

NetApp, Inc.
Form 10-Q
August 28, 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 July 25, 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 August 18, 2014, there were 319,256,006 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 July 25, 2014 and April 25, 2014</u>	3
	<u>Condensed Consolidated Statements of Operations for the Three Months Ended July 25, 2014 and July 26, 2013</u>	4
	<u>Condensed Consolidated Statements of Comprehensive Income for the Three Months Ended July 25, 2014 and July 26, 2013</u>	5
	<u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended July 25, 2014 and July 26, 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>	22
Item 3	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	36
Item 4	<u>Controls and Procedures</u>	38

PART II OTHER INFORMATION

Item 1	<u>Legal Proceedings</u>	39
Item 1A	<u>Risk Factors</u>	39
Item 2	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	50
Item 3	<u>Defaults upon Senior Securities</u>	50
Item 4	<u>Mine Safety Disclosures</u>	50
Item 5	<u>Other Information</u>	50
Item 6	<u>Exhibits</u>	50
	<u>SIGNATURE</u>	51

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, Cloud ONTAP, Clustered Data ONTAP, Customer Fitness, Data ONTAP, DataMotion, Fitness, Flash Accel, Flash Cache, Flash Pool, FlashRay, FlexArray, FlexCache, FlexClone, FlexPod, FlexScale, FlexShare, FlexVol, FPolicy, GetSuccessful, LockVault, Manage ONTAP, Mars, MetroCluster, MultiStore, NetApp Insight, 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, Unbound Cloud, 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)**

	July 25, 2014	April 25, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,031.6	\$ 2,291.0
Short-term investments	2,532.6	2,712.3
Accounts receivable, net of allowances of \$1.6 million and \$1.7 million as of July 25, 2014 and April 25, 2014, respectively	585.4	855.9
Inventories	104.2	122.4
Other current assets	494.3	489.7
Total current assets	6,748.1	6,471.3
Property and equipment, net	1,098.0	1,108.8
Goodwill	988.1	988.1
Purchased intangible assets, net	107.0	121.5
Other non-current assets	531.2	529.5
Total assets	\$ 9,472.4	\$ 9,219.2
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 183.1	\$ 247.0
Accrued compensation and related benefits	243.0	407.8
Other current liabilities	318.4	386.0
Short-term deferred revenue	1,656.4	1,653.8
Total current liabilities	2,400.9	2,694.6
Long-term debt	1,494.1	995.5
Other long-term liabilities	320.8	296.2
Long-term deferred revenue	1,419.9	1,446.4
Total liabilities	5,635.7	5,432.7
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Common stock, \$0.001 par value, (325.5 and 324.5 shares issued as of July 25, 2014 and April 25, 2014, respectively)	0.3	0.3
Additional paid-in capital	3,791.2	3,776.0

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

Retained earnings	36.1	1.1
Accumulated other comprehensive income	9.1	9.1
Total stockholders' equity	3,836.7	3,786.5
Total liabilities and stockholders' equity	\$ 9,472.4	\$ 9,219.2

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	
	July 25, 2014	July 26, 2013
Revenues:		
Product	\$ 882.6	\$ 930.8
Software entitlements and maintenance	221.3	228.5
Service	385.3	356.9
Net revenues	1,489.2	1,516.2
Cost of revenues:		
Cost of product	394.2	449.9
Cost of software entitlements and maintenance	8.2	7.5
Cost of service	148.7	149.2
Total cost of revenues	551.1	606.6
Gross profit	938.1	909.6
Operating expenses:		
Sales and marketing	480.2	467.8
Research and development	228.0	228.1
General and administrative	70.0	68.4
Restructuring and other charges	0.0	48.4
Total operating expenses	778.2	812.7
Income from operations	159.9	96.9
Other income (expense), net:		
Interest income	8.3	10.0
Interest expense	(9.0)	(16.5)
Other income, net	0.5	1.9
Total other expense, net	(0.2)	(4.6)
Income before income taxes	159.7	92.3
Provision for income taxes	71.3	10.7
Net income	\$ 88.4	\$ 81.6
Net income per share:		
Basic	\$ 0.27	\$ 0.23

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

Diluted	\$ 0.27	\$ 0.23
Shares used in net income per share calculations:		
Basic	323.5	350.9
Diluted	329.1	359.9
Cash dividends declared per share	\$ 0.165	\$ 0.150

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended	
	July 25, 2014	July 26, 2013
Net income	\$ 88.4	\$ 81.6
Other comprehensive income (loss):		
Foreign currency translation adjustments	(0.8)	(1.2)
Defined benefit obligations:		
Defined benefit obligation adjustments	1.5	0.1
Income tax effect on defined benefit obligations	(0.5)	0.0
Reclassification adjustment for actuarial net losses from defined benefit obligations into earnings	0.1	0.0
Unrealized gains (losses) on available-for-sale securities:		
Unrealized holding losses arising during the period	(1.8)	(8.4)
Income tax effect on unrealized holding gains	0.2	1.0
Reclassification adjustments for (gains) losses included in net income	0.2	(0.1)
Unrealized gains (losses) on cash flow hedges:		
Unrealized holding losses arising during the period	(0.6)	(0.4)
Reclassification adjustments for (gains) losses included in net income	1.7	(1.0)
Other comprehensive income (loss)	0.0	(10.0)
Comprehensive income	\$ 88.4	\$ 71.6

