior year.

Sales and Marketing (in millions, except percentages):

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
Sales and marketing expenses	\$ 382.8	\$ 300.8	27%	\$ 737.0	\$ 602.3	22%

Table of Contents

Sales and marketing expense consists primarily of compensation costs, commissions, outside services, allocated facilities and IT costs, advertising and marketing promotional expense, and travel and entertainment expense, and increased \$82.0 million, or 27%, and \$134.7 million, or 22%, for the three and six month periods ended October 29, 2010, respectively, from the comparable period in the prior year. This change was comprised of the following elements (in percentage points of the total change):

	Three Months Ended Fiscal 2010 to Fiscal 2011 Percentage Points	Six Months Ended Fiscal 2010 to Fiscal 2011 Percentage Points
Salaries	6	5
Incentive plan compensation	1	1
Stock based compensation	1	
Other compensation and benefit costs	3	2
Commissions	2	3
Outside services	5	4
Advertising and marketing promotional expense	3	2
Travel and entertainment	1	1
Facilities and IT support costs	3	2
Other	2	2
Total change	27	22

The increase in salaries and related expenses reflects an increase in average sales and marketing headcount of 17% and 13% for the three and six month periods ended October 29, 2010, respectively, compared to the same periods in the prior year.

Research and Development (in millions, except percentages):

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
Research and development expenses	\$ 156.6	\$ 132.4	18%	\$ 306.1	\$ 262.7	17%

Research and development expense consists primarily of compensation costs, allocated facilities and IT costs, depreciation and amortization, prototypes, non-recurring engineering, or NRE charges and other outside services costs. Research and development expenses increased \$24.2 million, or 18%, and \$43.4 million, or 17%, for the three and six month periods ended October 29, 2010, respectively, from the comparable periods in the prior year. This change was comprised of the following elements (in percentage points of the total change):

	Three Months Ended Fiscal 2010 to Fiscal 2011 Percentage Points	Six Months Ended Fiscal 2010 to Fiscal 2011 Percentage Points
Salaries	8	6
Incentive plan compensation	1	2
Stock based compensation	1	
Travel and entertainment	1	1
Facilities and IT support costs	3	3
NRE charges		1
Outside services	1	1
Equipment and software related costs	1	1
Other	2	2

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

Total change

18

17

30

Table of Contents

The increase in salaries and related expenses reflects an increase in average engineering headcount of 23% and 18% for the three and six month periods ended October 29, 2010, respectively, compared to the same periods in the prior year.

General and Administrative (in millions, except percentages):

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
General and administrative expenses	\$ 64.2	\$ 56.9	13%	\$ 120.4	\$ 116.4	3%

General and administrative expense consists primarily of compensation costs, professional and corporate legal fees, recruiting expenses, and allocated facilities and IT costs. General and administrative expenses increased \$7.3 million, or 13%, and \$4.0 million, or 3%, for the three and six month periods ended October 29, 2010, respectively, from the comparable periods in the prior year. This change was comprised of the following elements (in percentage points of the total change):

	Three Months Ended Fiscal 2010 to Fiscal 2011 Percentage Points	Six Months Ended Fiscal 2010 to Fiscal 2011 Percentage Points
Salaries	3	1
Incentive plan compensation	2	2
Stock based compensation	2	(1)
Other compensation and benefits costs	2	1
Professional and corporate legal fees	(1)	(2)
IT costs	3	1
Other	2	1
Total change	13	3

Restructuring and Other Charges (in millions, except percentages):

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
Restructuring and other charges	\$ 0.1	\$ 1.2	(92)%	\$ 0.1	\$ 2.7	(96)%

In each of the three and six month periods ended October 30, 2009, we recorded restructuring expense of \$1.2 million and \$2.7 million, respectively, primarily related to adjustments to future lease commitments and employee severance costs associated with our fiscal 2009 restructuring plan.

Acquisition Related (Income) Expense, Net (in millions, except percentages):

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
Acquisition related (income) expense, net	\$ 0.0	\$ 0.0	0%	\$ 0.3	\$ (41.1)	NM

NM Not meaningful

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

In the six month period ended October 29, 2010, we incurred \$0.3 million of costs associated with our acquisition of Bycast Inc. In the six month period ended October 30, 2009, we received a \$57.0 million termination fee related to the terminated merger transaction with Data Domain Corporation, partially offset by \$15.9 million of incremental third-party costs.

Table of Contents*Other Income and Expense***Interest Income (in millions, except percentages):**

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
Interest income	\$ 9.5	\$ 7.0	36%	\$ 19.3	\$ 15.6	24%

The increase in interest income for the three and six month periods ended October 29, 2010 compared to the comparable periods in the prior year was primarily due to higher levels of investments in fiscal 2011.

Interest Expense (in millions except percentages):

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
Interest expense	\$ (18.6)	\$ (17.9)	4%	\$ (37.2)	\$ (37.1)	0%

Interest expense was relatively flat for the three and six month periods ended October 29, 2010, compared to the comparable periods in the prior year. We recognized incremental non-cash interest expense from the amortization of debt discount and issuance costs relating to our convertible notes (the Notes) of \$13.0 million and \$25.9 million, during the three and six month periods ended October 29, 2010, respectively, and \$12.2 million and \$25.3 million, for the three and six month periods ended October 30, 2009, respectively. The coupon interest expense related to the Notes was \$5.5 million and \$11.0 million for the three and six month periods ended October 29, 2010, respectively, and \$5.5 million and \$11.4 million for the three and six month periods ended October 30, 2009, respectively.

Other Income (Expenses), Net (in millions, except percentages):

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change
Realized gain (loss) on investments, net	\$ (0.1)	\$ 2.8	NM	\$ 2.6	\$ 2.7	(4)%
Other expenses, net	(1.3)	(1.3)	0%	(1.8)	(2.3)	(22)%
Other income (expense), net	\$ (1.4)	\$ 1.5	NM	\$ 0.8	\$ 0.4	100%

NM Not meaningful

Other income (expense), net for the three and six month periods ended October 29, 2010 included \$0.1 million of net loss and \$2.6 million of net gains on investment, respectively. Other expenses for the three and six month periods ended October 29, 2010 included \$2.4 million and \$2.7 million, respectively, in net losses on foreign currency transactions and related hedging activities, compared to \$1.5 million and \$3.5 million for the three and six month periods ended October 30, 2009, respectively.

