

NetApp, Inc.  
Form 10-Q  
February 26, 2014  
Table of Contents

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

Washington, D.C. 20549

**Form 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended January 24, 2014

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 000-27130

**NetApp, Inc.**

*(Exact name of registrant as specified in its charter)*

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

**77-0307520**  
*(I.R.S. Employer*

*Identification No.)*

**495 East Java Drive,**

**Sunnyvale, California 94089**

*(Address of principal executive offices, including zip code)*

**(408) 822-6000**

*(Registrant's telephone number, including area code)*

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

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 Website, 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.

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

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

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

As of February 18, 2014, there were 331,275,224 shares of the registrant's common stock, \$0.001 par value, outstanding.

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

Item 1	<u>Condensed Consolidated Financial Statements (Unaudited)</u>	3
	<u>Condensed Consolidated Balance Sheets as of January 24, 2014 and April 26, 2013</u>	3
	<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended January 24, 2014 and January 25, 2013</u>	4
	<u>Condensed Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended January 24, 2014 and January 25, 2013</u>	5
	<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended January 24, 2014 and January 25, 2013</u>	6
	<u>Notes to Condensed Consolidated Financial Statements</u>	7
Item 2	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	24
Item 3	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	39
Item 4	<u>Controls and Procedures</u>	41

**PART II OTHER INFORMATION**

Item 1	<u>Legal Proceedings</u>	42
Item 1A	<u>Risk Factors</u>	42
Item 2	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	54
Item 3	<u>Defaults upon Senior Securities</u>	54
Item 4	<u>Mine Safety Disclosures</u>	54
Item 5	<u>Other Information</u>	54
Item 6	<u>Exhibits</u>	54
	<u>SIGNATURE</u>	55

**TRADEMARKS**

© 2014 NetApp, Inc. All rights reserved. No portions of this document may be reproduced without prior written consent of NetApp, Inc. Specifications are subject to change without notice. NetApp, the NetApp logo, Go Further, Faster, ASUP, AutoSupport, Campaign Express, Clustered Data ONTAP, Customer Fitness, CyberSnap, Data ONTAP, DataFort, DataMotion, FilerView, Fitness, Flash Accel, Flash Cache, Flash Pool, FlashRay, FlexCache, FlexClone, FlexPod, FlexScale, FlexShare, FlexVol, GetSuccessful, LockVault, Manage ONTAP, Mars, MetroCluster, MultiStore, Network Appliance, the Network Appliance logo, OnCommand, ONTAP, ONTAPI, RAID-DP, SANtricity, SecureShare, Simplicity, Simulate ONTAP, Snap Creator, SnapCopy, SnapDrive, SnapIntegrator, SnapLock, SnapManager, SnapMirror, SnapMover, SnapProtect, SnapRestore, Snapshot, SnapValidator, SnapVault, StorageGRID, Tech OnTap, and WAFL are trademarks or registered trademarks of NetApp, Inc. in the United States and/or other countries. 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, except par value)****(Unaudited)**

	<b>January 24, 2014</b>	<b>April 26, 2013</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 2,152.7	\$ 3,277.1
Short-term investments	2,916.6	3,675.5
Accounts receivable, net of allowances of \$2.2 million and \$4.2 million as of January 24, 2014 and April 26, 2013, respectively	584.3	800.9
Inventories	118.2	139.5
Other current assets	457.6	525.2
<b>Total current assets</b>	<b>6,229.4</b>	<b>8,418.2</b>
Property and equipment, net	1,128.6	1,170.9
Goodwill	988.1	988.1
Purchased intangible assets, net	136.1	180.6
Other non-current assets	518.4	484.6
<b>Total assets</b>	<b>\$ 9,000.6</b>	<b>\$ 11,242.4</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 186.6	\$ 259.7
Accrued compensation and related benefits	296.9	348.0
Other current liabilities	374.0	401.8
Current portion of long-term debt	0.0	1,257.8
Short-term deferred revenue	1,566.3	1,563.3
<b>Total current liabilities</b>	<b>2,423.8</b>	<b>3,830.6</b>
Long-term debt	995.2	994.6
Other long-term liabilities	272.7	253.5
Long-term deferred revenue	1,393.0	1,446.2
<b>Total liabilities</b>	<b>5,084.7</b>	<b>6,524.9</b>
Commitments and contingencies (Note 16)		
Stockholders' equity:		
Common stock, \$0.001 par value, (333.2 and 460.9 shares issued as of January 24, 2014 and April 26, 2013, respectively)	0.3	0.5

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

Additional paid-in capital	3,908.9	4,738.9
Treasury stock, at cost (no shares and 104.3 shares as of January 24, 2014 and April 26, 2013, respectively)	0.0	(2,927.4)
Retained earnings	0.0	2,896.8
Accumulated other comprehensive income	6.7	8.7
<b>Total stockholders' equity</b>	<b>3,915.9</b>	<b>4,717.5</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 9,000.6</b>	<b>\$ 11,242.4</b>

See accompanying notes to condensed consolidated financial statements.

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

(In millions, except per share amounts)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
<b>Revenues:</b>				
Product	\$ 1,015.0	\$ 1,060.7	\$ 2,901.1	\$ 2,954.5
Software entitlements and maintenance	227.0	228.6	687.3	666.5
Service	368.0	340.8	1,087.7	994.9
<b>Net revenues</b>	<b>1,610.0</b>	<b>1,630.1</b>	<b>4,676.1</b>	<b>4,615.9</b>
<b>Cost of revenues:</b>				
Cost of product	450.7	512.5	1,323.9	1,442.0
Cost of software entitlements and maintenance	7.7	7.3	22.7	20.9
Cost of service	149.3	145.4	452.4	424.1
<b>Total cost of revenues</b>	<b>607.7</b>	<b>665.2</b>	<b>1,799.0</b>	<b>1,887.0</b>
<b>Gross profit</b>	<b>1,002.3</b>	<b>964.9</b>	<b>2,877.1</b>	<b>2,728.9</b>
<b>Operating expenses:</b>				
Sales and marketing	475.9	493.5	1,423.2	1,464.6
Research and development	230.3	215.6	686.6	660.8
General and administrative	69.4	66.2	207.3	198.4
Restructuring and other charges	0.0	0.0	49.5	0.0
Acquisition-related expense	0.0	1.7	0.0	1.7
<b>Total operating expenses</b>	<b>775.6</b>	<b>777.0</b>	<b>2,366.6</b>	<b>2,325.5</b>
<b>Income from operations</b>	<b>226.7</b>	<b>187.9</b>	<b>510.5</b>	<b>403.4</b>
<b>Other income (expense), net:</b>				
Interest income	7.9	10.3	26.4	32.1
Interest expense	(6.7)	(24.0)	(29.7)	(63.7)
Other income, net	1.7	1.6	6.9	5.9
<b>Total other income (expense), net</b>	<b>2.9</b>	<b>(12.1)</b>	<b>3.6</b>	<b>(25.7)</b>
<b>Income before income taxes</b>	<b>229.6</b>	<b>175.8</b>	<b>514.1</b>	<b>377.7</b>
Provision for income taxes	37.5	17.7	73.6	46.2
<b>Net income</b>	<b>\$ 192.1</b>	<b>\$ 158.1</b>	<b>\$ 440.5</b>	<b>\$ 331.5</b>
<b>Net income per share:</b>				
Basic	\$ 0.57	\$ 0.44	\$ 1.28	\$ 0.91

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

Diluted	\$ 0.55	\$ 0.43	\$ 1.25	\$ 0.90
---------	---------	---------	---------	---------

**Shares used in net income per share calculations:**

Basic	339.4	359.5	343.7	362.5
-------	-------	-------	-------	-------

Diluted	346.2	364.7	351.7	368.1
---------	-------	-------	-------	-------

<b>Cash dividends declared per share</b>	\$ 0.15	\$ 0.00	\$ 0.45	\$ 0.00
--	---------	---------	---------	---------

See accompanying notes to condensed consolidated financial statements.

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>January 24, 2014</b>	<b>January 25, 2013</b>	<b>January 24, 2014</b>	<b>January 25, 2013</b>
<b>Net income</b>	\$ 192.1	\$ 158.1	\$ 440.5	\$ 331.5
<b>Other comprehensive income (loss):</b>				
Foreign currency translation adjustments	(2.7)	1.5	0.9	(0.1)
Defined benefit obligation adjustments	0.1	0.0	0.3	0.2
Unrealized gains (losses) on available-for-sale securities:				
Unrealized holding gains (losses) arising during the period	1.6	(1.9)	(2.4)	4.7
Income tax effect on unrealized holding gains (losses)	0.1	0.3	1.1	0.0
Reclassification adjustments for losses (gains) included in net income	0.0	0.1	(1.1)	(0.5)
Unrealized gains (losses) on cash flow hedges:				
Unrealized holding gains (losses) arising during the period	1.5	(2.7)	(2.0)	(1.8)
Reclassification adjustments for losses (gains) included in net income	(0.2)	3.1	1.2	1.2
<b>Other comprehensive income (loss)</b>	0.4	0.4	(2.0)	3.7
<b>Comprehensive income</b>	\$ 192.5	\$ 158.5	\$ 438.5	\$ 335.2

See accompanying notes to condensed consolidated financial statements.

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

	<b>Nine Months Ended</b>	
	<b>January 24, 2014</b>	<b>January 25, 2013</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 440.5	\$ 331.5
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	252.0	255.5
Stock-based compensation	205.8	211.5
Accretion of discount and issuance costs on debt	9.2	44.0
Deferred income taxes	(30.9)	(57.9)
Excess tax benefit from stock-based compensation	(33.4)	(53.0)
Other non-cash items, net	(0.7)	49.6
Changes in assets and liabilities, net of acquisition of business:		
Accounts receivable	213.4	193.1
Inventories	21.3	(11.4)
Other operating assets	78.3	(59.3)
Accounts payable	(69.8)	(16.0)
Accrued compensation and other current liabilities	(94.5)	(35.1)
Deferred revenue	(27.0)	62.7
Other operating liabilities	15.9	15.5
Net cash provided by operating activities	980.1	930.7
<b>Cash flows from investing activities:</b>		
Purchases of investments	(701.3)	(1,548.3)
Maturities, sales and collections of investments	1,464.0	1,752.4
Purchases of property and equipment	(165.4)	(239.7)
Acquisition of business, net of cash acquired	0.0	(89.4)
Other investing activities, net	2.6	3.0
Net cash provided by (used in) investing activities	599.9	(122.0)
<b>Cash flows from financing activities:</b>		
Issuance of common stock under employee stock plans	191.8	95.5
Repurchase of common stock and forward contract	(1,507.0)	(410.0)
Excess tax benefit from stock-based compensation	33.4	53.0
Repayment of long-term debt	(1,264.9)	0.0
Issuance of long-term debt, net	0.0	987.3
Dividends paid	(153.1)	0.0
Other financing activities, net	(7.5)	(0.7)
Net cash provided by (used in) financing activities	(2,707.3)	725.1
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>2.9</b>	<b>(1.9)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(1,124.4)</b>	<b>1,531.9</b>
<b>Cash and cash equivalents:</b>		

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

Beginning of period	3,277.1	1,549.8
End of period	\$ 2,152.7	\$ 3,081.7

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****NETAPP, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****1. The Company**

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

**2. Condensed Consolidated Financial Statements**

*Fiscal Year* Our fiscal year is reported on a 52- or 53-week year ending on the last Friday in April. Every quarter of fiscal 2014 and 2013 was a 13-week period.

*Basis of Presentation* The accompanying unaudited condensed consolidated financial statements have been prepared by the Company, and reflect all adjustments, consisting only of normal recurring adjustments, that are, in the opinion of management, necessary for the fair presentation of our financial position, results of operations, comprehensive income and cash flows for the interim periods presented. The statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these statements do not include all information and footnotes required by GAAP for annual consolidated financial statements, and should be read in conjunction with our audited consolidated financial statements as of and for the fiscal year ended April 26, 2013 contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on June 17, 2013. The results of operations for the three and nine months ended January 24, 2014 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 as of and for the nine months ended January 24, 2014, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended April 26, 2013.

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

**4. Statements of Cash Flows**

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

	<b>Nine Months Ended</b>	
	<b>January 24, January 25,</b>	
	<b>2014</b>	<b>2013</b>
<b>Non-cash Investing and Financing Activities:</b>		
Reclassification of equity component of Convertible Notes	\$ 0.0	\$ 62.6
Acquisition of property and equipment outstanding in accounts payable	\$ 25.7	\$ 30.4
Acquisition of software through long-term financing	\$ 11.4	\$ 0.8
Vested options assumed in acquisition	\$ 0.0	\$ 1.2
<b>Supplemental Cash Flow Information:</b>		

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

Income taxes paid, net of refunds	\$ 39.5	\$	33.9
Interest paid, net of capitalized interest	\$ 35.0	\$	22.6

**Table of Contents****5. Business Combination**

On November 14, 2012, we acquired all of the outstanding shares of CacheIQ, Inc., a privately-held storage solutions company based in Texas, for \$89.8 million in cash and \$1.2 million in equity. This acquisition provides us with technology that extends our capabilities to support non-disruptive operations for enterprise data center environments. We will integrate this technology into our product offerings over time.

Following are the fair value of assets acquired and liabilities assumed as of the closing date (in millions):

Cash	\$ 0.4
Other current assets	4.0
Finite-lived intangible assets	22.0
Goodwill	72.9
Other assets	0.9
Total assets acquired	100.2
Current liabilities	(0.5)
Deferred income taxes	(8.7)
Total purchase price	\$ 91.0

The results of operations of CacheIQ have been included in our condensed consolidated statements of operations from the acquisition date. Pro forma results of operations have not been presented because the acquisition was not material to our results of operations.