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended	
	July 25, 2014	July 26, 2013
Cash flows from operating activities:		
Net income	\$ 88.4	\$ 81.6
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	77.5	85.9
Stock-based compensation	62.3	66.3
Accretion of discount and issuance costs on debt	0.6	8.2
Deferred income taxes	8.2	(10.1)
Excess tax benefit from stock-based compensation	(42.6)	(0.1)
Other non-cash items, net	36.9	(25.3)
Changes in assets and liabilities:		
Accounts receivable	271.5	265.2
Inventories	18.1	22.9
Other operating assets	(13.1)	53.8
Accounts payable	(62.3)	(37.9)
Accrued compensation and other current liabilities	(227.1)	(175.4)
Deferred revenue	(26.5)	(54.3)
Other operating liabilities	23.6	5.0
Net cash provided by operating activities	215.5	285.8
Cash flows from investing activities:		
Purchases of investments	(331.7)	(234.9)
Maturities, sales and collections of investments	522.9	624.9
Purchases of property and equipment	(58.4)	(65.3)
Other investing activities, net	0.2	1.2
Net cash provided by investing activities	133.0	325.9
Cash flows from financing activities:		
Issuance of common stock under employee stock plans	28.4	71.5
Repurchase of common stock and forward contract	(118.9)	(849.5)
Excess tax benefit from stock-based compensation	42.6	0.1
Repayment of long-term debt	0.0	(1,264.9)
Issuance of long-term debt, net	494.7	0.0
Dividends paid	(53.4)	(51.4)
Other financing activities, net	(1.8)	9.5
Net cash provided by (used in) financing activities	391.6	(2,084.7)
Effect of exchange rate changes on cash and cash equivalents	0.5	(7.3)
Net increase (decrease) in cash and cash equivalents	740.6	(1,480.3)
Cash and cash equivalents:		
Beginning of period	2,291.0	3,277.1

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

End of period

\$ 3,031.6

\$ 1,796.8

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NETAPP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Description of Business and Significant Accounting Policies

NetApp, Inc. (we, us, or the Company) is a global provider of innovative storage and data management software, systems and services. Our storage solutions help customers create the flexible, efficient and highly available IT infrastructures they need to support their organizations. We are a storage and data management provider to enterprises of all sizes, service providers, governmental organizations and original equipment manufacturers.

Basis of Presentation and Preparation

Our fiscal year is reported on a 52- or 53-week year ending on the last Friday in April. The first quarters of fiscal 2015 and 2014 were each 13-week periods.

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 25, 2014 contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on June 17, 2014. The results of operations for the three months ended July 25, 2014 are not necessarily indicative of the operating results to be expected for the full fiscal year or future operating periods.

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

There have been no significant changes in our significant accounting policies as of and for the three months ended July 25, 2014, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended April 25, 2014.

2. Recent Accounting Standards Not Yet Effective

In April 2014, the FASB issued an accounting standard update that changes the criteria for reporting discontinued operations and expands related disclosure requirements. This accounting standard will be effective for us beginning in our first quarter of fiscal 2016. The effects of this guidance will depend on the nature and significance of discontinued operations occurring after the effective date.

In May 2014, the Financial Accounting Standards Board issued new guidance related to the recognition and reporting of revenue that establishes a comprehensive new revenue recognition model designed to depict the transfer of goods or services to a customer in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services. The guidance allows for the use of either the full or modified retrospective transition method, and the standard will be effective for us in the first quarter of our fiscal year 2018; early adoption is not permitted. We are currently evaluating the impact of this new standard on our consolidated financial statements, as well as which transition method we intend to use.

Table of Contents**3. Statements of Cash Flows**

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

	Three Months Ended	
	July 25, 2014	July 26, 2013
Non-cash Investing and Financing Activities:		
Capital expenditures incurred but not paid	\$ 11.5	\$ 17.7
Acquisition of software through long-term financing	\$ 3.1	\$ 10.6
Supplemental Cash Flow Information:		
Income taxes paid, net of refunds	\$ 68.2	\$ 19.1
Interest paid, net of capitalized interest	\$ 11.7	\$ 23.0

4. Purchased Intangible Assets, Net

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

	July 25, 2014			April 25, 2014		
	Gross Assets	Accumulated Amortization	Net Assets	Gross Assets	Accumulated Amortization	Net Assets
Developed technology	\$ 283.0	\$ (176.9)	\$ 106.1	\$ 283.0	\$ (162.6)	\$ 120.4
Customer contracts/relationships	2.6	(2.1)	0.5	9.6	(9.0)	0.6
Trademarks and trade names	2.9	(2.5)	0.4	2.9	(2.4)	0.5
Covenants not to compete	0.0	0.0	0.0	1.6	(1.6)	0.0
Total purchased intangible assets	\$ 288.5	\$ (181.5)	\$ 107.0	\$ 297.1	\$ (175.6)	\$ 121.5