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

	Three Months Ended			Six Months Ended		
	October 29, 2010	October 30, 2009	% Change	October 29, 2010	October 30, 2009	% Change

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

Provision for income taxes	\$ 22.3	\$ 10.3	117%	\$ 38.1	\$ 17.8	114%
----------------------------	---------	---------	------	---------	---------	------

The increase in the provision for income taxes for the six month period ended October 29, 2010 was primarily due to a 109% increase in income before income taxes from the comparable period in the prior year. Our effective tax rate for the six month period ended October 29, 2010 was 11.1%, compared to an effective tax rate of 10.8% for the six month period ended October 30, 2009. Our effective tax rate reflects our corporate legal entity structure and the global nature of our business with a significant amount of our profits generated and taxed in foreign jurisdictions at rates below the U.S. statutory tax rate.

Table of Contents***Liquidity and Capital Resources***

The following sections discuss our principal liquidity requirements, as well as our sources and uses of cash flows on our liquidity and capital resources. The principal objectives of our investment policy are the preservation of principal and maintenance of liquidity. We attempt to mitigate default risk by investing in high-quality investment grade securities, limiting the time to maturity and by 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 29, 2010.

Liquidity Sources, Cash Requirements

Our principal sources of liquidity as of October 29, 2010 consisted of approximately \$4.5 billion in cash, cash equivalents and short-term and long-term investments, as well as cash we expect to generate from operations.

Cash, cash equivalents and investments consist of the following:

	October 29, 2010	April 30, 2010
Cash and cash equivalents	\$ 1,771.1	\$ 1,705.0
Short-term investments	2,610.4	2,019.0
Long-term investments and restricted cash	69.8	72.8
 Total cash, cash equivalents and investments	 \$ 4,451.3	 \$ 3,796.8

As of October 29, 2010, \$2.5 billion of cash, cash equivalents and investments were held in the United States, while \$2.0 billion were held in foreign countries. Our principal liquidity requirements are primarily to meet our working capital needs, support ongoing business activities, fund research and development, meet capital expenditure needs, invest in critical or complementary technologies, and to service our debt and synthetic leases.

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

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

Capital Expenditure Requirements

We expect to fund our capital expenditures, including our commitments related to facilities and 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 at this time 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 financing our facilities requirements. We expect that our existing facilities and those being developed in Sunnyvale, California; Research Triangle Park, North Carolina; and worldwide are adequate for our requirements over at least the next two years and that additional space will be available as needed. We expect to incur approximately \$155.0 million related to capital projects for the remaining six months of fiscal year 2011.

Table of Contents*Cash Flows*

As of October 29, 2010, our cash and cash equivalents and short-term and long-term investments increased by \$0.7 billion from April 30, 2010 to \$4.4 billion. The increase was primarily a result of cash provided by operating activities and issuances of common stock related to employee stock option exercises and purchases under the employee stock purchase plan, partially offset by \$74.9 million net cash paid in connection with the acquisition of Bycast Inc. and \$83.5 million in capital expenditures. We derive our liquidity and capital resources primarily from our cash flow from operations and from working capital. Days sales outstanding as of October 29, 2010 decreased to 34 days, compared to 37 days as of April 30, 2010, primarily due to improvements in shipment linearity. Working capital increased by \$0.7 billion to \$3.3 billion as of October 29, 2010, compared to \$2.6 billion as of April 30, 2010, primarily due to an increase in cash, cash equivalents and short-term investments of \$0.7 billion.

Cash Flows from Operating Activities

During the six month period ended October 29, 2010, we generated cash from operating activities of \$542.0 million. The primary sources of cash from operations consisted of net income of \$306.4 million, adjusted by non-cash stock-based compensation expense of \$82.0 million and depreciation and amortization expense of \$82.3 million. Significant changes in assets and liabilities impacting operating cash flows included a decrease in accrued compensation and other current liabilities of \$96.1 million, primarily attributable to employee payouts related to fiscal year 2010 s commissions and incentive compensation plans, partially offset by an increase in deferred revenue of \$81.6 million.

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

Cash Flows from Investing Activities

Capital expenditures for the six month period ended October 29, 2010 were \$83.5 million. We paid \$594.8 million for net purchases and redemptions of our investments for the six month period ended October 29, 2010. During the six month period ended October 29, 2010, we completed our acquisition of Bycast Inc. for total cash payments of \$74.9 million, net of cash acquired.

Cash Flows from Financing Activities

We received \$266.8 million from financing activities for the six month period ended October 29, 2010, which primarily consisted of \$236.1 million of proceeds from employee equity award plans, net of shares withheld for taxes, and \$32.7 million of excess tax benefit from stock-based compensation.

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

Stock Repurchase Program

Since the May 13, 2003 inception of our stock repurchase program through October 29, 2010, our Board of Directors has authorized the repurchase of up to \$4.0 billion of common stock under such stock repurchase program. At October 29, 2010, \$1.1 billion remains available under these authorizations. The stock repurchase program may be suspended or discontinued at any time.

Convertible Notes

As of October 29, 2010, we had \$1.265 billion principal amount of 1.75% Convertible Senior Notes due 2013 (the Notes). The Notes will mature on June 1, 2013, unless earlier repurchased or converted. As of October 29, 2010, the Notes have not been repurchased or converted. We also have not received any shares under the related Note hedges or delivered cash or shares under the related warrants.

Table of Contents*Contractual Obligations*

The following summarizes our contractual obligations, and commitments at October 29, 2010 and the effect such obligations are expected to have on our liquidity and cash flows in future periods (in millions):

	2011	2012	2013	2014	2015	Thereafter	Total
Off-balance sheet commitments:							
Office operating lease payments	\$ 14.4	\$ 26.5	\$ 21.0	\$ 17.4	\$ 15.8	\$ 21.2	\$ 116.3
Real estate lease payments (1)	1.6	3.2	92.3	0.0	0.0	0.0	97.1
Less: sublease income	(0.8)	(1.4)	(1.4)	(1.1)	(1.0)	(0.5)	(6.2)
Equipment operating lease payments	14.3	15.3	8.5	2.5	0.2	0.1	40.9
Purchase commitments with contract manufacturers (2)	117.6	3.6	3.6	1.2	0.2	0.0	126.2
Capital expenditures	12.1	18.0	0.0	0.0	0.0	0.0	30.1
Other purchase obligations (3)	116.2	112.1	72.7	19.3	13.6	3.2	337.1
Total off balance sheet commitments	275.4	177.3	196.7	39.3	28.8	24.0	741.5
Long-term financing arrangements	2.2	4.5	4.5	0.0	0.0	0.0	11.2
1.75% Convertible Notes (4)	11.1	22.1	22.1	1,276.1	0.0	0.0	1,331.4
Uncertain tax positions (5)							126.0
Total	\$ 288.7	\$ 203.9	\$ 223.3	\$ 1,315.4	\$ 28.8	\$ 24.0	\$ 2,210.1
Other Commercial Commitments:							
Letters of credit	\$ 3.1	\$ 0.9	\$ 0.1	\$ 0.0	\$ 0.0	\$ 0.8	\$ 4.9