**6. Purchased Intangible Assets, Net**

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

	January 24, 2014			April 26, 2013		
	Gross Assets	Accumulated Amortization	Net Assets	Gross Assets	Accumulated Amortization	Net Assets
Developed technology	\$ 283.0	\$ (148.3)	\$ 134.7	\$ 312.4	\$ (134.9)	\$ 177.5
Customer contracts/relationships	9.6	(8.9)	0.7	54.7	(53.1)	1.6
Trademarks and trade names	2.9	(2.3)	0.6	9.9	(8.9)	1.0
Covenants not to compete	1.6	(1.5)	0.1	2.2	(1.7)	0.5
Total purchased intangible assets	\$ 297.1	\$ (161.0)	\$ 136.1	\$ 379.2	\$ (198.6)	\$ 180.6

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

	Three Months Ended		Nine Months Ended		Statements of Operations Classifications
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013	
Developed technology	\$ 14.2	\$ 13.9	\$ 42.8	\$ 41.8	Cost of revenues
Customer contracts/relationships	0.3	6.3	1.0	18.9	Operating expenses
Trademarks and trade names	0.1	1.1	0.3	3.1	Operating expenses
Covenants not to compete	0.1	0.1	0.4	0.5	Operating expenses

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

\$ 14.7	\$ 21.4	\$ 44.5	\$ 64.3
---------	---------	---------	---------

As of January 24, 2014, future amortization expense related to purchased intangible assets is as follows (in millions):

<b>Fiscal Year</b>	<b>Amount</b>
Remainder of 2014	\$ 14.7
2015	57.8
2016	53.6
2017	6.7
2018	3.3
Total	\$ 136.1

**Table of Contents****7. Balance Sheet Details***Cash and cash equivalents (in millions):*

	January 24, 2014	April 26, 2013
Cash	\$ 1,989.8	\$ 1,634.7
Cash equivalents	162.9	1,642.4
<b>Cash and cash equivalents</b>	<b>\$ 2,152.7</b>	<b>\$ 3,277.1</b>

*Inventories (in millions):*

	January 24, 2014	April 26, 2013
Purchased components	\$ 18.9	\$ 16.3
Finished goods	99.3	123.2
<b>Inventories</b>	<b>\$ 118.2</b>	<b>\$ 139.5</b>

*Other current assets (in millions):*

	January 24, 2014	April 26, 2013
Prepaid expenses and other current assets	\$ 210.6	\$ 271.5
Deferred tax assets	247.0	253.7
<b>Other current assets</b>	<b>\$ 457.6</b>	<b>\$ 525.2</b>

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

	January 24, 2014	April 26, 2013
Land and land improvements	\$ 265.7	\$ 265.5
Buildings and building improvements	540.6	534.8
Leasehold improvements	102.3	100.3
Computer, production, engineering and other equipment	759.0	714.0
Software	429.4	422.6
Furniture and fixtures	86.1	82.2
Construction-in-progress	61.2	19.9
	2,244.3	2,139.3
Accumulated depreciation and amortization	(1,115.7)	(968.4)
<b>Property and equipment, net</b>	<b>\$ 1,128.6</b>	<b>\$ 1,170.9</b>

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

Software includes capitalized internal-use software development costs with a net book value as follows (in millions):

	January 24, 2014	April 26, 2013
Computer software	\$ 119.9	\$ 162.5

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

	January 24, 2014	April 26, 2013
Auction rate securities	\$ 40.4	\$ 42.0
Deferred tax assets	224.3	200.4
Other assets	253.7	242.2
Other non-current assets	\$ 518.4	\$ 484.6

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

	January 24, 2014	April 26, 2013
Product	\$ 32.4	\$ 15.7
Software entitlements and maintenance and service	2,926.9	2,993.8
<b>Total</b>	<b>\$ 2,959.3</b>	<b>\$ 3,009.5</b>
Reported as:		
Short-term	\$ 1,566.3	\$ 1,563.3
Long-term	1,393.0	1,446.2
<b>Total</b>	<b>\$ 2,959.3</b>	<b>\$ 3,009.5</b>

**8. Financial Instruments and Fair Value Measurements**

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

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

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

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

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

**Investments**

The following is a summary of our investments (in millions):

	January 24, 2014 Gross Unrealized			April 26, 2013 Gross Unrealized			Estimated Fair Value	
	Cost or Amortized Cost	Gains	Losses	Cost or Amortized Cost	Gains	Losses		
Corporate bonds	\$ 2,433.8	\$ 11.5	\$ (0.7)	\$ 2,444.6	\$ 3,132.8	\$ 14.9	\$ (0.6)	\$ 3,147.1
U.S. Treasury and government debt securities	249.3	0.3	0.0	249.6	392.8	0.9	0.0	393.7
Commercial paper	237.2	0.0	0.0	237.2	178.5	0.0	0.0	178.5
Certificates of deposit	135.0	0.0	0.0	135.0	135.4	0.1	0.0	135.5
Money market funds	13.1	0.0	0.0	13.1	1,463.1	0.0	0.0	1,463.1
Auction rate securities	41.9	0.0	(1.5)	40.4	44.2	0.5	(2.7)	42.0

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

Equity funds	32.5	0.0	0.0	32.5	28.3	0.0	0.0	28.3
Total debt and equity securities	\$ 3,142.8	\$ 11.8	\$ (2.2)	\$ 3,152.4	\$ 5,375.1	\$ 16.4	\$ (3.3)	\$ 5,388.2

The unrealized losses on our available-for-sale investments were caused by market value declines as a result of the economic environment, as well as fluctuations in market interest rates. Because the declines in market value are attributable to changes in market conditions and not credit quality, and because we have currently concluded that we neither intend to sell nor is it more likely than not that we will be required to sell these investments prior to a recovery of par value, we do not consider these investments to be other-than temporarily impaired as of January 24, 2014.

**Table of Contents**

The following table presents the contractual maturities of our debt investments as of January 24, 2014 (in millions):

	Amortized Cost	Fair Value
Due in one year or less	\$ 1,155.4	\$ 1,157.5
Due in one through five years	1,750.1	1,759.1
Due after ten years*	41.9	40.4
	\$ 2,947.4	\$ 2,957.0

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

**Fair Value of Financial Instruments**

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis as of January 24, 2014 (in millions):

	Total	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets</b>				
Corporate bonds	\$ 2,444.6	\$ 0.0	\$ 2,444.6	\$ 0.0
U.S. Treasury and government debt securities	249.6	180.5	69.1	0.0
Commercial paper	237.2	0.0	237.2	0.0
Certificates of deposit	135.0	0.0	135.0	0.0
Money market funds	13.1	13.1	0.0	0.0
Auction rate securities	40.4	0.0	0.0	40.4
Equity funds	32.5	32.5	0.0	0.0
Foreign currency contracts	2.4	0.0	2.4	0.0
Total	\$ 3,154.8	\$ 226.1	\$ 2,888.3	\$ 40.4
<b>Liabilities</b>				
Foreign currency contracts	\$ 2.0	\$ 0.0	\$ 2.0	\$ 0.0

The following table summarizes the balance sheet classifications of our financial assets and liabilities measured at fair value on a recurring basis as of January 24, 2014 (in millions):

Total	Fair Value Measurements at Reporting Date Using		
	Quoted Prices in Active Markets for	Significant Other Observable Inputs	Significant Unobservable Inputs (Level 3)

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

		Identical Assets (Level 1)	(Level 2)	
<b>Assets</b>				
Cash equivalents	\$ 162.9	\$ 13.1	\$ 149.8	\$ 0.0
Short-term investments	2,916.6	180.5	2,736.1	0.0
Other current assets	6.2	3.8	2.4	0.0
Other non-current assets	69.1	28.7	0.0	40.4
 Total	 \$ 3,154.8	 \$ 226.1	 \$ 2,888.3	 \$ 40.4
<b>Liabilities</b>				
Other current liabilities	\$ 2.0	\$ 0.0	\$ 2.0	\$ 0.0

Level 2 investments are held by a custodian who prices some of the investments using standard inputs in various asset price models or obtains investment prices from a third-party pricing provider that incorporates standard inputs in various asset price models. We review Level 2 inputs and fair value for reasonableness and the values may be further validated by comparison to multiple independent pricing sources. In addition, we review third-party pricing providers' models, key inputs and assumptions and understand the pricing processes at our third-party providers in determining the overall reasonableness of the fair value of our Level 2 financial instruments. As of January 24, 2014, we have not made any adjustments to the prices obtained from our third-party pricing providers.

**Table of Contents**

Quantitative information about our Level 3 fair value measurements is as follows (fair value in millions):

	Estimated Fair Value as of January 24, 2014	Valuation Techniques	Unobservable Inputs	Range (Weighted average)
ARSs	\$ 40.4	Discounted cash flow	Time-to-economic maturity	6.7 yrs. - 10.6 yrs. (8.2 yrs.)
			Illiquidity premium	1.5% - 3.3% (2.3%)
			Coupon rate	1.1% - 2.7% (1.9%)
		Market comparable securities	Discount rate	2.0% - 4.0% (2.8%)

All of our ARSs are classified as other non-current assets and are backed by pools of student loans guaranteed by the U.S. Department of Education. We estimate the fair value of each individual ARS using an income (discounted cash flow) and market approach that incorporate both observable and unobservable inputs. Key inputs into the discounted cash flow analysis include the time-to-economic maturity, illiquidity premium, which factors in liquidity risk, market credit spread and other factors, and a coupon rate. The key input into the market approach is a discount rate. A significant increase (decrease) in the time-to-economic maturity, liquidity risk premium, market credit spread and other factors, coupon rate or discount rate could result in a significantly lower (higher) fair value estimate. We review the fair value of our Level 3 financial instruments for overall reasonableness by reviewing service provider pricing methodologies, key inputs and assumptions and by understanding the processes used by our third-party service provider. We will continue to monitor our ARS investments in light of the debt market environment and evaluate these investments for impairment and classification.

The table below provides a reconciliation of the beginning and ending balance of our Level 3 ARSs measured at fair value on a recurring basis using significant unobservable inputs (in millions):

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
Balance at beginning of period	\$ 39.5	\$ 46.5	\$ 42.0	\$ 51.0
Total unrealized gains, net included in other comprehensive income (loss)	0.9	0.0	0.7	0.5
Total realized gains included in earnings	0.0	0.7	0.7	0.7
Sales	0.0	0.0	(3.0)	0.0
Settlements	0.0	(5.0)	0.0	(10.0)
Balance at end of period	\$ 40.4	\$ 42.2	\$ 40.4	\$ 42.2

**Fair Value of Debt**

As of January 24, 2014, the fair value of our 2.00% Senior Notes and 3.25% Senior Notes (collectively referred to as Senior Notes) was approximately \$983.7 million. The fair value of our debt was based on observable market prices in a less active market and discounted cash flow models that take into consideration variables such as credit-rating and interest rate changes. All of our debt obligations are categorized as Level 2 instruments.

**9. Financing Arrangements****Long-term Debt**

The following table summarizes the carrying value of our long-term debt (in millions):

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

	January 24, 2014		April 26, 2013	
	Amount	Effective Interest Rate	Amount	Effective Interest Rate
2.00% Senior Notes due 2017	\$ 750.0	2.25%	\$ 750.0	2.25%
3.25% Senior Notes due 2022	250.0	3.43%	250.0	3.43%
1.75% Convertible Notes due 2013	0.0	N/A	1,264.9	6.31%
Total principal amount	1,000.0		2,264.9	
Less: Unamortized discount	(4.8)		(12.5)	
Total debt	995.2		2,252.4	
Less: Current portion	(0.0)		(1,257.8)	
Total long-term portion	\$ 995.2		\$ 994.6	

N/A - Not Applicable

---

**Table of Contents**
*Senior Notes*

Our Senior Notes, issued in December 2012, are unsecured, unsubordinated obligations, which pay interest semi-annually on June 15 and December 15 and rank equally in right of payment with any future senior unsecured indebtedness. Interest expense associated with the Senior Notes was \$6.2 million and \$18.7 million for the three and nine months ended January 24, 2014, respectively, and was \$3.1 million for each of the three and nine months ended January 25, 2013.

We may redeem the Senior Notes in whole or in part at any time at our option at specified redemption prices. In addition, upon the occurrence of certain change of control triggering events, we may be required to repurchase the Senior Notes at 101% of their aggregate principal amount, plus accrued and unpaid interest to the date of repurchase. The Senior Notes also include covenants that limit our ability to incur debt secured by liens on assets or on shares of stock or indebtedness of our subsidiaries; to engage in sale and lease-back transactions; and to consolidate, merge or sell all or substantially all of our assets. As of January 24, 2014, we were in compliance with all covenants associated with the Senior Notes.

*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 (the Convertible Notes) with a maturity date of June 1, 2013. The Convertible Notes were unsecured, unsubordinated obligations of the Company and paid interest in cash semi-annually at a rate of 1.75% per annum. Upon maturity, the Convertible Notes were converted into shares of common stock at a conversion rate of 31.40 shares of common stock per \$1,000 principal amount of the Convertible Notes (which represented the effective conversion price of \$31.85 per share). Upon conversion in June 2013, the holders received cash for the principal amount of the Convertible Notes and an aggregate of 4.9 million shares of common stock for the \$178.9 million excess of the conversion value over the principal amount.

We separately accounted for the liability and equity components of the Convertible Notes. The initial debt component of the Convertible Notes was valued at \$1,017.0 million based on the contractual cash flows discounted at an appropriate comparable market non-convertible debt borrowing rate at the date of issuance of 6.31%, with the equity component representing the residual amount of the proceeds of \$248.0 million which was recorded as a debt discount. Issuance costs were allocated pro-rata based on the relative initial carrying amounts of the debt and equity components. As a result, \$5.2 million of the issuance costs was allocated to the equity component of the Convertible Notes, and \$21.4 million of the issuance costs remained classified as other non-current assets. The debt discount and the issuance costs allocated to the debt component were amortized as additional interest expense over the term of the Convertible Notes using the effective interest method.

*Convertible Note Hedges and Warrants*

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

**Convertible Note Hedges:** As of April 26, 2013, we had arrangements with counterparties to buy up to approximately 31.8 million shares of our common stock, at a price of \$31.85 per share. In June 2013, concurrent with the repayment and conversion of the Convertible Notes, we exercised the Convertible Note hedges that were net settled for an aggregate of 3.9 million shares from the counterparties.

**Warrants:** As of April 26, 2013, we had outstanding warrants for certain counterparties to acquire 39.7 million shares of our common stock at an exercise price of \$41.28 per share. The warrants were exercisable on a series of days commencing on September 3, 2013 and ending on October 28, 2013. The number of warrants and exercise price were adjusted in July 2013 to 39.9 million and \$41.12 per share, respectively, to reflect our July 2013 dividend. On October 17, 2013, the exercise price of the warrants then outstanding was further adjusted to \$40.97 per share to reflect our October 2013 dividend. Through October 28, 2013, 31.9 million warrants were exercised and net settled with 1.1 million shares of our common stock equal to the difference between the market price on the date of exercise and the exercise price of the warrants on the respective exercise dates. No warrants were exercised during the three months ended January 24, 2014 as their exercise price exceeded the market value of our stock prior to their expiration during the quarter.

**Table of Contents***Interest Expense on Convertible Notes*

The following table presents the amount of interest expense related to the Convertible Notes (in millions):

	<b>Three Months Ended</b>	<b>Nine Months Ended</b>	
	<b>January 25, 2013</b>	<b>January 24, 2014</b>	<b>January 25, 2013</b>
Contractual coupon interest expense	\$ 5.5	\$ 2.5	\$ 16.5
Amortization of debt discount	13.9	7.1	41.0
Amortization of debt issuance costs	1.2	0.6	3.6
Less capitalized interest	0.0	0.0	(1.1)
<b>Total interest expense related to Convertible Notes</b>	<b>\$ 20.6</b>	<b>\$ 10.2</b>	<b>\$ 60.0</b>

No interest expense related to the Convertible Notes was recognized in the three months ended January 24, 2014 due to their maturity.

*Debt Maturities*

As of January 24, 2014, our aggregate future principal debt maturities are as follows (in millions):

<b>Fiscal Year</b>	<b>Amount</b>
2018	\$ 750.0
Thereafter	250.0
<b>Total</b>	<b>\$ 1,000.0</b>

*Credit Facility*

In December 2012, we entered into a credit agreement with a syndicated group of lenders that provides for an unsecured \$250.0 million revolving credit facility that is comprised of revolving loans, Eurocurrency loans and/or swingline loans. The credit facility includes a \$100.0 million foreign currency sub-facility, a \$50.0 million letter of credit sub-facility and a \$10.0 million swingline sub-facility available on same-day notice. Available borrowings under the credit facility are reduced by the amount of any outstanding borrowings on the sub-facilities. We may also, subject to certain requirements, request an increase in the facility up to an additional \$100.0 million and request two additional one-year extensions, subject to certain conditions. The proceeds from the facility may be used by us for general corporate purposes.