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

- (1) Included in real estate lease payments pursuant to four financing arrangements with BNP Paribas LLC (BNPPLC) are (i) lease commitments of \$1.6 million in the remainder of fiscal year 2011; \$3.2 million in fiscal 2012; and \$2.1 million in fiscal 2013, which are based on either the LIBOR rate at October 29, 2010 plus a spread or a fixed rate for terms of five years, and (ii) at the expiration or termination of the lease, a supplemental payment obligation equal to our minimum guarantee of \$90.2 million in the event that we elect not to purchase or arrange for sale of the buildings.
- (2) Contract manufacturer commitments consist of obligations for on hand inventories and non-cancelable purchase order with our contract manufacturer. We record a liability for firm, noncancelable, and nonreturnable purchase commitments for quantities in excess of our future demand forecasts, which is consistent with the valuation of our excess and obsolete inventory. As of October 29, 2010, the liability for these purchase commitments in excess of future demand was approximately \$3.5 million and is recorded in other current liabilities.
- (3) Purchase obligations represent an estimate of all open purchase orders and contractual obligations in the ordinary course of business, other than commitments with contract manufacturers and suppliers, for which we have not received the goods or services. Purchase obligations do not include contracts that may be cancelled without penalty. Although open purchase orders are considered enforceable and legally binding, the terms generally allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to the delivery of goods or performance of services.
- (4) Included in these amounts are obligations related to the \$1.265 billion principal amount of 1.75% Notes due 2013 (see Note 9 of the accompanying condensed consolidated financial statements). Estimated interest payments for the Notes are \$66.4 million for the remainder of fiscal 2011 through fiscal 2014.
- (5) As of October 29, 2010, our liability for uncertain tax positions was \$126.0 million, which due to the uncertainty of the timing of future payments, are presented in the total column on a separate line in this table.

Table of Contents

As of October 29, 2010, we have four leasing arrangements (Leasing Arrangements 1, 2, 3 and 4) with BNPPLC which requires us to lease certain of our land to BNPPLC for a period of 99 years and to lease approximately 0.6 million square feet of office space for our headquarters in Sunnyvale, which had an original cost of \$149.6 million. Under these leasing arrangements, we pay BNPPLC minimum lease payments, which vary based on LIBOR plus a spread or a fixed rate on the costs of the facilities on the respective lease commencement dates. We make payments for each of the leases for a term of five years. We have the option to renew each of the leases for two consecutive five-year periods upon approval by BNPPLC. Upon expiration (or upon any earlier termination) of the lease terms, we must elect one of the following options: (i) purchase the buildings from BNPPLC at cost; (ii) if certain conditions are met, arrange for the sale of the buildings by BNPPLC to a third party for an amount equal to at least 85% of the costs (residual guarantee), and be liable for any deficiency between the net proceeds received from the third party and such amounts; or (iii) pay BNPPLC supplemental payments for an amount equal to at least 85% of the costs (residual guarantee), in which event we may recoup some or all of such payments by arranging for a sale of each or all buildings by BNPPLC during the ensuing two-year period. The following table summarizes the costs, the residual guarantee, the applicable LIBOR plus spread or fixed rate at October 29, 2010 and the date we began to make payments for each of our leasing arrangements (in millions):

Leasing Arrangements	Cost	Residual Guarantee	LIBOR plus	Lease	
			Spread or Fixed Rate	Commencement Date	Term
1	\$ 48.5	\$ 41.2	3.69%	January 2008	5 years
2	80.0	68.0	0.81%	December 2007	5 years
3	10.5	8.9	3.67%	December 2007	5 years
4	10.6	9.0	3.69%	December 2007	5 years

As of October 29, 2010, we estimated that the fair value of the properties under synthetic lease was \$36.9 million less than their aggregate residual guarantees. We are accruing for this deficiency over the remaining terms of the respective leases.

Legal Contingencies

On September 5, 2007, we filed a patent infringement lawsuit in the Eastern District of Texas seeking compensatory damages and a permanent injunction against Sun Microsystems (Sun). On October 25, 2007, Sun filed a counter claim against us in the Eastern District of Texas seeking compensatory damages and a permanent injunction. On October 29, 2007, Sun filed a second lawsuit against us in the Northern District of California asserting additional patents against us. The Texas court granted a joint motion to transfer the Texas lawsuit to the Northern District of California on November 26, 2007. On March 26, 2008, Sun filed a third lawsuit in federal court that extends the patent infringement charges to storage management technology we acquired in January 2008. In January 2010, Oracle Corporation acquired Sun. In September 2010, the lawsuits were dismissed without prejudice.

On October 13, 2010, Amalgamated Bank (as trustee of the Longview Largecap 500 Index Fund and the Longview Largecap 500 Index Veba Fund) filed a derivative lawsuit on behalf of NetApp, Inc. and NetApp U.S. Public Sector, Inc. in the Superior Court of the State of California, Santa Clara County. The lawsuit names 15 current and former NetApp directors as defendants, alleging breach of fiduciary duty and wasting of corporate assets. The lawsuit alleges that the defendants failed to implement and oversee internal controls to ensure that we complied with legal requirements in its General Services Administration (GSA) contracting activities, and that this purported failure of oversight required us to incur significant costs in defending and settling a dispute with the United States of America regarding these past GSA contracting activities. The complaint seeks disgorgement of salaries and other compensation from the defendants and seeks additional unspecified damages. We and the defendants have filed demurrers seeking to have the lawsuit dismissed.

In addition, we are subject to various legal proceedings and claims which have arisen or may arise in the normal course of business. While the outcome of these legal matters is currently not determinable, we do not believe that any current litigation or claims will have a material adverse effect on our business, cash flow, operating results, or financial condition.

Off-Balance Sheet Arrangements

During the ordinary course of business, we provide standby letters of credit or other guarantee instruments to third parties as required for certain transactions initiated either by us or our subsidiaries. As of October 29, 2010, our financial guarantees of \$4.9 million that were not recorded on our balance sheet consisted of standby letters of credit related to workers' compensation, a customs guarantee, a corporate credit card program, foreign rent guarantees and surety bonds, which were primarily related to self-insurance.

Table of Contents

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

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

We use currency forward contracts to hedge exposures related to forecasted sales denominated in certain foreign currencies. These contracts are designated as cash flow hedges and in general closely match the underlying forecasted transactions in duration.

As of October 29, 2010, our notional value of foreign exchange forward and foreign currency option contracts totaled \$518.8 million. We do not believe that these derivatives present significant credit risks, because of the short term maturity of the outstanding contracts at any point in time, the counterparties to the derivatives consist of major financial institutions, and we manage the notional amount of contracts entered into with any one counterparty. Other than the risk associated with the financial condition of the counterparties, our maximum exposure related to foreign currency forward and option contracts is limited to the premiums paid. See Note 11 of the accompanying condensed consolidated financial statements for more information related to our hedging activities.

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

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 party due to various events, such as lawsuits arising from patent or copyright infringement. These indemnification obligations are considered off-balance sheet arrangements under accounting guidance.

We have commitments related to four lease arrangements with BNPPLC for approximately 0.6 million square feet of office space for our headquarters in Sunnyvale, California (as further described above under Contractual Obligations). Our future minimum lease payments and residual guarantees under these real estate leases will amount to a total of \$97.1 million as discussed in above in Contractual Obligations .

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Market Risk and Market Interest Risk

Investment and Interest Income As of October 29, 2010, we had available-for-sale investments of \$2.7 billion. Our investment portfolio primarily consists of investments with original maturities at the date of purchase of greater than three months, which are classified as available-for-sale. These investments, consisting primarily of corporate bonds, commercial paper, U.S. agency securities, U.S. Treasuries, and certificates of deposit, are subject to interest rate and interest income risk and will decrease in value if market interest rates increase. A hypothetical 10 percent increase in market interest rates from levels at October 29, 2010 would cause the fair value of these available-for-sale investments to decline by approximately \$2.4 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 will monitor and evaluate the accounting for our investment portfolio on a quarterly basis for additional

other-than-temporary impairment charges.

Table of Contents

We are also exposed to market risk relating to our auction rate securities due to uncertainties in the credit and capital markets. As of October 29, 2010, we recorded cumulative unrealized loss of \$4.5 million, offset by \$0.5 million of unrealized gains related to these securities. The fair value of our auction rate securities may change significantly due to events and conditions in the credit and capital markets. These securities/issuers could be subject to review for possible downgrade. Any downgrade in these credit ratings may result in an additional decline in the estimated fair value of our auction rate securities. Changes in the various assumptions used to value these securities and any increase in the markets perceived risk associated with such investments may also result in a decline in estimated fair value.

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

Lease Commitments As of October 29, 2010, one of our four lease arrangements with BNPPLC is based on a floating interest rate. The minimum lease payments will vary based on LIBOR plus a spread. All of our leases have an initial term of five years, and we have the option to renew these leases for two consecutive five-year periods upon approval by BNPPLC. A hypothetical 10 percent increase in market interest rate from the level at October 29, 2010 would increase our lease payments on this one floating lease arrangement under the initial five-year term by an immaterial amount. We do not currently hedge against market interest rate increases.

Convertible Notes In June 2008, we issued \$1.265 billion in aggregate principal amount of 1.75% Convertible Senior Notes due 2013 (the Notes), of which \$1.017 billion was allocated to debt and \$0.248 billion was allocated to equity. Holders may convert the Notes prior to maturity upon the occurrence of certain circumstances, including, but not limited to:

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

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

upon the occurrence of specified corporate transactions under the indenture for the Notes.

The Notes are convertible into the right to receive cash in an amount up to the principal amount and shares of our common stock for the conversion value in excess of the principal amount, if any, at an initial conversion rate of 31.4006 shares of common stock per \$1,000 principal amount of Notes, subject to adjustment as described in the indenture governing the Notes, which represents an initial conversion price of approximately \$31.85 per share.

Concurrent with the issuance of the Notes, we entered into convertible Note hedge transactions and separately, warrant transactions, to reduce the potential dilution from the conversion of the Notes and to mitigate any negative effect such conversion may have on the price of our common stock. In fiscal 2010, we terminated the hedge transaction with a counterparty to 20% of our Note hedges as a result of the bankruptcy filing by Lehman Brothers OTC Derivatives Inc., which constituted an event of default under the Note hedge. Because we have decided not to replace the hedge, we are subject to potential dilution on the 20% unhedged portion of our Notes upon conversion if on the date of conversion the per-share market price of our common stock exceeds the conversion price of \$31.85.

For at least 20 trading days during the 30 consecutive trading days ended September 30, 2010, our common stock price exceeded the conversion threshold price of \$41.41 per share set forth for these Notes. Accordingly, the Notes are convertible at the holder's option through December 31, 2010. Based on the closing price of our common stock of \$53.25 on October 29, 2010, the if-converted value of our Notes exceeded their principal amount by approximately \$850.0 million.

The fair value of our Notes is subject to interest rate risk, market risk and other factors due to the convertible feature. Generally, the fair value of Notes will increase as interest rates fall and/or our common stock price increases, and decrease as interest rates rise and/or our common stock price decreases. The interest and market value changes affect the fair value of our Notes, but do not impact our financial position, cash flows, or results of operations due to the fixed nature of the debt obligations. We do not carry the Notes at fair value, but present the fair value of the

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

principal amount of our Notes for disclosure purposes. As of October 29, 2010, the principal amount of our Notes, which consists of the combined debt and equity components, was \$1.265 billion, and the total estimated fair value of such was \$2.2 billion based on the closing trading price of \$174 per \$100 of our Notes as of that date.

Table of Contents**Foreign Currency Exchange Rate Risk and Foreign Exchange Forward Contracts**

We hedge risks associated with foreign currency transactions to minimize the impact of changes in foreign currency exchange rates on earnings. We utilize forward and option contracts to hedge against the short-term impact of foreign currency fluctuations on certain assets and liabilities denominated in foreign currencies. All balance sheet hedges are marked to market through earnings every period. We also use foreign exchange forward contracts to hedge foreign currency forecasted transactions related to forecasted sales transactions. These derivatives are designated as cash flow hedges under accounting guidance for derivatives and hedging. For cash flow hedges outstanding at October 29, 2010, the time-value component is recorded in earnings while all other gains or losses were included in other comprehensive income.