Borrowings under the facility, except for swingline loans, accrue interest in arrears at an alternate base rate as defined in the credit agreement or, at our option, an adjusted London Interbank Offered Rate (LIBOR) plus in each case, a spread (based on our public debt ratings and the type of loan) ranging from 0.2% to 1.2%. Swingline borrowings accrue interest at an alternate base rate. In addition, we are required to pay fees to maintain the credit facility, whether or not we have outstanding borrowings. The facility terminates on December 21, 2017 if no extensions have been requested and contains financial covenants requiring us to maintain a maximum leverage ratio of not more than 3.0:1.0 and a minimum interest coverage ratio of not less than 3.5:1.0. The facility contains customary affirmative and negative covenants, including covenants that limit our ability to incur debt secured by liens on assets or indebtedness of our subsidiaries and to consolidate, merge or sell all or substantially all of our assets. As of January 24, 2014, no borrowings were outstanding under the facility and we were in compliance with all covenants associated with the facility.

*Other Long-Term Financing Arrangements*

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

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

	January 24, 2014	April 26, 2013
Other long-term financing arrangements	\$ 14.8	\$ 10.8
Less: current portion	(6.9)	(5.2)
Non-current portion of other long-term financing arrangements	\$ 7.9	\$ 5.6

**Table of Contents****10. Stockholders Equity****Stock Options**

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

	Number of Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding as of April 26, 2013	19.2	\$ 31.27		
Granted	2.7	38.28		
Exercised	(5.7)	25.91		
Forfeited and expired	(1.1)	42.04		
Outstanding as of January 24, 2014	15.1	33.79	3.62	\$ 176.6
Vested and expected to vest as of January 24, 2014	14.6	33.67	3.54	173.0
Exercisable as of January 24, 2014	10.7	31.86	2.77	145.9

The aggregate intrinsic value represents the pre-tax difference between the exercise price of stock options and the quoted market price of our stock on that day for all in-the-money options.

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

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
Weighted-average fair value per share granted	\$ 10.34	\$ 20.53	\$ 9.88	\$ 11.54
Intrinsic value of exercises	\$ 20.9	\$ 15.0	\$ 81.3	\$ 30.8
Proceeds received from exercises	\$ 34.5	\$ 15.8	\$ 147.7	\$ 35.3
Fair value of options vested	\$ 10.6	\$ 14.5	\$ 36.0	\$ 44.0

**Restricted Stock Units**

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

	Number of Shares	Weighted- Average Grant Date Fair Value
Outstanding as of April 26, 2013	12.8	\$ 38.36
Granted	6.3	38.67
Vested	(4.0)	38.20
Forfeited	(1.4)	39.23
Outstanding as of January 24, 2014	13.7	38.45

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

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

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
Shares withheld for taxes	0.3	0.4	1.3	1.1
Fair value of shares withheld	\$ 12.1	\$ 12.2	\$ 51.4	\$ 34.8

**Table of Contents****Employee Stock Purchase Plan**

Under the Employee Stock Purchase Plan (ESPP), employees who elect to participate are granted purchase rights that include a purchase price adjustment provision under which the employees may purchase common stock at a 15% discount from the market value of the common stock at certain specified dates within a two-year offering period. Information related to the purchase rights issued under the ESPP is provided below (in millions, except per right information):

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
Weighted-average fair value per right granted	\$ 11.03	\$ 10.37	\$ 10.83	\$ 10.36
Shares issued under the ESPP	1.8	1.9	3.8	3.8
Proceeds from issuance of shares	\$ 45.6	\$ 46.8	\$ 95.5	\$ 95.0

**Stock-Based Compensation Expense**

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

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
Cost of product revenues	\$ 1.5	\$ 1.4	\$ 4.2	\$ 4.7
Cost of service revenues	4.6	4.8	12.8	15.0
Sales and marketing	33.0	31.9	94.6	101.8
Research and development	23.6	20.8	66.6	63.8
General and administrative	9.2	8.4	27.6	26.2
Total stock-based compensation expense	\$ 71.9	\$ 67.3	\$ 205.8	\$ 211.5

As of January 24, 2014, total unrecognized compensation expense related to our equity awards was \$449.3 million, which is expected to be recognized on a straight-line basis over a weighted-average remaining service period of 2.5 years.

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

	Nine Months Ended	
	January 24, 2014	January 25, 2013
Income tax benefits associated with employee stock transactions	\$ 22.5	\$ 35.4

**Valuation Assumptions**

The fair value of each stock option and ESPP purchase right is estimated on the grant date using the Black-Scholes option pricing model and the following weighted-average assumptions:

	Stock Options			
	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
Expected term in years	4.8	4.5	4.8	4.8
Risk-free interest rate	1.4%	0.6%	1.1%	0.6%
Volatility	32%	43%	34%	42%
Dividend yield	1.6%	0.0%	1.6%	0.0%

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

	ESPP			
	Three Months Ended		Nine Months Ended	
	January 24, 2013	January 25, 2013	January 24, 2012	January 25, 2013
Expected term in years	1.2	1.2	1.2	1.2
Risk-free interest rate	0.2%	0.2%	0.2%	0.2%
Volatility	30%	41%	31%	40%
Dividend yield	1.6%	0.0%	1.6%	0.0%

**Table of Contents**

The weighted-average assumptions used to value RSUs are summarized as follows:

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
Grant date fair value per share	\$ 39.87	\$ 30.69	\$ 38.67	\$ 29.45
Expected dividend	1.6%	0.0%	1.6%	0.0%

Prior to the initial declaration of a quarterly cash dividend on May 21, 2013, the fair value of RSUs was measured based on the grant date share price, as we did not historically pay cash dividends on our common stock. For awards granted on or subsequent to May 21, 2013, the fair value of RSUs was measured based on the grant date share price, less the present value of expected dividends during the vesting period, discounted at a risk-free interest rate.

**Stock Repurchase Program**

As of January 24, 2014, our Board of Directors has authorized the repurchase of up to \$7.1 billion of our common stock. Under this program, which we may suspend or discontinue at any time, we may purchase shares of our outstanding common stock through open market and privately negotiated transactions at prices deemed appropriate by our management.

The following table summarizes activity related to this program for the nine months ended January 24, 2014 (in millions, except per share information):

Number of shares repurchased	37.6
Average price per share	\$ 40.04
Aggregate purchase price	\$ 1,507.0
Remaining authorization at end of period	\$ 1,499.2

The aggregate purchase price of our stock repurchases for the nine months ended January 24, 2014 consisted of \$750.0 million under an accelerated share repurchase agreement (ASR) and \$757.0 million of open market purchases, for which collectively \$585.7 million and \$921.3 million was allocated to additional paid-in capital and retained earnings, respectively.

During the nine months ended January 24, 2014, we retired 104.3 million shares of common stock repurchased in prior years and previously reported as treasury stock, resulting in reductions of \$0.1 million in common stock (par value), \$614.0 million in additional paid-in capital and \$2,313.3 million in retained earnings.

**Accelerated Share Repurchase Agreement**

On June 5, 2013, we entered into a collared ASR with a counterparty under which we prepaid \$750.0 million to purchase shares of our common stock. The aggregate number of shares ultimately purchased was determined based on the volume weighted-average share price of our common stock over a specified period of time. The contract was settled in July 2013. The total number of shares repurchased under this ASR was 19.2 million shares, at an average price per share of \$39.13. The value of the ASR forward contract was determined to be \$13.9 million, which has been recorded as additional paid-in capital.

**Dividends**

During the nine months ended January 24, 2014, we declared and paid quarterly cash dividends of \$0.15 per share of outstanding common stock, or an aggregate of \$153.1 million, of which \$50.4 million and \$102.7 million was allocated to additional paid-in capital and retained earnings, respectively. On February 12, 2014, we declared a cash dividend of \$0.15 per share of common stock, payable on April 22, 2014 to holders of record as of the close of business on April 10, 2014. No dividends were declared or paid during the nine months ended January 25, 2013. The timing and amount of future dividends will depend on market conditions, corporate business and financial considerations and regulatory requirements. All dividends declared have been determined by the Company to be legally authorized under the laws of the state in which we are incorporated.



**Table of Contents****Retained Earnings**

A reconciliation of retained earnings for the nine months ended January 24, 2014 is as follows (in millions):

Balance as of April 26, 2013	\$ 2,896.8
Net income	440.5
Repurchases of common stock	(921.3)
Retirement of treasury stock	(2,313.3)
Dividends	(102.7)
Balance as of January 24, 2014	\$ 0.0

**Accumulated Other Comprehensive Income**

Changes in accumulated other comprehensive income (AOCI) by component, net of tax, for the nine months ended January 24, 2014 are summarized below (in millions):

	Foreign Currency Translation Adjustments	Defined Benefit Obligation Adjustments	Unrealized Gains on Available- for-Sale Securities	Unrealized Gains on Derivative Instruments	Total
Balance as of April 26, 2013	\$ 2.0	\$ (5.7)	\$ 11.4	\$ 1.0	\$ 8.7
Other comprehensive income (loss) (OCI) before reclassifications	0.9	0.3	(1.3)	(2.0)	(2.1)
Amounts reclassified from AOCI, net of tax	0.0	0.0	(1.1)	1.2	0.1
Net OCI	0.9	0.3	(2.4)	(0.8)	(2.0)
Balance as of January 24, 2014	\$ 2.9	\$ (5.4)	\$ 9.0	\$ 0.2	\$ 6.7

The amounts reclassified out of AOCI are as follows (in millions):

OCI Components	Three Months Ended January 24, 2014		Nine Months Ended January 24, 2014		Statements of Operations Location
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013	
	Amounts Reclassified from AOCI		Amounts Reclassified from AOCI		
Realized losses (gains) on available-for-sale securities	\$ 0.0	\$ 0.1	\$ (1.1)	\$ (0.5)	Other income (expense), net
Realized losses (gains) on cash flow hedges	(0.2)	3.1	1.2	1.2	Net revenues
Total reclassifications	\$ (0.2)	\$ 3.2	\$ 0.1	\$ 0.7	

**11. Derivatives and Hedging Activities**

We use derivative instruments to manage exposures to foreign currency risk. All contracts have a maturity of less than six months. The notional amount of our outstanding U.S. dollar equivalent foreign currency exchange forward contracts consisted of the following (in millions):

	January 24, 2014	April 26, 2013
<b>Cash Flow Hedges</b>		
Forward contracts purchased	\$ 188.8	\$ 108.4
<b>Balance Sheet Contracts</b>		
Forward contracts sold	148.4	158.2
Forward contracts purchased	340.5	358.4

We have master netting arrangements in place to mitigate the credit risk of our counterparties and to potentially reduce our losses due to counterparty nonperformance. We present our derivative instruments as net amounts in our condensed consolidated balance sheets. The gross and net fair value amounts of such instruments were not material as of January 24, 2014 and April 26, 2013. We did not recognize any gains and losses in earnings due to hedge ineffectiveness for any period presented.

**Table of Contents**

The effect of derivative instruments designated as cash flow hedges recognized in net revenues on our condensed consolidated statements of operations is presented in the condensed consolidated statements of comprehensive income and Note 10.

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

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
Foreign currency exchange forward contracts	\$ 1.0	\$ 0.0	\$ 1.8	\$ 6.2

**12. Restructuring and Other Charges**

In May 2013, we initiated a business restructuring plan under which we realigned internal resources, resulting in a reduction of our global workforce of approximately 7%. Such activities have been substantially completed as of January 24, 2014. Restructuring and other charges during the nine months ended January 24, 2014 consisted primarily of employee severance-related costs.

Activities related to this plan for the nine months ended January 24, 2014 were as follows (in millions):

	Total
Net charges	\$ 49.5
Cash payments	(48.9)
Balance as of January 24, 2014	\$ 0.6

The reserve balance as of January 24, 2014 is included in accrued compensation and related benefits in our condensed consolidated balance sheet.

**13. Income Taxes**

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

	Nine Months Ended	
	January 24, 2014	January 25, 2013
Effective tax rates	14.3%	12.2%

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

As of January 24, 2014, we had \$207.8 million of unrecognized tax benefits, of which \$148.6 million has been recorded in other long-term liabilities. Unrecognized tax benefits of \$135.8 million, including penalties and interest, would affect our provision for income taxes if recognized. During the nine months ended January 24, 2014, there was a gross increase in our unrecognized tax benefits of \$20.9 million for tax positions related to the current year, and a gross increase of \$1.8 million and gross decrease, including settlements and statute lapses, of \$4.5 million for tax positions related to prior years.

Our fiscal 2005 through 2007 income tax returns are currently under audit by the IRS. In September 2012, we reached a tentative agreement with the IRS field examination team on certain transfer pricing matters under appeals, and in July 2013, we received a revised Revenue Agent's Report (RAR) from the IRS. We are currently in the process of preparing for the review of the revised RAR by certain higher authorities within the IRS and the Joint Committee on Taxation. In February 2012, the IRS commenced an examination of our fiscal 2008 through fiscal 2010 income tax returns. Our open years in U.S. federal jurisdictions are fiscal 2005 and later years. In addition, we are effectively subject to federal tax examination adjustments for tax years ended on or after fiscal year 2000, in that we have tax attribute carryforwards from these years that

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

could be subject to adjustments, if and when utilized. In January 2014, the California Franchise Tax Board temporarily closed the audit of our fiscal 2007 and 2008 income tax returns and will reopen the audit upon the conclusion of the applicable federal IRS audits.

On September 17, 2010, the Danish Tax Authorities issued a decision concluding that distributions declared in 2005 and 2006 from our Danish subsidiary were subject to Danish at-source dividend withholding tax. We do not believe that our Danish subsidiary is liable for withholding tax and filed an appeal with the Danish Tax Tribunal to that effect. On December 19, 2011, the Danish Tax Tribunal issued a ruling that our Danish subsidiary was not liable for Danish withholding tax. The Danish tax examination agency appealed to the Danish High Court in March 2012.

**Table of Contents**

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

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

**14. Net Income per Share**

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

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
<b>Numerator:</b>				
Net income	\$ 192.1	\$ 158.1	\$ 440.5	\$ 331.5
<b>Denominator:</b>				
Shares used in basic computation	339.4	359.5	343.7	362.5
Dilutive potential shares related to employee equity award plans	6.8	5.1	7.0	5.1
Dilutive impact of assumed conversion of Convertible Notes	0.0	0.1	0.7	0.5
Dilutive impact of warrants	0.0	0.0	0.3	0.0
Shares used in diluted computation	346.2	364.7	351.7	368.1
<b>Net Income per Share:</b>				
Basic	\$ 0.57	\$ 0.44	\$ 1.28	\$ 0.91
Diluted	\$ 0.55	\$ 0.43	\$ 1.25	\$ 0.90

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

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
Employee equity award plans	5.7	15.0	6.5	16.4

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

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

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

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

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
Americas (United States, Canada and Latin America)	\$ 838.7	\$ 882.8	\$ 2,596.4	\$ 2,581.2
Europe, Middle East and Africa	546.9	528.6	1,439.9	1,405.6
Asia Pacific	224.4	218.7	639.8	629.1
Net revenues	\$ 1,610.0	\$ 1,630.1	\$ 4,676.1	\$ 4,615.9

**Table of Contents**

Americas revenues consist of Americas commercial and U.S. public sector revenues. Sales to customers inside the United States comprised \$734.6 million and \$778.9 million of Americas net revenues during the three months ended January 24, 2014 and January 25, 2013, respectively, and \$2,308.1 million and \$2,287.9 million of Americas net revenues during the nine months ended January 24, 2014 and January 25, 2013, respectively. Sales to Germany accounted for \$163.8 million of net revenues for the three months ended January 25, 2013. No single foreign country accounted for 10% or more of our net revenues for any other period presented.

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

	January 24, 2014	April 26, 2013
United States	\$ 1,010.3	\$ 3,419.3
International	4,111.0	3,586.8
<b>Total</b>	<b>\$ 5,121.3</b>	<b>\$ 7,006.1</b>

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

	January 24, 2014	April 26, 2013
United States	\$ 1,043.6	\$ 1,076.3
International	85.0	94.6
<b>Total</b>	<b>\$ 1,128.6</b>	<b>\$ 1,170.9</b>

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

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
Arrow Electronics, Inc. <sup>(1)</sup>	20%	18%	21%	19%
Avnet, Inc. <sup>(1)</sup>	15%	15%	16%	15%

<sup>(1)</sup> Net revenues for Arrow Electronics, Inc. for the nine months ended January 25, 2013 have been corrected from 18% previously disclosed to 19%. Net revenues for Avnet, Inc. for each of the three and nine months ended January 25, 2013 have been corrected from 14% previously disclosed to 15%.

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

	April 26, 2013
Arrow Electronics, Inc.	16%
Avnet, Inc.	14%

No customer accounted for 10% or more of net accounts receivable as of January 24, 2014.



**Table of Contents****16. Commitments and Contingencies*****Operating Lease Commitments***

As of January 24, 2014, future annual minimum lease payments under non-cancelable operating leases with an initial term in excess of one year totaled \$216.1 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 to the extent we believe it is probable that such components will not be utilized in future operations. To the extent that such forecasts are not achieved, our commitments and associated accruals may change. As of January 24, 2014, we had \$240.2 million in non-cancelable purchase commitments with our contract manufacturers. 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 cost of product revenues. As of January 24, 2014 and April 26, 2013, such liability amounted to \$15.4 million and \$9.5 million, respectively, and is included in other current liabilities in our condensed consolidated balance sheets.

In addition to commitments with contract manufacturers and component suppliers, we have open purchase orders and contractual obligations associated with our ordinary course of business for which we have not received goods or services. As of January 24, 2014, we had \$44.1 million in capital purchase commitments and \$203.2 million in other purchase commitments.

***Product Warranties***

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

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
Beginning balance	\$ 116.0	\$ 111.8	\$ 117.2	\$ 83.1
Expense accrued during the period	21.1	23.5	59.4	74.3
Warranty costs incurred	(20.0)	(18.5)	(59.5)	(40.6)
Ending balance	\$ 117.1	\$ 116.8	\$ 117.1	\$ 116.8

Our warranty reserves were reported in our condensed consolidated balance sheets as follows (in millions):

	January 24, 2014	April 26, 2013
Other current liabilities	\$ 79.8	\$ 81.6
Other long-term liabilities	37.3	35.6
Total	\$ 117.1	\$ 117.2

***Financing Guarantees***

Some of our customers have entered into recourse and non-recourse financing leasing arrangements using third-party financing companies, and in some situations, we enter into customer financing arrangements for our products and services that are contemporaneously sold on a recourse or non-recourse basis to third-party financing companies. Under the terms of recourse leases, which are generally three years or less, we remain liable for the aggregate unpaid remaining lease payments to the third-party leasing companies in the event of end-user customer default. These

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

arrangements are generally collateralized by a security interest in the underlying assets. Under the terms of the nonrecourse leases, we do not have any continuing obligations or liabilities to the third-party financing companies. Where we provide a guarantee for recourse leases, we defer revenues subject to the industry-specific software revenue recognition guidance, and recognize revenues for non-software deliverables in accordance with our multiple deliverable revenue arrangement policy. In connection with certain recourse financing arrangements, we receive advance payments associated with undelivered elements that are subject to customer refund rights. We defer revenue associated with these advance payments until the related refund rights expire and we perform the services.

**Table of Contents**

The following schedule of financing guarantees represents the total maximum potential future payments under financing arrangements with third parties, and the related deferred revenue (in millions):

	January 24, 2014	April 26, 2013
Maximum guaranteed payment contingencies	\$ 218.0	\$ 182.4
Deferred revenue associated with financing guarantees	(203.8)	(168.6)
Maximum potential future payments relating to financing guarantees, net of associated deferred revenue	\$ 14.2	\$ 13.8

To date, we have not experienced material losses under our lease financing programs or other financing arrangements.

***Legal Contingencies***

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

We are subject to various legal proceedings and claims that arise in the normal course of business. No accrual has been recorded as of January 24, 2014 related to such matters as they are not probable and/or reasonably estimable.

**Table of Contents**

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

**Forward-Looking Statements**

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). Forward-looking statements are all statements (and their underlying assumptions) included in this document that refer, directly or indirectly, to future events or outcomes and, as such, are inherently not factual, but rather reflect only our current projections for the future. Consequently, forward-looking statements usually include words such as estimate, intend, plan, predict, seek, may, will, should, would, could, anticipate, expect, case, intended to refer to future events or circumstances. A non-comprehensive list of the topics including forward-looking statements in this document includes:

our future financial and operating results;

our strategies;

our beliefs and objectives for future operations, research and development;

political, economic and industry trends;

expected timing of, and benefits from, product introductions, developments, enhancements and acceptance;

expected benefits from acquisitions and joint ventures, growth opportunities and investments;

expected outcomes from legal, regulatory and administrative proceedings;

our competitive position;

our short-term and long-term cash requirements, including without limitation, anticipated capital expenditures;

our anticipated tax rate;

the repayment of our 2.00% Senior Notes due on December 15, 2017 and 3.25% Senior Notes due on December 15, 2022 (collectively referred to as the Senior Notes);

future uses of our cash, including, without limitation, the continuation of our stock repurchase and cash dividend programs.

All forward-looking statements included in this document are inherently uncertain as they are based on management's current expectations and assumptions concerning future events, and are subject to numerous known and unknown risks and uncertainties. Therefore, actual events and results may differ materially from these forward-looking statements. Factors that could cause actual results to differ materially from those

described herein include, but are not limited to:

our ability to accurately forecast demand for our products and services, and future financial performance;

our ability to understand, and effectively respond to changes affecting, our market environment, products, technologies and customer requirements;

**Table of Contents**

the overall growth and structure of the data storage industry;

general global political, macroeconomic and market conditions;

disruptions in our supply chain, which could limit our ability to ship products to our customers in the amounts and at the prices forecasted;

failure of our products and services to meet our customers' quality requirements, including, without limitation, any epidemic failure event relating to our products installed by our customers in their systems;

our ability to maintain our gross profit margins;

our ability to successfully manage our backlog;

the quality of our strategy and our ability to successfully execute on the same, including, without limitation, our organic and acquisition-related growth strategies;

our ability to effectively integrate acquired businesses, products and technologies;

our ability to timely and successfully introduce, and increase volumes of new products and services, and to forecast demand and pricing for the same;

our ability to design, manufacture and market products meeting global environmental standards;

the impact of industry consolidation, affecting our suppliers, competitors, partners and customers;

our ability to successfully recruit and retain critical employees and to manage our investment in people, process and systems;

our ability to maintain our customer, partner, supplier and contract manufacturer relationships on favorable terms and conditions;

the actions of our competitors, most of which are larger and have greater financial and other resources than we have, including, without limitation, their ability to introduce competitive products and to acquire businesses and technologies that negatively impact our strategy, operations or customer demand for our products;

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

the availability of acceptable financing to support our future cash requirements;

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

valuation and liquidity of our investment portfolio;

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

those factors discussed under the heading **Risk Factors** elsewhere in this Quarterly Report on Form 10-Q. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof and are based upon information available to us at this time. These statements are not guarantees of future performance. We disclaim any obligation to update information in any forward-looking statement. Actual results could vary from our forward-looking statements due to the foregoing factors as well as other important factors.

**Table of Contents****Overview*****Financial Results and Key Performance Metrics Overview***

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

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
Net revenues	\$ 1,610.0	\$ 1,630.1	\$ 4,676.1	\$ 4,615.9
Gross profit	\$ 1,002.3	\$ 964.9	\$ 2,877.1	\$ 2,728.9
Gross profit margin percentage	62.3%	59.2%	61.5%	59.1%
Income from operations	\$ 226.7	\$ 187.9	\$ 510.5	\$ 403.4
Income from operations as a percentage of net revenues	14.1%	11.5%	10.9%	8.8%
Net income	\$ 192.1	\$ 158.1	\$ 440.5	\$ 331.5
Diluted income per share	\$ 0.55	\$ 0.43	\$ 1.25	\$ 0.90
Operating cash flows	\$ 331.8	\$ 365.1	\$ 980.1	\$ 930.7

	January 24, 2014	April 26, 2013
Deferred revenue	\$ 2,959.3	\$ 3,009.5
Days sales outstanding (DSO)	33	42

**1.75% Convertible Notes and Hedges**

In June 2013, we settled our Convertible Notes. Upon conversion, we repaid the principal amount of \$1.3 billion and issued an aggregate of 4.9 million shares of common stock for the excess of the conversion value over the principal amount of the Convertible Notes. Concurrently, we exercised our Convertible Note hedges, for which we received 3.9 million shares from the counterparties.

**Dividends and Stock Repurchase Program Activity**

In May 2013, our Board of Directors approved a \$1.6 billion increase to our stock repurchase program under which during the nine months ended January 24, 2014 we repurchased 37.6 million shares of our common stock at an average price of \$40.04 per share, for an aggregate of \$1.5 billion. We also declared quarterly cash dividends of \$0.15 per share of common stock in fiscal 2014, for which we paid an aggregate of \$153.1 million during the nine months ended January 24, 2014.

**Restructuring and Other Charges**

In May 2013, we initiated a business restructuring plan under which we realigned internal resources, resulting in a reduction of our global workforce by approximately 7%. We substantially completed such activities in the three months ended January 24, 2014. The costs associated with the plan consisted of \$49.5 million of employee severance costs.

**Critical Accounting Policies and Estimates**

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

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

The summary of significant accounting policies is included in 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 26, 2013. An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably could have been used, or if changes in the estimate that are reasonably possible could materially impact the financial statements. There have been no material changes to the critical accounting policies and estimates as filed in such report.

**Table of Contents****Results of Operations**

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

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
<b>Revenues:</b>				
Product	63.0%	65.1%	62.0%	64.0%
Software entitlements and maintenance	14.1	14.0	14.7	14.4
Service	22.9	20.9	23.3	21.6
Net revenues	100.0	100.0	100.0	100.0
<b>Cost of revenues:</b>				
Cost of product	28.0	31.4	28.3	31.2
Cost of software entitlements and maintenance	0.5	0.5	0.5	0.5
Cost of service	9.2	8.9	9.7	9.2
<b>Gross profit</b>	62.3	59.2	61.5	59.1
<b>Operating expenses:</b>				
Sales and marketing	29.6	30.3	30.4	31.7
Research and development	14.3	13.2	14.7	14.3
General and administrative	4.3	4.1	4.4	4.3
Acquisition-related expense		0.1	1.1	
Total operating expenses	48.2	47.7	50.6	50.3
<b>Income from operations</b>	14.1	11.5	10.9	8.8
<b>Other income (expense), net</b>	0.2	(0.7)	0.1	(0.6)
<b>Income before income taxes</b>	14.3	10.8	11.0	8.2
Provision for income taxes	2.4	1.1	1.6	1.0
<b>Net income</b>	11.9%	9.7%	9.4%	7.2%

**Discussion and Analysis of Results of Operations*****Overview***

Net revenues for the three and nine months ended January 24, 2014 were \$1,610.0 million, down \$20.1 million, or 1%, and \$4,676.1 million, up \$60.2 million, or 1%, respectively, compared to the prior year. The decrease for the three months ended January 24, 2014 was primarily due to a decrease in product revenues, partially offset by an increase in hardware maintenance contract revenues. The increase for the nine months ended January 24, 2014 was primarily due to increases in hardware maintenance contract and software entitlements and maintenance (SEM) revenues, partially offset by a decrease in product revenues.

Gross profit as a percentage of net revenues increased 3% and 2% during the three and nine months ended January 24, 2014, respectively, compared to the same periods in the prior year, primarily due to lower unit materials costs due to supply chain efficiencies, partially offset by a lower average selling price (ASP) for total configured systems. Additionally, gross profit was favorably impacted by lower OEM revenues.

Sales and marketing, research and development, and general and administrative expenses for the three and nine months ended January 24, 2014 totaled \$775.6 million, up 1% as a percentage of net revenues, and \$2,317.1 million, down 1% as a percentage of net revenues, respectively,

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

compared to the same periods in the prior year. The increase during the three months ended January 24, 2014 was primarily due to increased incentive compensation and the decrease during the nine months ended January 24, 2014, reflects cost control programs implemented in fiscal 2014, partially offset by an increase in incentive compensation.

**Table of Contents****Net Revenues (in millions, except percentages):**

	Three Months Ended			Nine Months Ended		
	January	January	% Change	January	January	% Change
	24, 2014	25, 2013		24, 2014	25, 2013	
Net revenues	\$ 1,610.0	\$ 1,630.1	(1)%	\$ 4,676.1	\$ 4,615.9	1%

The decrease in net revenues for the three months ended January 24, 2014 was primarily due to a decrease in product revenues of \$45.7 million, partially offset by an increase in service revenues of \$27.2 million. The decrease in product revenues was primarily due to a \$43.3 million decrease in OEM product revenues. Product revenues comprised 63% of net revenues for the three months ended January 24, 2014 compared to 65% of net revenues for the three months ended January 25, 2013.

The increase in net revenues for the nine months ended January 24, 2014 was primarily due to increases in service and SEM revenues of \$92.8 million and \$20.8 million, respectively, partially offset by a decrease in product revenues of \$53.4 million. The decrease in product revenues was due to a \$142.8 million decrease in OEM product revenues, partially offset by an \$89.4 million increase in branded product revenues. Product revenues comprised 62% of net revenues for the nine months ended January 24, 2014 compared to 64% of net revenues for the nine months ended January 25, 2013.

Sales through our indirect channels represented 83% and 82% of net revenues for the three and nine months ended January 24, 2014, respectively, compared to 81% and 80% of net revenues for the three and nine months ended January 25, 2013, respectively. Included in indirect channel sales were \$157.3 million and \$474.9 million of OEM revenue during the three and nine months ended January 24, 2014, respectively, compared to \$203.2 million and \$621.7 million during the three and nine months ended January 25, 2013, respectively.

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

	Three Months Ended		Nine Months Ended	
	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
Arrow Electronics, Inc. <sup>(1)</sup>	20%	18%	21%	19%
Avnet, Inc. <sup>(1)</sup>	15%	15%	16%	15%

<sup>(1)</sup> Net revenues for Arrow Electronics, Inc. for the nine months ended January 25, 2013 have been corrected from 18% previously disclosed to 19%. Net revenues for Avnet, Inc. for each of the three and nine months ended January 25, 2013 have been corrected from 14% previously disclosed to 15%.