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

The following table provides information about our currency forward and option contracts outstanding on October 29, 2010 (in millions):

Currency	Local Currency Amount	October 29, 2010 Notional Contract Amount (USD)	Fair Value (USD)
Forward Contracts:			
Euro	223.4	\$ 310.4	\$ 311.3
British Pound Sterling	58.7	93.9	94.1
Canadian Dollar	19.6	19.3	19.2
Australian Dollar	30.9	30.1	30.2
Other	N/A	50.3	50.4
Option Contracts:			
Euro	11.0	\$ 14.8	\$ 0.0

Item 4. Controls and Procedures

Disclosure controls are controls and procedures designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, as amended (the Exchange Act), such as this Quarterly Report on Form 10-Q, is recorded, processed, summarized, and reported within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms. Disclosure controls and procedures are also designed to ensure that such information is accumulated and communicated to our management, including the 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 29, 2010, 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 relating to NetApp, including its consolidated subsidiaries, required to be disclosed in its Securities and Exchange Commission (SEC) reports (i) is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to NetApp management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On September 5, 2007, we filed a patent infringement lawsuit in the Eastern District of Texas seeking compensatory damages and a permanent injunction against Sun Microsystems (Sun). On October 25, 2007, Sun filed a counter claim against us in the Eastern District of Texas seeking compensatory damages and a permanent injunction. On October 29, 2007, Sun filed a second lawsuit against us in the Northern District of California asserting additional patents against us. The Texas court granted a joint motion to transfer the Texas lawsuit to the Northern District of California on November 26, 2007. On March 26, 2008, Sun filed a third lawsuit in federal court that extends the patent infringement charges to storage management technology we acquired in January 2008. In January 2010, Oracle Corporation acquired Sun. In September 2010, the lawsuits were dismissed without prejudice.

On October 13, 2010, Amalgamated Bank (as trustee of the Longview Largecap 500 Index Fund and the Longview Largecap 500 Index Veba Fund) filed a derivative lawsuit on behalf of NetApp, Inc. and NetApp U.S. Public Sector, Inc. in the Superior Court of the State of California, Santa Clara County. The lawsuit names 15 current and former NetApp directors as defendants, alleging breach of fiduciary duty and wasting of corporate assets. The lawsuit alleges that the defendants failed to implement and oversee internal controls to ensure that we complied with legal requirements in its General Services Administration (GSA) contracting activities, and that this purported failure of oversight required us to incur significant costs in defending and settling a dispute with the United States of America regarding these past GSA contracting activities. The complaint seeks disgorgement of salaries and other compensation from the defendants and seeks additional unspecified damages. We and the defendants have filed demurrers seeking to have the lawsuit dismissed.

Item 1A. Risk Factors

The following risk factors and other information included in this Quarterly Report on Form 10-Q should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we presently deem less significant may also impair our business operations. Please see page 23 of this Quarterly Report on Form 10-Q for a discussion of the forward-looking statements that are qualified by these risk factors. If any of the events or circumstances described in the following risk factors actually occurs, our business, operating results, and financial condition could be materially adversely affected.

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

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

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

Increased price competition for our products from competitors;

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

Risk of excess and obsolete inventories;

Risk of supply constraints;

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

Excess facilities costs;

Higher overhead costs as a percentage of revenues;

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

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

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

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

Table of Contents

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

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

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

A shift in federal government spending patterns;

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

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

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

Our ability to maintain appropriate inventory levels and purchase commitments;

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

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

Product configuration and mix;

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

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

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

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

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

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

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

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

Our ability to effectively manage our operating expenses;

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

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

Excess or inadequate facilities;

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

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

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

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

Table of Contents

Our revenue for a particular period is difficult to forecast, and a shortfall in revenue may harm our business and our operating results.

Our revenues for a particular period are difficult to forecast, especially in times of economic uncertainty. Our revenues are also difficult to forecast because the storage and data management market is rapidly evolving, and our sales cycle varies substantially from customer to customer. New or additional product introductions also increase the complexities of forecasting revenues.

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

We use a pipeline system, a common industry practice, to forecast bookings and trends in our business. Sales personnel monitor the status of potential business and estimate when a customer will make a purchase decision, the dollar amount of the sale and the products or services to be sold. These estimates are aggregated periodically to generate a bookings pipeline. Our pipeline estimates may prove to be unreliable either in a particular quarter or over a longer period of time, in part because the conversion rate of the pipeline into revenues varies from customer to customer, can be difficult to estimate, and requires management judgment, and also because customers purchasing decisions are subject to delay, reduction or cancellation. Small deviations from our forecasted conversion rate may result in inaccurate plans and budgets and could materially and adversely impact our business or our planned results of operations.

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

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

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

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

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

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

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

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

Demand for storage and data management products;

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

Direct versus indirect and OEM sales;

42

Table of Contents

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

The mix of sales to commercial and U.S. government sector end users;

The timing and amount of revenue recognized and deferred;

New product introductions and enhancements;

Licensing and royalty arrangements;

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

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

The cost of components, contract manufacturing costs, quality, warranty, and freight.
Changes in software entitlements and maintenance gross margins may result from various factors, such as:

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

The timing of technical support service contract renewals;

Demand for and the timing of delivery of upgrades; and

The level of spending on our customer support infrastructure.
Changes in service gross margins may result from various factors, such as:

The mix of customers;

The size and timing of service contract renewals;

Spares stocking requirements to support new product introductions;

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

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

Product quality and serviceability issues.

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

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

The storage and data management markets are intensely competitive and are characterized by rapidly changing technology. In the storage market, our primary and near-line storage system products and our associated software portfolio compete primarily with storage system products and data management software from EMC (including its recently announced acquisition of Isilon), Hitachi Data Systems, HP (including its acquisition of 3Par), IBM, and Oracle Corporation. In addition, Dell, Inc. is a competitor in the storage marketplace as a result of its business arrangement with EMC, which allows Dell to resell EMC storage hardware and software products, as well as a result of several of Dell's recent acquisitions. In the secondary storage market, which includes the disk-to-disk backup, compliance and business continuity segments, our solutions compete primarily against products from EMC and Oracle Corporation (through its acquisition of Sun Microsystems).

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

Table of Contents

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

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

We market and sell our storage data management solutions directly through our worldwide sales force and indirectly through channel partners such as value-added resellers, systems integrators, distributors, OEMs and strategic business partners, and we derive a significant portion of our revenues from these indirect channels. During the three and six month periods ended October 29, 2010, revenues generated from sales from our indirect channel distribution accounted for 72% and 70% of our revenues, respectively. In order for us to maintain or increase our revenues, we must effectively manage our relationships with channel partners.

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

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

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

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

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

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

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

Our OEM relationship may not continue to generate significant revenues.