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

	Three Months Ended			Nine Months Ended		
	January	January	% Change	January	January	% Change
	24, 2014	25, 2013		24, 2014	25, 2013	
Product revenues	\$ 1,015.0	\$ 1,060.7	(4)%	\$ 2,901.1	\$ 2,954.5	(2)%

Product revenues consist of configured systems, which include bundled hardware and software products, and non-configured products, which consist primarily of add-on storage, OEM products and add-on hardware and software products.

Total configured system revenues of \$569.1 million decreased by \$31.2 million, or 5%, during the three months ended January 24, 2014 compared to the same period in the prior year, primarily due to decreases in the 2000 and 6000 series systems revenues, partially offset by an increase in E-series configured revenues. Total configured systems unit volume decreased 3% during the three months ended January 24, 2014 compared to the same period in the prior year. Unit volume of the 2000 and 6000 series decreased, while unit volume of the E-series and 3000

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

series systems increased, reflecting a shift in demand from older 2000 series systems to newer 3000 series systems, increased demand for the E-series platform and a change in customer mix. The overall ASP of total configured systems decreased during the three months ended January 24, 2014 compared to the same period in the prior year, as a result of decreases in the 2000, 3000 and 6000 series ASPs due to a shift in product mix, partially offset by an increase in E-series ASP.

Non-configured product revenues of \$446.0 million decreased \$14.5 million, or 3%, during the three months ended January 24, 2014 compared to the same period in the prior year. This decrease was primarily due to lower revenue from non-configured OEM products, which declined 24%, partially offset by an 11% increase in add-on storage revenues.

**Table of Contents**

Total configured system revenues of \$1,655.2 million increased by \$52.4 million, or 3%, during the nine months ended January 24, 2014 compared to the same period in the prior year, primarily due to increases in the E-Series, 3000 and 6000 series systems revenues, partially offset by a decrease in the 2000 series systems revenues. Total configured systems unit volume increased 3% during the nine months ended January 24, 2014 compared to the same period in the prior year primarily as a result of unit increases in the E-series, 3000 and 6000 series systems, partially offset by a decrease in the 2000 series systems reflecting a shift in demand from the older 2000 series systems to newer 3000 series and increased demand for the E-series and 6000 series systems. The overall ASP of total configured systems decreased during the nine months ended January 24, 2014 compared to the same period in the prior year, partially offsetting the volume increases. The lower ASP was primarily in the 2000 and 3000 series due to a shift in product mix.

Non-configured product revenues of \$1,245.9 million decreased \$105.9 million, or 8%, during the nine months ended January 24, 2014 compared to the same period in the prior year. This decrease was primarily due to lower revenue from non-configured OEM products, which declined 25%.

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

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

	Three Months Ended			Nine Months Ended		
	January	January	% Change	January	January	% Change
	24, 2014	25, 2013		24, 2014	25, 2013	
Software entitlements and maintenance revenues	\$ 227.0	\$ 228.6	(1)%	\$ 687.3	\$ 666.5	3%

SEM revenues are associated with contracts which entitle customers to receive unspecified product upgrades and enhancements on a when-and-if-available basis, as well as bug fixes and patch releases.

The decrease in SEM revenues for the three months ended January 24, 2014 was due to lower aggregate deferred contract values. The increase in SEM revenues for the nine months ended January 24, 2014 was due to increases in the aggregate contract value of the installed base under SEM contracts, which is recognized as revenue ratably over the terms of the underlying contracts.

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

	Three Months Ended			Nine Months Ended		
	January	January	% Change	January	January	% Change
	24, 2014	25, 2013		24, 2014	25, 2013	
Service revenues	\$ 368.0	\$ 340.8	8%	\$ 1,087.7	\$ 994.9	9%

Service revenues include hardware maintenance, professional services, and educational and training services.

Hardware maintenance contract revenues comprised 78% and 77% of service revenues for the three and nine months ended January 24, 2014, respectively, compared to 75% and 73% for the three and nine months ended January 25, 2013, respectively. These revenues increased \$31.1 million, or 12%, and \$107.1 million, or 15% during the three and nine months ended January 24, 2014, respectively, compared to the same periods in the prior year, as a result of increases in the installed base and aggregate contract values under service contracts. Professional services and educational and training services comprised 22% and 23% of service revenues for the three and nine months ended January 24, 2014, respectively and 25% and 27% of service revenues for the three and nine months ended January 25, 2013, respectively.



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

	Three Months Ended			Nine Months Ended		
	January 24, 2014	January 25, 2013	% Change	January 24, 2014	January 25, 2013	% Change
Americas (United States, Canada and Latin America)	\$ 838.7	\$ 882.8	(5)%	\$ 2,596.4	\$ 2,581.2	1%
Europe, Middle East and Africa	546.9	528.6	3%	1,439.9	1,405.6	2%
Asia Pacific	224.4	218.7	3%	639.8	629.1	2%
Net revenues	\$ 1,610.0	\$ 1,630.1		\$ 4,676.1	\$ 4,615.9	

Americas revenues consist of Americas commercial and U.S. public sector revenues. Sales to customers inside the United States comprised 88% of Americas net revenues during each of the three months ended January 24, 2014 and January 25, 2013, and 89% of Americas net revenues during each of the nine months ended January 24, 2014 and January 25, 2013. Sales to Germany accounted for \$163.8 million of net revenues for the three months ended January 25, 2013. No single foreign country accounted for 10% or more of our net revenues for any other period presented.

**Cost of Revenues**

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

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

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

	Three Months Ended			Nine Months Ended		
	January 24, 2014	January 25, 2013	% Change	January 24, 2014	January 25, 2013	% Change
Cost of product revenues	\$ 450.7	\$ 512.5	(12)%	\$ 1,323.9	\$ 1,442.0	(8)%

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

	Three Months Ended Fiscal 2014 to Fiscal 2013 Percentage Change Points	Nine Months Ended Fiscal 2014 to Fiscal 2013 Percentage Change Points
	Materials cost	(10)
Warranty		(1)
Overhead		(1)
Other		(1)

Total change	(12)	(8)
--------------	------	-----

Cost of product revenues represented 44% and 46% of product revenues for the three and nine months ended January 24, 2014, respectively, compared to 48% and 49% for the three and nine months ended January 25, 2013, respectively.

Materials cost represented 84% and 83% of product costs for the three months ended January 24, 2014 and January 25, 2013, respectively, and decreased \$50.9 million from the prior year due to a decrease in average unit materials cost in the 2000, 3000 and 6000 platforms, reflecting increased supply chain efficiencies and favorable configuration mix. Additionally, materials cost was favorably impacted by a lower OEM product mix compared to the same period in the prior year. This decrease in materials cost also reflects a 3% volume decrease in configured systems and resulted in higher gross margins on products compared to the same period in the prior year.

**Table of Contents**

Materials cost represented 83% of product costs in each of the nine months ended January 24, 2014 and January 25, 2013, and decreased \$90.5 million from the prior year due to an overall decrease in average unit materials cost primarily in the 2000 and 6000 platforms, reflecting increased supply chain efficiencies and favorable configuration mix. Additionally, materials cost was favorably impacted by lower OEM product mix compared to the same period in the prior year. This decrease was partially offset by a 3% volume increase in configured systems, resulting in higher gross margins on products compared to the same period in the prior year. In addition, cost of product revenues was favorably impacted by a \$15.0 million decrease in hardware-related warranty expense compared to the same period in the prior year.

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

	Three Months Ended			Nine Months Ended		
	January 24, 2014	January 25, 2013	% Change	January 24, 2014	January 25, 2013	% Change
Cost of software entitlements and maintenance revenues	\$ 7.7	\$ 7.3	5%	\$ 22.7	\$ 20.9	9%

Cost of SEM revenues represented 3% of SEM revenues for all periods presented. Cost of SEM revenues increases are primarily due to higher volume subject to royalty costs.

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

	Three Months Ended			Nine Months Ended		
	January 24, 2014	January 25, 2013	% Change	January 24, 2014	January 25, 2013	% Change
Cost of service revenues	\$ 149.3	\$ 145.4	3%	\$ 452.4	\$ 424.1	7%

Costs represented 41% and 43% of service revenues for the three months ended January 24, 2014 and January 25, 2013, respectively, and represented 42% and 43% of service revenues for the nine months ended January 24, 2014 and January 25, 2013, respectively. Increases in cost of service revenues during the three ended January 24, 2014 are primarily due to higher service logistics costs, and during the nine months ended January 24, 2014, higher service logistics and outsourced service provider costs.

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

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

Total compensation costs included in operating expenses increased \$31.8 million, or 8%, and \$33.9 million, or 3%, for the three and nine months ended January 24, 2014, respectively, compared to the same periods in the prior year primarily due to increases in incentive compensation reflecting stronger operating performance against goals.

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

	Three Months Ended			Nine Months Ended		
	January 24, 2014	January 25, 2013	% Change	January 24, 2014	January 25, 2013	% Change
Sales and marketing expenses	\$ 475.9	\$ 493.5	(4)%	\$ 1,423.2	\$ 1,464.6	(3)%

Sales and marketing expenses consist primarily of compensation costs, commissions, outside services, allocated facilities and information technology (IT) costs, advertising and marketing promotional expense and travel and entertainment expense. Sales and marketing expenses decreased due to the following:

	<b>Three Months Ended Fiscal 2014 to Fiscal 2013 Percentage Change Points</b>	<b>Nine Months Ended Fiscal 2014 to Fiscal 2013 Percentage Change Points</b>
Compensation costs	2	
Outside services	(2)	(1)
Depreciation and amortization	(1)	(1)
Other	(3)	(1)
<b>Total change</b>	<b>(4)</b>	<b>(3)</b>

**Table of Contents**

The increase in compensation costs during the three months ended January 24, 2014 is primarily due to higher incentive compensation compared to the same period in the prior year. The decrease in outside services during the three and nine months ended January 24, 2014 reflects lower spending on third party sales support. Depreciation and amortization expense decreased during the three and nine months ended January 24, 2014 due to certain intangible assets becoming fully amortized during fiscal 2013.

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

	Three Months Ended			Nine Months Ended		
	January 24, 2014	January 25, 2013	% Change	January 24, 2014	January 25, 2013	% Change
Research and development expenses	\$ 230.3	\$ 215.6	7%	\$ 686.6	\$ 660.8	4%

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

	Three Months Ended Fiscal 2014 to Fiscal 2013 Percentage Change Points	Nine Months Ended Fiscal 2014 to Fiscal 2013 Percentage Change Points
Compensation costs	7	3
Depreciation	1	1
Development projects	(1)	(1)
Other		1
<b>Total change</b>	<b>7</b>	<b>4</b>

The increase in compensation costs during the three months ended January 24, 2014 is primarily due to higher incentive compensation, and during the nine months ended January 24, 2014 is primarily due to higher salaries and incentive compensation. Depreciation expense during the three and nine months ended January 24, 2014 increased due to higher levels of investment in engineering equipment. The decrease in development projects expense during the three and nine months ended January 24, 2014 reflects lower spending on materials and services associated with engineering activities to develop new product lines and enhancements to existing products.

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

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

	Three Months Ended			Nine Months Ended		
	January 24, 2014	January 25, 2013	% Change	January 24, 2014	January 25, 2013	% Change
General and administrative expenses	\$ 69.4	\$ 66.2	5%	\$ 207.3	\$ 198.4	4%

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

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

	<b>Three Months Ended Fiscal 2014 to Fiscal 2013 Percentage Change Points</b>	<b>Nine Months Ended Fiscal 2014 to Fiscal 2013 Percentage Change Points</b>
Compensation costs	9	5
Outside services	(2)	
Professional and corporate legal fees	1	2
Bad debt expense	(2)	(2)
Other	(1)	(1)
Total change	5	4

**Table of Contents**

The increase in compensation costs for the three months ended January 24, 2014 is primarily due to higher incentive compensation, and in the nine months ended January 24, 2014 higher salaries and incentive compensation. The decrease in outside services during the three months ended January 24, 2014 reflects lower spending levels on contractors and professional services, primarily legal services. Professional and corporate legal fees were higher during the three and nine months ended January 24, 2014 primarily due to higher spending on various legal activities. Bad debt expense for the three and nine months ended January 24, 2014 decreased \$1.2 million and \$3.7 million, respectively, compared to the same periods in the prior year.

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

	Three Months Ended			Nine Months Ended		
	January 24, 2014	January 25, 2013	% Change	January 24, 2014	January 25, 2013	% Change
Acquisition-related expense	\$	\$ 1.7	(100)%	\$	\$ 1.7	(100)%

During the three and nine months ended January 25, 2013, we incurred acquisition costs primarily related to severance costs associated with the termination of certain acquiree company employees.

*Restructuring and other charges:*

In May 2013, we initiated a business restructuring plan under which we realigned internal resources resulting in a reduction of our global workforce by approximately 7%. We recognized \$49.5 million of employee severance costs in connection with the plan in the nine months ended January 24, 2014. We substantially completed such activities in the three months ended January 24, 2014 with no additional charges.

**Other Income (Expense), Net**

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

	Three Months Ended			Nine Months Ended		
	January 24, 2014	January 25, 2013	% Change	January 24, 2014	January 25, 2013	% Change
Interest income	\$ 7.9	\$ 10.3	(23)%	\$ 26.4	\$ 32.1	(18)%

The decrease in interest income during the three and nine months ended January 24, 2014 was primarily due to a decrease in our investment portfolio as a result of the liquidation of some of our investments to repay our Convertible Notes.

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

	Three Months Ended			Nine Months Ended		
	January 24, 2014	January 25, 2013	% Change	January 24, 2014	January 25, 2013	% Change
Interest expense	\$ (6.7)	\$ (24.0)	(72)%	\$ (29.7)	\$ (63.7)	(53)%

Interest expense, including the amortization of debt discount and issuance costs, is related to our Senior Notes and Convertible Notes as summarized below:

Three Months Ended

Nine Months Ended

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

	January 24, 2014	January 25, 2013	January 24, 2014	January 25, 2013
Senior Notes	\$ 6.2	\$ 3.1	\$ 18.7	\$ 3.1
Convertible Notes		20.6	10.2	60.0
<b>Total</b>	<b>\$ 6.2</b>	<b>\$ 23.7</b>	<b>\$ 28.9</b>	<b>\$ 63.1</b>

The increase in interest expense related to our Senior Notes reflects their issuance in December 2012, and the decrease in interest expense related to our Convertible Notes reflects their maturity in June 2013.

**Table of Contents**

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

	Three Months Ended			Nine Months Ended		
	January 24,	January 25,	% Change	January 24,	January 25,	% Change
	2014	2013		2014	2013	
Other income, net	\$ 1.7	\$ 1.6	6%	\$ 6.9	\$ 5.9	17%

The increase in other income, net for the three months ended January 24, 2014 compared to the same period in the prior year is primarily due to higher net foreign exchange gains, partially offset by lower realized net gains on investments. The increase in other income, net for the nine months ended January 24, 2014 compared to the same period in the prior year is primarily due to higher unrealized net gains on investments, partially offset by lower net foreign exchange gains.

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

	Three Months Ended			Nine Months Ended		
	January 24,	January 25,	% Change	January 24,	January 25,	% Change
	2014	2013		2014	2013	
Provision for income taxes	\$ 37.5	\$ 17.7	112%	\$ 73.6	\$ 46.2	59%

Our effective tax rate for the three months ended January 24, 2014 was 16.3% compared to an effective tax rate of 10.1% for the three months ended January 25, 2013. Our effective tax rate for the nine months ended January 24, 2014 was 14.3% compared to an effective tax rate of 12.2% for the nine months ended January 25, 2013. Our effective tax rates reflect 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. The effective tax rates during the three and nine months ended January 24, 2014 and January 25, 2013, respectively, were favorably impacted by the geographic mix of profits.

Our provision for income taxes increased for the three and nine months ended January 24, 2014 compared to the prior year primarily as a result of higher pre-tax income. Our effective tax rates increased for the three and nine months ended January 24, 2014 compared to the prior year primarily as a result of higher pre-tax income in the United States and the expiration of the federal research credit, partially offset by a higher discrete tax benefit from equity awards.

We continue to monitor the progress of various ongoing tax controversies and the impact, if any, of the expected expiration of the statute of limitations in various taxing jurisdictions, as further discussed in Note 13 of the accompanying condensed consolidated financial statements.

As of January 24, 2014, we had \$207.8 million of unrecognized tax benefits, of which \$148.6 million has been recorded in other long-term liabilities. Unrecognized tax benefits of \$135.8 million, including penalties and interest, would affect our provision for income taxes if recognized. During the nine months ended January 24, 2014, there was a gross increase in our unrecognized tax benefits of \$20.9 million for tax positions related to the current year, and a gross increase of \$1.8 million and gross decrease, including settlements and statute lapses, of \$4.5 million for tax positions related to prior years.

**Liquidity and Capital Resources**

The following sections discuss our principal liquidity requirements, as well as our sources and uses of cash flows on our liquidity and capital resources. The principal objectives of our investment policy are the preservation of principal and maintenance of liquidity. We attempt to mitigate default risk by investing in high-quality investment grade securities, limiting the time to maturity and monitoring the counter-parties and underlying obligors closely. We believe our cash equivalents and short-term investments are liquid and accessible. We are not aware of any significant deterioration in the fair value of our cash equivalents or investments from the values reported as of January 24, 2014.

**Liquidity, Capital Resources and Cash Requirements**

(\$ in Millions)

January 24, 2014

April 26, 2013

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

Cash and cash equivalents and short-term investments	\$	5,069.3	\$	6,952.6
Current portion of principal amount of Convertible Notes				1,264.9
Principal amount of Senior Notes		1,000.0		1,000.0
Debt as a % of stockholders' equity		26%		48%

**Table of Contents**

The following is a summary of our cash flow activities:

(In Millions)	Nine Months Ended	
	January 24, 2014	January 25, 2013
Net cash provided by operating activities	\$ 980.1	\$ 930.7
Net cash provided by (used in) investing activities	599.9	(122.0)
Net cash provided by (used in) financing activities	(2,707.3)	725.1
Effect of exchange rate changes on cash and cash equivalents	2.9	(1.9)
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>\$ (1,124.4)</b>	<b>\$ 1,531.9</b>

**Cash Flows**

As of January 24, 2014, our cash, cash equivalents and short-term investments decreased by \$1.9 billion from April 26, 2013, to \$5.1 billion. The decrease was primarily due to the repayment of the principal amount of our Convertible Notes of \$1.3 billion and \$1.5 billion in cash paid for the repurchase of our common stock, partially offset by \$1.0 billion of cash provided by operating activities. We derive our liquidity and capital resources primarily from our operating cash flows and from working capital. Accounts receivable days sales outstanding as of January 24, 2014 decreased to 33 days, compared to 42 days as of April 26, 2013, primarily due to improvements in shipment linearity in which a lesser proportion of shipments was made in the latter part of the third quarter of fiscal 2014, compared to the fourth quarter of fiscal 2013. Working capital decreased by \$0.8 billion to \$3.8 billion as of January 24, 2014 as a result of a decrease of \$2.2 billion in current assets, primarily due to the net decrease in cash, cash equivalents and short-term investments, partially offset by a decrease of \$1.4 billion in current liabilities, primarily due to the maturity of our Convertible Notes.

*Cash Flows from Operating Activities*

During the nine months ended January 24, 2014, we generated cash from operating activities of \$980.1 million. The primary sources of cash from operating activities during the nine months ended January 24, 2014 consisted of net income of \$440.5 million, adjusted by depreciation and amortization of \$252.0 million and stock-based compensation of \$205.8 million.

Changes in assets and liabilities as of January 24, 2014 included the following:

*Accounts receivable* increased due to improved shipment linearity compared to the fourth quarter of fiscal 2013.

*Accrued compensation and related benefits* decreased primarily due to lower employee stock purchase plan (ESPP) withholdings and accrued payroll and related taxes as a result of the timing of ESPP purchases and payroll cycles, respectively.

We expect that cash provided by operating activities may materially 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 or charges from stock-based compensation, and the timing and amount of compensation and other payments.

*Cash Flows from Investing Activities*

During the nine months ended January 24, 2014, we generated \$762.7 million from maturities and sales of investments, net of purchases, and paid \$165.4 million for capital expenditures.

*Cash Flows from Financing Activities*

During the nine months ended January 24, 2014, we used \$1.3 billion for the principal repayment of our Convertible Notes and used \$1.5 billion for the repurchase of 37.6 million shares of our common stock and the purchase of a related forward contract.

*Liquidity*

Our principal sources of liquidity as of January 24, 2014 consisted of cash, cash equivalents and short-term investments, as well as cash we expect to generate from operations.

**Table of Contents**

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

	January 24, 2014	April 26, 2013
Cash and cash equivalents	\$ 2,152.7	\$ 3,277.1
Short-term investments	2,916.6	3,675.5
<b>Total</b>	<b>\$ 5,069.3</b>	<b>\$ 6,952.6</b>

As of January 24, 2014, \$1.0 billion of cash, cash equivalents and short-term investments was held in the United States, while \$4.1 billion was held in foreign countries. Most of the amounts held outside the United States can be repatriated to the United States but, under current law, would be subject to U.S. federal and state income taxes. If we were to repatriate foreign earnings for cash requirements in the United States, we would incur U.S. federal and state income taxes reduced by the current amount of our U.S. federal and state tax credit carry forwards. However, our intent is to keep these funds permanently reinvested outside of the United States, and our current plans do not contemplate a need to repatriate them to fund our U.S. operations. Our principal liquidity requirements are primarily to meet our working capital needs, support ongoing business activities, fund research and development, meet capital expenditure needs, invest in critical or complementary technologies, and service interest and principal payments on our debt.

Key factors that could affect our cash flows include changes in our revenue mix and profitability, our ability to effectively manage our working capital, in particular, accounts receivable and inventories, our ability to effectively integrate acquired products, businesses and technologies and the timing of repayments of our debt. Based on past performance and our current business outlook, we believe that our sources of cash will satisfy our working capital needs, capital expenditures, investment requirements, stock repurchases, cash dividends, contractual obligations, commitments, principal and interest payments on our debt and other liquidity requirements associated with operations and meet our cash requirements for at least the next 12 months. We anticipate the cash used for future dividends and stock repurchases will come from our domestic cash and cash generated from ongoing domestic operating activities. However, in the event our liquidity is insufficient, we may be required to curtail spending and implement additional cost saving measures and restructuring actions or enter into new financing arrangements. We cannot be certain that we will continue to generate cash flows at or above current levels or that we will be able to obtain additional financing, if necessary, on satisfactory terms, if at all.

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 the market risk of 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, debt obligations or other cash requirements. We routinely monitor our financial exposure to both sovereign and non-sovereign borrowers and counterparties.

*Senior Notes*

The following table summarizes the principal amount of our Senior Notes as of January 24, 2014 (in millions):

2.00% Senior Notes Due 2017	\$ 750.0
3.25% Senior Notes Due 2022	250.0
<b>Total</b>	<b>\$ 1,000.0</b>

Interest on the Senior Notes is payable semi-annually. For further information on the underlying terms, see Note 9 of the accompanying condensed consolidated financial statements.

*Credit Facility*

We have an unsecured \$250.0 million five-year revolving credit facility that terminates on December 21, 2017 if no extensions have been requested at that time, and contains financial covenants requiring us to maintain a maximum leverage ratio and a minimum interest coverage

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

ratio. We may also, subject to certain requirements, request an increase in the facility up to an additional \$100.0 million and request two additional one-year extensions, subject to certain conditions. As of January 24, 2014, no borrowings were outstanding under the facility and we were in compliance with all covenants associated with the facility.

---

## **Table of Contents**

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

We expect to fund our capital expenditures, including our commitments related to facilities, equipment, operating leases and internal-use software development projects over the next few years through existing cash, cash equivalents, investments and cash generated from operations. The timing and amount of our capital requirements cannot be precisely determined and will depend on a number of factors, including future demand for products, changes in the network storage industry, hiring plans and our decisions related to the financing of our facilities and equipment requirements. We expect that our existing facilities and those being developed in North Carolina, California and India and other locations worldwide are adequate for our requirements over at least the next two years and that additional space will be available as needed. Our capital expenditures were \$165.4 million during the nine months ended January 24, 2014. We anticipate capital expenditures for the remainder of fiscal 2014 to be between \$25.0 million and \$75.0 million.

### ***Dividends and Stock Repurchase Program***

On February 12, 2014, we declared a cash dividend of \$0.15 per share of common stock, payable on April 22, 2014 to holders of record as of the close of business on April 10, 2014.

As of January 24, 2014, our Board of Directors had authorized the repurchase of up to \$7.1 billion of our common stock under our stock repurchase program, including an increase of \$1.6 billion approved by our Board of Directors in May 2013. Under this program, we can purchase shares of our outstanding common stock through open market and privately negotiated transactions at prices deemed appropriate by our management. The stock repurchase program may be suspended or discontinued at any time. Since the May 13, 2003 inception of this program through January 24, 2014, we repurchased a total of 174.7 million shares of our common stock at an average price of \$32.20 per share, for an aggregate purchase price of \$5.6 billion. As of January 24, 2014, the remaining authorized amount for stock repurchases under this program was \$1.5 billion with no termination date. We plan to complete the program by May 2016, including planned repurchases of \$0.5 billion by the end of May 2014.

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

### ***Contractual Obligations***

#### ***Operating Lease Commitments***

As of January 24, 2014, future annual minimum lease payments under non-cancelable operating leases with an initial term in excess of one year totaled \$216.1 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 to the extent we believe it is probable that such components will not be utilized in future operations. To the extent that such forecasts are not achieved, our commitments and associated accruals may change. As of January 24, 2014, we had \$240.2 million in non-cancelable purchase commitments with our contract manufacturers. 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 cost of product sales. As of January 24, 2014 and April 26, 2013, such liability amounted to \$15.4 million and \$9.5 million, respectively, and is included in other current liabilities in our condensed consolidated balance sheets.

In addition to commitments with contract manufacturers and component suppliers, we have open purchase orders and contractual obligations associated with our ordinary course of business for which we have not received goods or services. As of January 24, 2014, we had \$44.1 million in capital purchase commitments and \$203.2 million in other purchase commitments.

#### ***Unrecognized Tax Benefits***

As of January 24, 2014, our liability for uncertain tax positions was \$152.7 million, including interest and penalties. Due to the uncertainty of the timing of future cash payments, we cannot make reasonably reliable estimates of the period of cash settlement with the taxing authorities.



## **Table of Contents**

### ***Legal Contingencies***

We are subject to various legal proceedings and claims which arise in the normal course of business. See further details on such matters in Note 16 to our condensed consolidated financial statements.

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

In the ordinary course of business, we provide standby letters of credit or other guarantee instruments to third parties as required for certain transactions initiated either by us or our subsidiaries. As of January 24, 2014, our financial guarantees of \$12.3 million that were not recorded on our consolidated balance sheet consisted of standby letters of credit and surety bonds.

In the ordinary course of business, some of our customers have entered into recourse and non-recourse financing leasing arrangements using third-party financing companies, and in some situations, we enter into customer financing arrangements for our products and services that are contemporaneously sold on a recourse or non-recourse basis to third-party financing companies. During the terms of recourse leases, which are generally three years or less, we remain liable for the aggregate unpaid remaining lease payments to the third-party leasing companies in the event of end-user customer default. Where we provide a guarantee for recourse leases, we defer revenues subject to the industry-specific software revenue recognition guidance, and recognize revenues for non-software deliverables in accordance with our multiple deliverable revenue arrangement policy. In connection with certain recourse financing arrangements, we receive advance payments associated with undelivered elements that are subject to customer refund rights. We defer revenue associated with these advance payments until the related refund rights expire and we perform the services. As of January 24, 2014, the maximum guaranteed payment contingencies under our financing arrangements totaled \$218.0 million and the related deferred revenue totaled \$203.8 million.

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

---

**Table of Contents**
**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 foreign currency exchange risks. We do not use derivative financial instruments for speculative or trading purposes. All financial instruments are used in accordance with management-approved policies.

**Market Risk and Market Interest Risk**

*Investment and Interest Income* As of January 24, 2014, we had debt investments of \$3.0 billion. Our investment portfolio primarily consists of investments with original maturities greater than three months at the date of purchase, which are classified as available-for-sale investments. These investments, which consist primarily of corporate bonds, commercial paper, certificates of deposit, U.S. Treasury securities and U.S. government agency securities, are subject to interest rate and interest income risk and will decrease in value if market interest rates increase. Conversely, declines in interest rates, including the impact from lower credit spreads, could have a material adverse impact on interest income for our investment portfolio. A hypothetical 100 basis point increase in market interest rates from levels as of January 24, 2014 would have resulted in a decrease in the fair value of our fixed-income securities of approximately \$31 million. Volatility in market interest rates over time will cause variability in our interest income. We do not use derivative financial instruments in our investment portfolio.

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

We are also exposed to market risk relating to our auction rate securities (ARSs) due to uncertainties in the credit and capital markets. As of January 24, 2014, our holdings in these securities had a par value of \$41.9 million and an estimated fair value of \$40.4 million. The fair value of our ARSs 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 ARSs. Changes in the various assumptions used to value these securities and any increase in the market's perceived risk associated with such investments may also result in a decline in the estimated fair value.

*Debt* As of January 24, 2014, we have outstanding \$1.0 billion aggregate principal amount of Senior Notes. We carry these instruments at face value less unamortized discount on our condensed consolidated balance sheets. Since these instruments bear interest at fixed rates, we have no financial statement risk associated with changes in interest rates. However, the fair value of these instruments fluctuates when interest rates change. See Note 9 of the accompanying consolidated financial statements for more information.

*Credit Facility* We are exposed to the impact of changes in interest rates in connection with our \$250.0 million five-year revolving credit facility. Borrowings under the facility accrue interest at rates that vary based on certain market rates and our credit rating on our Senior Notes. Consequently, our interest expense would fluctuate with any changes in these market interest rates or in our credit rating if we were to borrow any amounts under the credit facility. As of January 24, 2014, no amounts were outstanding under the credit facility.

**Foreign Currency Exchange Rate Risk**

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

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

**Table of Contents**

The following table provides information about our U.S. dollar equivalent foreign currency exchange forward contracts outstanding on January 24, 2014 and April 26, 2013 (in millions):

	<b>January 24, 2014</b>	<b>April 26, 2013</b>
	<b>Notional</b>	<b>Notional</b>
	<b>Contract</b>	<b>Contract</b>
	<b>Amount</b>	<b>Amount</b>
Forward contracts sold	\$ 148.4	\$ 158.2
Forward contracts purchased	529.3	466.8

The fair value of these contracts did not differ materially from their notional contract amounts.