In April 2005, we entered into an OEM agreement with IBM, which enables IBM to sell IBM branded solutions based on NetApp unified solutions, including NearStore® and V-Series systems, as well as associated software offerings. While this agreement is an element of our strategy to expand our reach into more customers and countries, we do not have an exclusive relationship with IBM, and there is no minimum commitment for any given period of time; therefore, this relationship may not continue to generate significant revenues. In addition, we have no control over the products that IBM selects to sell, or its release schedule and timing of those products; nor do we control its pricing.

In the event that sales through our OEM relationship increase, we may experience distribution channel conflicts between our direct sales force and the OEM or among our channel partners. If we fail to minimize channel conflicts, or if our OEM relationship does not continue to generate significant revenues, our operating results and financial condition could be harmed.

Table of Contents

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

During the three and six month periods ended October 29, 2010, sales to distributor Arrow Electronics, Inc. accounted for approximately 18% and 17%, respectively, of our net revenues, and sales to Avnet, Inc., accounted for approximately 15% and 13%, respectively of our net revenues. The loss of orders from these, or any of our more significant customers, strategic partners, distributors or resellers could cause our revenues and profitability to suffer. Our ability to attract new customers will depend on a variety of factors, including the cost-effectiveness, reliability, scalability and comprehensiveness of our product offerings, and our ability to address customer demands.

We also have an agreement with Fujitsu Technology Solutions (Fujitsu), which enables Fujitsu to lease, sell, market and resell NetApp products to end users and Fujitsu sales partners worldwide and to integrate NetApp products into Fujitsu bundled offerings, as well as to market NetApp s support services.

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

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

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

The U.S. government has contributed to our revenue growth and has become an important customer for us. Future revenue from the U.S. government is subject to shifts in government spending patterns. A decrease in government demand for our products could materially affect our revenues. In addition, our business could be adversely affected as a result of future examinations by the U.S. government.

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

In addition, selling our products to the U.S. government, whether directly or indirectly, also subjects us to certain regulatory requirements. For example, in April 2009, we entered into a settlement agreement with the United States of America, acting through the United States Department of Justice (DOJ) and on behalf of the General Services Administration (the GSA), related to a dispute regarding our discount practices and compliance with the price reduction clause provisions of GSA contracts for certain specified prior years. Our or our reseller partners failure to comply with U.S. government regulatory requirements could subject us to fines and other penalties, which could have a material adverse effect on our revenues, operating results and financial position.

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

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

expected revenue growth, suffer delays in product development, or other operational difficulties.

Table of Contents

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

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

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

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

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

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

The fact that we do not own or operate our manufacturing facilities and supply chain exposes us to risks, including reduced control over quality assurance, production costs and product supply, which could have a material adverse impact on the supply of our products and on our business and operating results. We rely on a limited number of suppliers for components utilized in the assembly of our products, which has and could subject us to future periodic supply constraints and price rigidity.

Financial problems of either contract manufacturers, component suppliers or other parties in our supply chain and reservation of manufacturing capacity at our contract manufacturers by other companies, inside or outside of our industry, could either limit supply or increase costs of our products. Qualifying a new contract manufacturer and commencing volume production is expensive and time-consuming, and disruption or termination of manufacturing capacity from any contract manufacturer could negatively impact our ability to manufacture and sell our products.

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

Table of Contents

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

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

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

Beyond our open credit arrangements, we also have recourse and nonrecourse customer financing leasing arrangements using third party leasing companies. Under the terms of recourse leases, which are treated as off-balance sheet arrangements, we remain liable for the aggregate unpaid remaining lease payments to the third party leasing company in the event of end-user customer default. We also offer financing arrangements whereby the end-user customer pays a fixed monthly amount plus a variable amount based on actual storage capacity used. These arrangements subject us to additional risk around revenue recognition and profitability due to the uncertainties associated with the variable portion of the arrangements. In addition, from time to time we provide guarantees for a portion of other financing arrangements under which we could be called upon to make payments to our funding parties in the event of nonpayment by end-user customers.

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

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

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

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

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

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

Industry consolidation and the resulting perception of increased competition;

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

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

Changes in analysts' recommendations or projections;

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

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

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

Dilutive impacts of our convertible Notes and related warrants;

47

Table of Contents

International conflicts and acts of terrorism;

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

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

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

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

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

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

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

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

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

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

Risks inherent in our international operations could have a material adverse effect on our business.

A substantial portion of our revenues are derived from sales outside of the United States. During the three and six month periods ended October 29, 2010, our international revenues accounted for 45% and 47% of our total revenues, respectively. A substantial portion of our products are manufactured outside of the U.S., and we have research and development and service centers overseas. Accordingly, our business and our future operating results could be adversely affected by a variety of factors affecting our international operations, some of which are beyond our control, including regulatory, political, or economic conditions in a specific country or region, trade protection measures and other

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

regulatory requirements, government spending patterns, and acts of terrorism and international conflicts. In addition, we may not be able to maintain or increase international market demand for our products.

Table of Contents

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

Certain United States Government export restrictions impede our ability to sell to certain end users certain of our products. The United States, through the Bureau of Industry Security, places restrictions on the export of certain encryption technology. These restrictions may include: the requirement to have a license to export the technology; the requirement to have software licenses approved before export is allowed; and outright bans on the licensing of certain encryption technology to particular end users or to all end users in a particular country. Certain of our products are subject to various levels of export restrictions. These export restrictions could negatively impact our business. Our international operations are subject to other risks, including general import/export restrictions, regulations related to data privacy, and other complex rules and regulations under which we must conduct business in foreign countries. 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. law. Such factors could have an adverse impact on our business, operating results and financial position.

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 regulations applicable to us, such as the Foreign Corrupt Practices Act. Although we implement policies and procedures designed to ensure compliance with these laws, our employees, contractors and agents, as well as those companies to which we outsource certain of our business operations, may take actions in violation of these policies. Any such violation could subject us to fines and other penalties, which could have a material adverse effect on our business, financial condition or results of operations.

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

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

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

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

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

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

Table of Contents

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

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

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

A change in our decision to indefinitely reinvest foreign earnings.

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

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

During fiscal year 2009, we received Notices of Proposed Adjustments from the IRS in connection with a federal income tax audit of our fiscal 2003 and 2004 tax returns. We filed a protest with the IRS in response to the Notices of Proposed Adjustments and subsequently received a rebuttal from the IRS examination team in response to our protest. We are currently at the IRS Appeals level for further administrative review. The Notices of Proposed Adjustments in this audit focus primarily on issues of the timing and the amount of income recognized, deductions taken and on the level of cost allocations made to foreign operations during the audit years.

The IRS recently commenced the examination of our fiscal 2005 through 2007 federal income tax returns, and in addition, the California Franchise Tax Board has begun the examination of our fiscal 2007 and 2008 California income tax returns. The scope of each of the IRS and California Franchise Tax Board examinations is unclear at this time.

On September 17, 2010, the Danish tax authorities issued a decision concluding that distributions declared in 2005 and 2006 from the Company's indirect Danish subsidiary to the subsidiary's immediate parent affiliate, for which the Company has not paid or accrued any taxes on, are subject to Danish at-source dividend withholding tax. The Company has appealed this assessment decision with the Danish National Tax Tribunal.

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

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

Table of Contents

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

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

Impacting our ability to satisfy our obligations;

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

Impairing our ability to obtain additional financing in the future;

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

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

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

Any conversion of our Notes may cause dilution to our shareholders and to our earnings per share. If the price of our common stock exceeds the conversion price, initially \$31.85 per share, the Notes will cause a dilution in our reported earnings per share. For at least 20 trading days during the 30 consecutive trading days ended September 30, 2010, our common stock price exceeded the conversion threshold price of \$41.41 per share set forth for these Notes. Accordingly, the Notes are convertible at the holder's option through December 31, 2010. Based on the trading price of our common stock on October 29, 2010, we had approximately 17 million shares of common stock potentially issuable on conversion of our Notes. Upon conversion of any Notes, we will deliver cash up to the principal amount of the Notes and, with respect to any excess conversion value greater than the principal amount of the Notes, shares of our common stock, which would result in dilution to our shareholders.

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

In connection with the issuance of the Notes, we entered into privately negotiated convertible note hedge transactions with certain option counterparties (the Counterparties), which are expected to offset the potential dilution to our common stock upon any conversion of the Notes. At the same time, we also entered into warrant transactions with the Counterparties pursuant to which we may issue shares of our common stock above a certain strike price. In connection with these hedging transactions, the Counterparties may have entered into various over-the-counter derivative transactions with respect to our common stock or purchased shares of our common stock in secondary market transactions at or following the pricing of the Notes. Such activities may have had the effect of increasing the price of our common stock. The Counterparties are likely to modify their hedge positions from time to time prior to conversion or maturity of the Notes by purchasing and selling shares of our common stock or entering into other derivative transactions. Additionally, these transactions may expose us to counterparty credit risk for nonperformance. The effect, if any, of any of these transactions and activities on the market price of our common stock or the Notes will depend,

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

in part, on market conditions and cannot be ascertained at this time, but any of these activities could adversely affect the value of our common stock. In addition, if our stock price exceeds the strike price for the warrants, there could be additional dilution to our shareholders, which could adversely affect the value of our common stock.

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

Table of Contents

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

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

The conversion of some or all of our outstanding Notes will dilute the ownership interest of existing stockholders to the extent we deliver common stock upon conversion of the Notes. For at least 20 trading days during the 30 consecutive trading days ended September 30, 2010, our common stock price exceeded the conversion threshold price of \$41.41 per share set forth for these Notes. Accordingly, the notes are convertible at the holder's option through December 31, 2010. Upon conversion of any Notes, we will satisfy our obligation by delivering cash for the principal amount of the Notes and shares of common stock, if any, to the extent the conversion value exceeds the principal amount. Any new issuance of equity securities, including the issuance of shares upon conversion of the Notes or the exercise of related warrants which are not offset by our Note hedges, could dilute the interests of our then-existing stockholders, including holders who receive shares upon conversion of their Notes, and could substantially decrease the trading price of our common stock and the Notes. In addition, any sales in the public market of any common stock issuable upon such conversion or the exercise of warrants could adversely affect prevailing market prices of our common stock.

As of October 29, 2010, we had options to purchase approximately 27 million shares of our common stock outstanding and a total of approximately 9 million restricted stock units outstanding. If all of these outstanding options and restricted stock units were exercised the proceeds to the Company would average approximately \$18 per share. We also had 18 million shares of our common stock reserved for issuance under our stock plans with respect to equity awards that have not been granted. The exercise of all of the outstanding options and/or the vesting of all outstanding restricted shares and restricted stock units would dilute the interests of our then-existing stockholders, and any sales in the public market of the common stock issuable upon such exercise could adversely affect the trading price of our common stock.

In addition, we have an Employee Stock Purchase Plan (ESPP) under which employees are entitled to purchase shares of our common stock at 85% of the fair market value at certain specified dates over a two-year period. As of October 29, 2010, we had approximately 7 million shares of our common stock available for issuance under the ESPP. The issuance of shares under the ESPP would dilute the interests of our then-existing stockholders, and any sales in the public market of the common stock issuable upon such exercise could adversely affect the trading price of our common stock.

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

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

At October 29, 2010, we had \$4.5 billion in cash, cash equivalents, available-for-sale securities and restricted cash and investments. We invest our cash in a variety of financial instruments, consisting principally of investments in U.S. Treasury securities, commercial paper, U.S. government agency bonds, corporate bonds, certificates of deposit, and money market funds. These investments are subject to general credit, liquidity, market and interest rate risks, which have been exacerbated by unusual events such as the financial and credit crisis, and bankruptcy filings in the United States which have affected various sectors of the financial markets and led to global credit and liquidity issues. These securities are generally classified as available-for-sale and, consequently, are recorded on our consolidated balance sheets at fair value with unrealized gains or losses reported as a component of accumulated other comprehensive income (loss), net of tax.

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

Table of Contents

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

On occasion, we make strategic investments in other companies, including private equity funds, which may decline in value and/or not meet desired objectives. The success of these investments depends on various factors over which we may have limited or no control. As of October 29, 2010, we had an investment with the carrying value of \$1.3 million in a private equity fund.

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

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

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

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

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

Our future minimum lease payments under these synthetic leases limit our flexibility in planning for, or reacting to, changes in our business by restricting the funds available for use in addressing such changes. If we are unable to grow our business and revenues proportionately to our increase in fixed costs, our operating results will be harmed. If we elect not to purchase the properties at the end of the lease term, we have guaranteed a minimum residual value to BNPPLC. If the fair value of the properties declines below that guaranteed minimum residual value, our residual value guarantee would require us to pay the difference to BNPPLC. As of October 29, 2010, the estimated fair value of the properties was approximately \$36.9 million below the guaranteed minimum residual value, which we are accruing over the remaining term of the respective leases. Any further decline in the fair value of the properties could adversely impact our cash flows, financial condition and operating results.