**Table of Contents**

**Item 4. Controls and Procedures.**

*Disclosure Controls and Procedures*

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

Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of January 24, 2014, the end of the fiscal period covered by this Quarterly Report on Form 10-Q (the Evaluation Date). Based on this evaluation, our CEO and CFO concluded as of the Evaluation Date that our disclosure controls and procedures were effective such that the information required to be disclosed in our SEC reports (i) is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

*Changes in Internal Control Over Financial Reporting*

There has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) identified in connection with our evaluation that occurred during the third quarter of fiscal 2014 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.**

None

**Item 1A. Risk Factors.**

*The following risk factors and other information included elsewhere in this Quarterly Report on Form 10-Q should be considered and understood in the context of the following risk factors, which describe circumstances that may materially harm our future business, operating results or financial condition. The following discussion reflects our current judgment regarding the most significant risks we face. These risks can and will change in the future.*

***Continuing uncertain economic conditions restrict our visibility and may harm our operating results.***

The continuing global economic uncertainty and related political and fiscal challenges in the U.S. and abroad (particularly the Eurozone) due to the debt and fiscal crises of recent years have, among other things, limited our ability to forecast future demand for our products, contributed to increased periodic volatility in the computer, storage, and networking industries at large, as well as the information technology (IT) market, and could constrain future access to capital for our suppliers, customers and partners. The impacts of these circumstances are global and pervasive, affecting all participants in our industry, and the timing and nature of any ultimate resolution of these matters remain highly uncertain. Moreover, a significant portion of our sales are to Eurozone customers and, accordingly, we are particularly sensitive to developments in that region. Additionally, fiscal restraints have caused, and may in the future again cause, governments, including the U.S. government, to defer purchases in response to tighter budgets. Consequently, we expect these concerns to challenge our business for the foreseeable future, and potentially cause harm to our operating results. Such conditions have resulted, and may in the future again result in failure to meet our forecasted financial expectations.

When and if the current macroeconomic and U.S. government fiscal challenges are resolved, we expect the risk of economic uncertainty to continue, with the potential to restrict our visibility and harm our operating results.

***Our business may be harmed if growth in the storage market declines.***

Our industry has experienced significant historical growth due to the continuing increase in the demand for storage by consumers, enterprises and government bodies around the world, and our customers' purchases of storage solutions to address this demand. While IT spending has fluctuated periodically due to technology transitions and changing economic and business environments, overall growth in demand for storage has continued. Recent technology trends, such as the emergence of hosted (or cloud) storage, software as a service (SaaS) and mobile data access, are driving significant changes in storage architectures and solution requirements. The impact of these trends on overall long-term growth patterns is uncertain. Nevertheless, if the general level of historic industry growth, or if the growth of the specific markets in which we compete, were to decline, our business and results of operations could suffer.

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

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

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

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

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

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

---

**Table of Contents**

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

Our business and sales models make revenues difficult to forecast. We sell to a variety of customers, with a corresponding variety of sales cycles. In addition, the majority of our sales are made indirectly through channel partners, including value-added resellers, systems integrators, distributors, original equipment manufacturers (OEMs) and strategic business partners. During the nine months ended January 24, 2014, revenues generated from sales through our indirect channel accounted for 82% of net revenues. This structure significantly complicates our ability to forecast future revenue, particularly within any particular fiscal quarter or year. Moreover, our relationships with our indirect channel partners are critical to our success. The loss of one or more of our key indirect channel partners in a given geographic area could harm our operating results, as qualifying and developing new indirect channel partners typically require a significant investment of time and resources before acceptable levels of productivity are met. If we fail to maintain our relationships with our indirect channel partners, if their financial condition, business or customer relationships were to weaken or if they fail to comply with legal or regulatory requirements, our business and operating results could be harmed.

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

We derive a majority of our revenues in any given quarter from orders booked in the same quarter. Bookings typically follow intra-quarter seasonality patterns weighted toward the back end of the quarter. If we do not achieve the level, timing and mix of bookings consistent with our quarterly targets and historical patterns, or if we experience cancellations of significant orders, our financial results will be harmed. Additionally, due to the complexities associated with revenue recognition, we may not be able to accurately forecast our non-deferred and deferred revenues, which could harm our operating results.

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

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

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

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

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

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

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

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

Geopolitical disputes disrupting our supply chain;

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

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

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

## **Table of Contents**

We have encountered some of these risks, such as the 2011 Thailand floods, which subjected us to supply constraints, price increases and minimum purchase commitments, and expect to be subject to similar risks in the future. When we do, our business, results of operations and financial condition could be harmed. The risks associated with our out-sourced manufacturing model are particularly acute when we transition products to new facilities or manufacturers, introduce and increase volumes of new products or qualify new contract manufacturers or suppliers, at which times our ability to manage the relationships among us, our manufacturing partners and our component suppliers, becomes critical. New manufacturers, products, components or facilities create increased costs and risk that we will fail to deliver high quality products in the required volumes to our customers. Any failure of a manufacturer or component supplier to meet our quality, quantity or delivery requirements in a cost-effective manner will harm our business, operating results and customer relationships.

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

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

### ***Our gross margins vary.***

Our gross margins reflect a variety of factors, including competitive pricing, component and product design, the volume and relative mixture of product, services and software entitlements and maintenance (SEM) revenues. Increased component costs, increased pricing pressures, the relative and varying rates of increases or decreases in component costs and product prices, changes in product, services and SEM revenue mixture or decreased volume could harm our revenues, gross margins or earnings. Our gross margins are also impacted by quality failures and our sales and distribution activities, including, without limitation, pricing actions, rebates, sales initiatives and discount levels, and the timing of service contract renewals.

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

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

The storage and data management markets are intensely competitive and are characterized by rapidly changing technology and consolidation. We compete with many companies in the markets we serve. Over the last decade, the expansion of market opportunities by large, broad-portfolio technology companies, by vertical integration of storage products, technologies and services, such as the acquisition of Sun Microsystems by Oracle, and through internal and external storage-related corporate initiatives, by companies such as HP, Dell and IBM, has increased the number of large, diversified technology companies with which we compete. Accordingly, many of our key competitors have greater financial resources and offer a broad portfolio of IT products and services (full-stack vendors). These competitors typically maintain broad and deep relationships with customers and partners across a diverse portfolio of products and services. They may also be able to offer lower pricing (or other preferred terms) on storage system products due to these broader relationships. We believe further storage market expansion by large, diversified technology companies, in addition to any future industry consolidation, may result in stronger competitors that are better able to compete for customers as sole-source vendors. In addition, current and potential competitors have established or may establish strategic alliances among themselves or with third parties, including some of our partners. It is possible that new competitors or alliances among competitors may emerge and rapidly acquire significant market share. We may not be able to compete successfully against current or future competitors. Competitive pressures we face could harm our business and operating results. A detailed description of storage and software products we compete with is identified in the Business Section of our Annual Report on Form 10-K filed with the Securities and Exchange Commission on June 17, 2013.

There have been trends toward consolidation in the storage industry and market expansion by technology companies for several years, both of which have risks for us. Among other things, the last few years have witnessed considerable consolidation in the disk drive industry, an industry we depend upon for critical storage components. We expect this trend to continue as companies attempt to strengthen or hold their market positions in an evolving, maturing industry, as companies become unable to maintain their competitive positions or continue operations and as customers demand more flexible business models and terms. Disk drive and other component manufacturing industry consolidations may lead to higher component prices and supply constraints for us, which may, in turn, harm our operating results.



---

**Table of Contents**

***Our OEM relationships may not generate significant revenues.***

We have OEM relationships with several companies, which collectively accounted for 10% of our net revenues during the nine months ended January 24, 2014. These OEMs market and sell their branded solutions based on our unified solutions, as well as associated software offerings. While these arrangements are part of our general strategy to expand our reach to more customers and into more countries, we do not have exclusive relationships with our OEMs, and there is no minimum commitment for any given period of time. We also compete with some of our OEMs, further complicating our relationships with them. Therefore, our relationships with these OEMs may not continue to generate significant revenues. In addition, we have no control over the products that the OEMs select to sell, or their release schedule and timing of those products; nor do we control their pricing.

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

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

For the nine months ended January 24, 2014, sales to distributors Arrow Electronics, Inc. and Avnet, Inc. accounted for 21% and 16%, respectively, of our net revenues. We generally do not enter into binding purchase commitments with our customers, resellers and distributors for extended periods 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. In addition, unfavorable economic conditions may negatively impact the solvency of our customers, resellers and distributors or the ability of such customers, resellers and distributors to obtain credit to finance purchases of our products. If any of our key customers, resellers or distributors changes its pricing practices, reduces the size or frequency of its orders for our products, or stops purchasing our products altogether, our operating results and financial condition could be materially adversely impacted.

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

The U.S. government has become an important customer for us. However, government demand is uncertain, as it is subject to political and budgetary fluctuations and constraints. Recent events, such as the U.S. federal government shutdown in October 2013, and continued uncertainty regarding the U.S. budget and debt levels has increased demand uncertainty for our products. If the U.S. government or an individual agency or multiple agencies within the U.S. government continue to reduce or shift their IT spending patterns, our revenues and operating results may be harmed.

Selling our products to the U.S. government, whether directly or through channel partners, also subjects us to certain regulatory and contractual requirements. Failure to comply with these requirements by either us or our channel partners could subject us to investigations, fines, and other penalties, which could materially harm our operating results and financial condition. As an example, the United States Department of Justice (DOJ) and the General Services Administration (GSA) have in the past pursued claims against and financial settlements with IT vendors, including us and several of our competitors and channel partners, under the False Claims Act and other statutes related to pricing and discount practices and compliance with certain provisions of GSA contracts for sales to the federal government. Although the DOJ and GSA currently have no claims pending against us, we could face claims in the future. Violations of certain regulatory and contractual requirements could also result in us being suspended or debarred from future government contracting. Any of these outcomes could have a material adverse effect on our revenues, operating results and financial position.

---

**Table of Contents**

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

Due to the global nature of our business, we are subject to import and export restrictions and regulations, including the Export Administration Regulations administered by the Commerce Department's Bureau of Industry and Security (BIS) and the trade and economic sanctions regulations administered by the Treasury Department's Office of Foreign Assets Control (OFAC). The U.S., through the BIS and OFAC, places restrictions on the sale or export of certain products and services to certain countries and persons. Violators of these export control and sanctions laws may be subject to significant penalties, which may include significant monetary fines, criminal proceedings against them and their officers and employees, a denial of export privileges, and suspension or debarment from selling products to the federal government. We take a variety of precautions to prevent our products from being shipped to U.S.-sanctioned targets; however, our products could be shipped to those targets by third parties, including potentially our channel partners, despite such precautions. For instance, media reports starting in November 2011 have asserted that certain of our products were delivered to Syria through a third-party possibly in violation of U.S. export-control laws. We have publicly stated that we condemn any use of our products or technologies in Syria, we have notified the U.S. government that we are conducting a review of these allegations, and intend to cooperate fully with any government inquiry. We have met with U.S. government officials, provided information at their request, and expressed our willingness to continue cooperating with any further inquiry or investigation. If we are found to have violated U.S. export control laws, we may be subject to various penalties available under the laws, any of which could have a material and adverse impact on our business, operating results and financial position. Even if we are not found to have violated such laws, the political and media scrutiny surrounding any governmental investigation of us could cause us significant financial and reputational harm and distract senior executives from managing our normal day-to-day operations, which could have a material and adverse impact on our business, operating results and financial position.

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

Our growth strategy includes developing and maintaining strategic partnerships with major third-party software and hardware vendors to integrate our products into their products and also co-market our products with them. A detailed description of these partnership relationships is identified in the Business Section of our Annual Report on Form 10-K filed with the Securities and Exchange Commission on June 17, 2013. A number of these strategic partners are industry leaders that offer us expanded access to segments of the storage and data management market. However, there is intense competition for attractive strategic partners, and these relationships may not be exclusive, may not generate significant revenues and may terminate on short notice. For instance some of our partners are also partnering with our competitors, which may increase the availability of competing solutions and harm our ability to grow our relationships with those partners. Moreover, some of our partners, particularly large, more diversified technology companies, are also competitors, complicating our relationships. If we are unable to establish new partnerships or maintain existing partnerships, if our strategic partners favor their relationships with other vendors in the storage industry or if our strategic partners increasingly compete with us, we could experience lower than expected revenues, suffer delays in product development, or experience other harm to our operating results and business.

***Our failure to adjust to emerging standards in the storage industry may harm our business.***

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

***If our products are defective, our gross margins, operating results and customer relationships may be harmed.***

Our products are complex. We have experienced in the past, and expect to experience in the future, quality issues. Quality risk is most acute when we are introducing new products, as we discuss in the next risk factor. 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 higher ongoing warranty and service costs, and these occurrences could have a material impact on our gross margins, business 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**

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

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

We are currently devoting considerable effort and resources to develop, introduce and gain customer acceptance for our clustered Data ONTAP-based products (cDOT). cDOT is our next generation storage operating system for our core products and represents a fundamental and revolutionary change to our solution architecture. Over time, our goal is to replace our existing technology Data ONTAP 7-Mode with cDOT and, consequently, we anticipate that a majority of our revenues will ultimately derive from cDOT. We face considerable challenges as we develop and market cDOT, including, without limitation, cost and complexity associated with migrating customer data and applications from legacy systems to cDOT-based systems, developing some features for cDOT currently available with Data ONTAP 7 and potentially required by our customers, and maintaining service, support and customer relationships as we replace Data ONTAP-7 with cDOT.

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

New or additional product introductions also increase the complexities of forecasting revenues, and subject us to additional financial and operational risks. In addition, as new or enhanced products are introduced, we must also avoid excessive levels of older product inventories and related components and ensure that enough supplies of new products can be delivered to meet customers' demands. If these risks are not managed effectively, we could experience material risks to our operations, financial condition and business model.

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

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

A significant portion of our operations are located, and a significant portion of our revenues are derived, outside of the U.S. For the nine months ended January 24, 2014, our international revenues accounted for 51% of our net revenues. In addition, 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 factors affecting our international operations, but not experienced in the U.S., including, among other things, local political or economic conditions, trade protection and export and import requirements, local labor conditions, transportation costs, government spending patterns, acts of terrorism, international conflicts and natural disasters in areas with limited infrastructure. In addition, due to the global nature of our business, we are subject to complex legal and regulatory requirements in the U.S. and the foreign jurisdictions in which we operate and sell our products, including antitrust and anti-competition laws, rules and regulations, and regulations related to data privacy. We are also subject to the potential loss of proprietary information due to piracy, misappropriation, or laws that may be less protective of our intellectual property rights than U.S. laws. Such factors could have an adverse impact on our business, operating results and financial position.

We face exposure to adverse movements in foreign currency exchange rates as a result of our international operations. These exposures may change over time as business practices evolve, and they could have a material adverse impact on our financial results and cash flows. We utilize forward and option contracts in an attempt to reduce the adverse earnings impact from the effect of exchange rate fluctuations on certain assets and liabilities as well as certain anticipated foreign currency cash flows on a short-term basis. Our hedging strategies may not be successful, and currency exchange rate fluctuations could have a material adverse effect on our operating results. In addition, our foreign currency exposure on assets and liabilities for which we do not hedge could have a material impact on our results of operations in periods when the U.S. dollar significantly fluctuates in relation to unhedged non-U.S. currencies in which we transact business.

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

---

## **Table of Contents**

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

### ***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 is influenced by a variety of factors, many of which are outside of our control. These factors include among other things, fluctuations in our earnings and financial results in the various countries and states in which we do business, and changes to the tax regulations in such jurisdictions. Any of these factors could materially impact our operating results.

We receive significant tax benefits from sales to our non-U.S. customers. These benefits are contingent upon existing tax laws and regulations in the U.S. and in the countries in which our international operations are located. Future changes in domestic or international tax laws and regulations could adversely affect our ability to continue to realize these tax benefits. We have not provided for U.S. federal and state income taxes or foreign withholding taxes that may result from future remittances of undistributed earnings of foreign subsidiaries. The United States, countries in the European Union and other countries where we do business have been considering changes in relevant tax laws applicable to multinational corporations such as ours. These potential changes could adversely affect our effective tax rate or result in higher cash tax liabilities.

We are currently undergoing income tax audits in the U.S. and several foreign tax jurisdictions, as described in Note 13 to our consolidated financial statements. The rights to some of our intellectual property (IP) are owned by certain of our foreign subsidiaries, and payments are made between U.S. and foreign tax jurisdictions relating to the use of this IP in a qualified cost sharing arrangement. In recent years, several other U.S. companies have had their foreign IP arrangements challenged as part of Internal Revenue Service (IRS) examinations, which have resulted in material proposed assessments and/or litigation with respect to those companies.

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. Additionally, 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.

### ***Future issuances of common stock related to employee equity awards may adversely affect the trading price of our common stock.***

Any new issuance of equity securities, including the issuance of shares issued in connection with employee equity awards could dilute the interests of our then-existing stockholders, and could substantially decrease the trading price of our common stock.

### ***Our failure to pay quarterly dividends to our shareholders and to fully consummate our stock repurchase program could cause the market price of our stock to decline significantly.***

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



---

**Table of Contents**

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

As part of our strategy, we seek to acquire other businesses and technologies to complement our current products, expand the breadth of our markets, or enhance our technical capabilities. In fiscal 2011, we completed acquisitions of two technology companies. In fiscal 2012, we completed the acquisition of certain assets related to Engenio, and in fiscal 2013, we completed the acquisitions of CacheIQ and IonGrid. The benefits we expect to receive from these and other acquisitions depend on our ability to successfully conduct due diligence, negotiate the terms of acquisition and integrate the acquired business. Any inaccuracy in our acquisition assumptions, any failure to uncover liabilities or risks associated with the acquisition, any failure to make the acquisition on favorable terms, or any failure to integrate the acquired business or assets as and when expected, may reduce or eliminate the expected benefits of the acquisition to us, increase our costs, disrupt our operations, result in additional liabilities, investigations and litigation, and may also harm our strategy, our results of operations or our business. The failure to achieve expected acquisition benefits may also result in impairment charges for goodwill and purchased intangible assets.

***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.***

We maintain an investment portfolio of various holdings, types, and maturities. A significant part of our investment portfolio consists of U.S. government securities. If global credit experiences prolonged periods of decline, or if there is a downgrade of U.S. government debt, our investment portfolio may be adversely impacted and we could determine that more of our investments have experienced an other-than-temporary decline in fair value, requiring impairment charges that could adversely affect our financial results. For a summary of these investments and our management of the same, please see [Quantitative and Qualitative Disclosures About Market Risk](#) in this document.

***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, some of our customers have entered into recourse and nonrecourse financing leasing arrangements using third-party leasing companies. Under the terms of recourse leases, which are generally three years or less, we remain liable for the aggregate unpaid remaining lease payments to the third-party leasing companies in the event of end-user customer default.

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

In the past, there have been bankruptcies by our customers to whom we had extended open credit, provided lease financing arrangements or guaranteed lease payments under full recourse lease arrangements. Such events have caused us to incur bad debt charges, in the case of financing arrangements have caused a loss of revenues, and in the case of recourse lease arrangements have caused us to make payments to third-party financiers. 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 continuing turmoil in the credit markets makes it more difficult for customers to obtain open credit or lease financing, those customers' ability to purchase our products could be adversely impacted, which in turn could have a material adverse impact on our financial condition and operating results.

***Any repatriation of our overseas cash to fund U.S. operations, strategic opportunities or debt service may subject us to a significant tax liability.***

As of January 24, 2014, \$4.1 billion of cash, cash equivalents and short-term investments was held in foreign countries. Under current law, dividend repatriation of any of this cash would trigger significant adverse tax consequences in the U.S. As a result, if the cash generated by our domestic operations is not sufficient to fund our domestic operations and our broader corporate initiatives, such as stock repurchases, dividends, 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 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-held cash and incur a significant tax expense. In any such case, our business, operating results or financial condition could be adversely impacted.



---

## **Table of Contents**

***If we default under our significant debt obligations, including our Senior Notes, our business, results of operations and financial condition will be harmed. Moreover, covenants associated with our Senior Notes may unduly restrict our business.***

We have Senior Notes outstanding in an aggregate principal amount of \$1.0 billion that mature at specific dates in calendar 2017 and 2022. We have also established a revolving credit facility under which we may borrow an aggregate amount outstanding at any time of \$250.0 million, under which we had no borrowings outstanding as of January 24, 2014. We may fail to pay these obligations, as and when required. Specifically, if we are unable to generate sufficient cash flows from operations or to borrow sufficient funds in the future to service or refinance our debt, our business, results of operations and financial condition will be harmed.

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

***We may incur asset impairment and restructuring charges in response to changing market conditions or cost-cutting initiatives.***

We may undertake cost savings initiatives in response to changes in market conditions and market demand for our products. These initiatives may include restructuring, disposing of, and/or otherwise discontinuing certain products, or both. Any decision to take these actions may result in charges to earnings associated with, among other things, inventory or other fixed, intangible or goodwill asset reductions (including, without limitation, impairment charges), workforce and facility reductions and penalties and claims from third party resellers or users of discontinued products. These charges would harm our operating results. We have previously recognized restructuring and other charges associated with these activities including \$49.5 million of restructuring charges recognized in the nine months ended January 24, 2014. In addition to the costs associated with these activities, we may not realize any of the anticipated benefits of the same.

***We could be harmed if we fail to manage our growth.***

While we have historically grown rapidly, primarily through organic initiatives our acquisition activity has been ongoing and we expect to continue to look for opportunities to supplement our organic growth through strategic initiatives.

Our growth has at times led to both organizational change and strain. We may continue to experience rapid growth and organizational change, which may continue to place significant demands on our management, operational and financial resources and systems. We incur significant expenditures of funds and the allocation of management and other resources to manage our growth and assimilate new human resources in a manner that preserves the key aspects of our corporate culture and our reputation in the marketplace. We may experience periods when our pace of growth exceeds the capacity and capabilities of our organization and systems. If we do not effectively manage our growth through cost-effective organizational and system programs, our corporate culture could be undermined, the quality of our products and customer service could suffer, and our reputation could be harmed, each of which could adversely impact our business, financial condition and results of operations.

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

We continuously seek to make our cost structure and business processes more efficient, including by moving our business activities from higher-cost to lower-cost locations, outsourcing certain business processes and functions, and implementing changes to our business information systems. These efforts involve a significant investment of financial and human resources and significant changes to our current operating processes. In addition, as we move operations into lower-cost jurisdictions and outsource certain business processes, we become subject to new regulatory regimes and lose control of certain aspects of our operations and, as a consequence, become more dependent upon the systems and business processes of third-parties. If we are unable to move our operations, outsource business processes and implement new business information systems in a manner that complies with local law and maintains adequate standards, controls and procedures, the quality of our products and services may suffer and we may be subject to increased litigation risk, either of which could have an adverse effect on our business and results of operations.

---

**Table of Contents*****If we are unable to attract and retain qualified personnel, our business and operating results could be harmed.***

Our continued success depends, in part, on our ability to hire 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 hire and retain qualified engineers. Competition for qualified employees, particularly in Silicon Valley, is 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. Equity grants are a critical component of our current compensation programs. If we reduce, modify or eliminate our equity programs, due to increased shareholder activism, heightened focus on corporate compensation practices, or increased scrutiny of the dilutive effects of such programs, we may have difficulty attracting and retaining critical employees.

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

***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 economic failure or other material disruption caused by natural disasters, including fires, floods, hurricanes, earthquakes, and volcanoes; power loss or shortages; environmental disasters; telecommunications or business information systems failures or break-ins and similar events could also adversely affect our ability to conduct business. If such disruptions result in cancellations of customer orders or contribute to a general decrease in economic activity or corporate spending on information technology, or directly impact our marketing, manufacturing, financial and logistics functions, or impair our ability to meet our customer demands, our results of operations and financial condition could be materially adversely affected. In addition, our headquarters and one of our major data centers are located in Northern California, an area susceptible to earthquakes. If any significant disaster were to occur, our ability to operate our business and our financial condition could be impaired.

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

Our success depends significantly upon developing, maintaining and protecting proprietary technology. We rely on a combination of patents, copyrights, trademarks, trade secrets, confidentiality procedures and contractual provisions with employees, resellers, strategic partners and customers, to protect our proprietary rights. We currently have multiple U.S. and international patent applications pending and multiple U.S. and international patents issued. The pending applications may not be approved, and our existing and future patents may be challenged. If such challenges are brought, the patents may be invalidated. We may not be able to develop proprietary products or technologies that are patentable, and patents issued to us may not provide us with any competitive advantages and may be challenged by third parties. Further, the patents of others may materially and adversely affect our ability to do business. In addition, a failure to obtain and defend our trademark registrations may impede our marketing and branding efforts and competitive position.

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

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

---

**Table of Contents**

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

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

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

Our clients (including data centers, SaaS, cloud computing and Internet infrastructure and bandwidth providers) rely on our products for their data storage needs. We exercise little control over how our clients use or maintain our products, and in some cases improper usage or maintenance could impair the performance of our products.

Our clients may authorize third-party technology providers to access their data on our systems. Because we do not control the transmissions between our clients, their customers, and third-party technology providers, or the processing of such data by third-party technology providers, we cannot ensure the complete integrity or security of such transmissions or processing. Errors or wrongdoing by clients, their customers, or third-party technology providers resulting in security breaches may be attributed to us.

A failure or inability to meet our clients' expectations with respect to security and confidentiality through a disruption in the services provided by these third-party vendors, or the loss of data stored by such vendors, could result in financial or reputational harm to our business to the extent that such disruption or loss is caused by, or perceived by our customers to have been caused by, defects in our products. Moreover, the risk of reputational harm may be magnified and/or distorted through the rapid dissemination of information over the Internet, including through news articles, blogs, chat rooms, and social media sites. This may affect our ability to retain clients and attract new business.

***If our security measures are breached or if stored data is improperly accessed, customers may reduce or cease using our solutions, our reputation may be harmed and we may incur significant liabilities.***

We store and transmit sensitive and proprietary data related to our employees, clients and partners (including third-party vendors such as data centers and providers of SaaS, cloud computing, and Internet infrastructure and bandwidth), and their respective customers, including intellectual property, books of record and personally identifiable information. Security breaches could result in unauthorized access to, or loss or unauthorized disclosure of, such information, litigation, indemnity obligations, government investigations and other possible liabilities, as well as negative publicity, which could damage our reputation. Additionally, our clients and customers use our platforms for the transmission and storage of sensitive data. We do not regularly monitor or review the information or content that our clients and their customers upload and store, and, therefore, we have no direct control over the substance of the information or content stored within our platforms. Therefore, if employees, clients, partners or their respective customers use our platforms for the transmission or storage of personally identifiable or other sensitive information and our security measures are breached as a result of third-party action, employee error, malfeasance, stolen or fraudulently obtained log-in credentials or otherwise, our reputation could be damaged, our business may be harmed and we could incur significant liabilities. Because techniques used to obtain unauthorized access or to sabotage systems change frequently and often are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. As we continue to increase our client base and expand our brand, we may become more of a target for third parties seeking to compromise our security systems.

**Table of Contents**

Many jurisdictions have enacted laws requiring companies to notify individuals of data security breaches involving certain types of personal data. These mandatory disclosures regarding security breaches often lead to widespread negative publicity. Moreover, the risk of reputational harm may be magnified and/or distorted through the rapid dissemination of information over the Internet, including through news articles, blogs, chat rooms, and social media sites. Any security breach, whether actual or perceived, could harm our reputation, erode client confidence in the effectiveness of our data security measures, negatively impact our ability to attract new clients, cause existing clients to elect not to renew their support contracts, or subject us to third-party lawsuits, regulatory fines or other action or liability, which could materially and adversely affect our business and operating results.

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

*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, the increased use of fair value measures, changes to revenue recognition, lease accounting, financial instruments and other accounting standards, and the potential requirement that U.S. registrants prepare financial statements in accordance with International Financial Reporting Standards (IFRS), could have a significant effect on our reported financial results or the way we conduct our business.

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

**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.***Purchases of equity securities*

The following table provides information with respect to the shares of common stock repurchased by us during the three months ended January 24, 2014:

<u>Period</u>	Total Number of Shares Purchased (Shares in thousands)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program <sup>(1)</sup> (Shares in thousands)	Approximate Dollar Value of Shares That May Yet Be Purchased Under The Repurchase Program <sup>(1)</sup> (Dollars in millions)
October 26, 2013 – November 22, 2013	1,253	\$ 38.80	163,548	\$ 1,957.7
November 23, 2013 – December 20, 2013	4,364	\$ 40.73	167,912	1,779.9
December 21, 2013 – January 24, 2014	6,751	\$ 41.57	174,663	1,499.2
Total	12,368	\$ 40.99	174,663	1,499.2

<sup>(1)</sup> As of January 24, 2014, our Board of Directors had authorized the repurchase of up to \$7.1 billion of our common stock under a stock repurchase program, including an increase of \$1.6 billion approved by our Board of Directors in May 2013. Since the May 13, 2003 inception of this program through January 24, 2014, we repurchased a total of 174.7 million shares of our common stock at an average price of \$32.20 per share, for an aggregate purchase price of \$5.6 billion. As of January 24, 2014, the remaining authorized amount for stock repurchases under this program was \$1.5 billion with no termination date. The stock repurchase program may be suspended or discontinued at any time.

**Item 3. Defaults upon Senior Securities.**

None

**Item 4. Mine Safety Disclosures.**

Not Applicable.

**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, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NETAPP, INC.

(Registrant)

/s/ NICHOLAS R. NOVIELLO

Nicholas R. Noviello  
Executive Vice President and  
Chief Financial Officer

Dated: February 26, 2014

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

<b>Exhibit</b>		<b>Incorporation by Reference</b>					
		<b>No</b>	<b>Description</b>	<b>Form</b>	<b>File No.</b>	<b>Exhibit</b>	<b>Filing Date</b>
3.1	Certificate of Incorporation of the Company, as amended.			10-Q	000-27130	3.1	November 26, 2013
3.2	Bylaws of the Company, as amended.			8-K	000-27130	3.1	February 13, 2014
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						