Table of Contents

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

We have credit exposure to our hedging counterparties.

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

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

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

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

Incur indebtedness;

Incur indebtedness at the subsidiary level;

Grant liens;

Sell all or substantially all our assets;

Enter into certain mergers;

Change our business;

Enter into swap agreements;

Enter into transactions with our affiliates; and

Enter into certain restrictive agreements.

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

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

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

Table of Contents

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

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

All of our ARSs are backed by pools of student loans guaranteed by the U.S. Department of Education, and we believe the credit quality of these securities is high based on this guarantee. However, liquidity issues in the global credit markets resulted in the failure of auctions for certain of our ARS investments, with a par value of \$72.3 million. For each failed auction, the interest rate resets to a maximum rate defined for each security, and the ARS continue to pay interest in accordance with their terms, although the principal associated with the ARS will not be accessible until there is a successful auction or such time as other markets for ARS investments develop or the final maturity of the individual securities.

As of October 29, 2010, we determined there was a total decline in the fair value of our ARS investments of approximately \$6.1 million, of which we have recorded cumulative temporary impairment charges of \$4.0 million, and \$2.1 million was recognized as an other-than-temporary impairment charge. In addition, we have classified all of our auction rate securities as long-term assets in our consolidated balance sheets at October 29, 2010 as our ability to liquidate such securities in the next 12 months is uncertain. Although we currently have the ability and intent to hold these ARS investments until recovery in market value or until maturity, if current market conditions deteriorate, or the anticipated recovery in market values does not occur, we may be required to record additional impairment charges in future quarters. We intend, and have the ability, to hold these investments until the market recovers.

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

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

Our acquisitions may not provide the anticipated benefits and may disrupt our existing business.

As part of our strategy, we are continuously evaluating opportunities to buy other businesses or technologies that would complement our current products, expand the breadth of our markets, or enhance our technical capabilities. The success of our acquisitions is impacted by a number of factors, and may be subject to the following risks:

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

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

The loss of key employees;

Substantial transaction costs and accounting charges; and

Exposure to litigation related to acquisitions.

Any future acquisitions may also result in risks to our existing business, including:

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

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

Assumption of additional liabilities;

Incurrence of additional debt or a decline in available cash;

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

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

Creation of goodwill or other intangible assets that could result in significant future amortization expense or impairment charges.

Table of Contents

The failure to achieve the anticipated benefits of an acquisition may also result in impairment charges for goodwill. For example, we have in the past ceased availability of certain products which were originally acquired through business combinations. Additional or realized risks of this nature could have a material adverse effect on our business, financial condition and results of operations.

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

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

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

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

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

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

We are subject to risks related to the provision of employee health care benefits.

We use a combination of insurance and self-insurance for workers' compensation coverage and health care plans. We record expenses under these plans based on estimates of the number and costs of expected claims, administrative costs and stop-loss premiums. These estimates are then adjusted each year to reflect actual costs incurred. Actual costs under these plans are subject to variability depending primarily upon participant enrollment and demographics, the actual number and costs of claims made and whether and how much the stop-loss insurance we purchase covers the cost of these claims. In the event that our cost estimates differ from actual costs, we could incur additional unplanned health care costs which could adversely impact our financial condition.

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

Table of Contents

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

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

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

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

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

We depend on the ability of our personnel, raw materials, equipment and products to move reasonably unimpeded around the world. Any political, military, terrorism, global trade, world health or other issue that hinders this movement or restricts the import or export of materials could lead to significant business disruptions. Furthermore, any strike, economic failure or other material disruption caused by fire, floods, hurricanes, volcanoes, power loss, power shortages, environmental disasters, telecommunications failures, 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 information technology, or directly impact our marketing, manufacturing, financial and logistics functions, our results of operations and financial condition could be materially adversely affected. In addition, our headquarters are located in Northern California, an area susceptible to earthquakes. If any significant disaster were to occur, our ability to operate our business could be impaired.

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

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

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

Table of Contents

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

We may be a party to lawsuits in the normal course of our business from time to time. Litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a particular lawsuit could have a material adverse effect on our business, operating results, or financial condition.

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

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

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

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

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

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

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

Decreased demand for storage products that produce significant greenhouse gases

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

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

Table of Contents

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

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

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

We completed our evaluation of our internal controls over financial reporting for the fiscal year ended April 30, 2010 as required by Section 404 of the Sarbanes-Oxley Act of 2002. Although our assessment, testing and evaluation resulted in our conclusion that as of April 30, 2010, our internal controls over financial reporting were effective, we cannot predict the outcome of our testing in future periods. If our internal controls are ineffective in future periods, our business and reputation could be harmed. We may incur additional expenses and commitment of management's time in connection with further evaluations, both of which could materially increase our operating expenses and accordingly reduce our operating results.

On July 21, 2010, the President signed into law the Dodd-Frank Act. Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on us. However, compliance with this new law and its implementing regulations is expected to result in additional operating costs that could have a material adverse effect on our financial condition and results of operations.

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

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

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

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

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

On May 13, 2003, we announced that our Board of Directors had authorized a stock repurchase program. As of October 29, 2010, our Board of Directors had authorized the repurchase of up to \$4,023.6 million of common stock under this program. We did not repurchase any common stock during the three month period ended October 29, 2010. As of October 29, 2010, we had repurchased 104.3 million shares of our common stock at a weighted-average price of \$28.06 per share for an aggregate purchase price of \$2,927.4 million since inception of the stock repurchase program, and the remaining authorized amount for stock repurchases under this program was \$1,096.2 million with no termination date.

Item 3. Defaults upon Senior Securities

None

Table of Contents

Item 4. Reserved

Item 5. Other Information

None

Item 6. Exhibits

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

Table of Contents

SIGNATURE

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

NETAPP, INC.
(Registrant)

/s/ STEVEN J. GOMO
Steven J. Gomo
Executive Vice President of Finance and
Chief Financial Officer

Date: December 6, 2010

Table of Contents**EXHIBIT INDEX**

Exhibit	
No	Description
3.1(1)	Certificate of Incorporation of the Company, as amended.
3.2	Bylaws of the Company.
10.1(2)	The Company's Amended and Restated 1999 Stock Option Plan.
10.2(2)	The Company's Amended and Restated Employee Stock Purchase Plan.
31.1	Certification of the Chief Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

- (1) Previously filed as an exhibit to the Company's Annual Report on Form 10-K dated June 24, 2008.
(2) Previously filed as an appendix to the Company's Proxy Statement dated July 13, 2010.