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

	Three Months Ended		Statements of
	July 25, 2014	July 26, 2013	Operations Classifications
Developed technology	\$ 14.3	\$ 14.3	Cost of revenues
Customer contracts/relationships	0.1	0.4	Operating expenses
Trademarks and trade names	0.1	0.1	Operating expenses
Covenants not to compete	0.0	0.1	Operating expenses
	\$ 14.5	\$ 14.9	

As of July 25, 2014, future amortization expense related to purchased intangible assets is as follows (in millions):

Fiscal Year	Amount
Remainder of 2015	\$ 43.4
2016	53.6
2017	6.7

2018	3.3
Total	\$ 107.0

5. Balance Sheet Details

Cash and cash equivalents (in millions):

	July 25, 2014	April 25, 2014
Cash	\$ 2,878.2	\$ 2,174.0
Cash equivalents	153.4	117.0
Cash and cash equivalents	\$ 3,031.6	\$ 2,291.0

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

	July 25, 2014	April 25, 2014
Purchased components	\$ 17.1	\$ 17.6
Finished goods	87.1	104.8
Inventories	\$ 104.2	\$ 122.4

Other current assets (in millions):

	July 25, 2014	April 25, 2014
Prepaid expenses and other current assets	\$ 240.7	\$ 219.4
Deferred tax assets	253.6	270.3
Other current assets	\$ 494.3	\$ 489.7

Property and equipment, net (in millions):

	July 25, 2014	April 25, 2014
Land	\$ 265.7	\$ 265.7
Buildings and building improvements	605.7	541.7
Leasehold improvements	103.9	102.9
Computer, production, engineering and other equipment	768.3	753.8
Software	376.5	369.1
Furniture and fixtures	88.3	86.4
Construction-in-progress	14.0	72.9
	2,222.4	2,192.5
Accumulated depreciation and amortization	(1,124.4)	(1,083.7)
Property and equipment, net	\$ 1,098.0	\$ 1,108.8

The net book value of software, which includes capitalized internal-use software development costs, is summarized below (in millions):

	July 25, 2014	April 25, 2014
Computer software	\$ 96.6	\$ 103.5

Other non-current assets (in millions):

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

	July 25, 2014	April 25, 2014
Auction rate securities	\$ 26.4	\$ 36.0
Deferred tax assets	241.0	245.0
Other assets	263.8	248.5
Other non-current assets	\$ 531.2	\$ 529.5

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

	July 25, 2014	April 25, 2014
Product	\$ 31.9	\$ 23.4
Software entitlements and maintenance and service	3,044.4	3,076.8
Total	\$ 3,076.3	\$ 3,100.2

Reported as:

Short-term	\$ 1,656.4	\$ 1,653.8
Long-term	1,419.9	1,446.4
Total	\$ 3,076.3	\$ 3,100.2

Table of Contents**6. Financial Instruments and Fair Value Measurements**

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

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

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

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

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

Investments

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

	July 25, 2014				April 25, 2014			
	Cost or Amortized Cost	Gross Unrealized		Estimated Fair Value	Cost or Amortized Cost	Gross Unrealized		Estimated Fair Value
Corporate bonds	\$ 1,905.8	\$ 8.5	\$ (0.4)	\$ 1,913.9	\$ 2,142.3	\$ 10.5	\$ (0.5)	\$ 2,152.3
U.S. Treasury and government debt securities	227.1	0.3	(0.1)	227.3	263.4	0.3	(0.1)	263.6
Commercial paper	174.5	0.0	0.0	174.5	168.4	0.0	0.0	168.4
Certificates of deposit	370.3	0.0	0.0	370.3	245.0	0.0	0.0	245.0
Auction rate securities	26.9	0.0	(0.5)	26.4	36.9	0.0	(0.9)	36.0
Equity funds	33.5	0.0	0.0	33.5	32.7	0.0	0.0	32.7
Total debt and equity securities	\$ 2,738.1	\$ 8.8	\$ (1.0)	\$ 2,745.9	\$ 2,888.7	\$ 10.8	\$ (1.5)	\$ 2,898.0

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 determined that (i) we do not have the intent to sell any of these investments and (ii) it is not more likely than not that we will be required to sell any of these investments before recovery of the entire amortized cost basis, we have concluded that no other-than-temporary impairments were required to be recognized on these investments as of July 25, 2014.

The following table presents the contractual maturities of our debt investments as of July 25, 2014 (in millions):

	Amortized Cost	Fair Value
Due in one year or less	\$ 1,413.8	\$ 1,416.2
Due in two through five years	1,263.9	1,269.8
Due after ten years*	26.9	26.4

\$ 2,704.6 \$ 2,712.4

* Consists of auction rate securities (ARSs) which have contractual maturities of greater than 10 years.
Actual maturities may differ from the contractual maturities because borrowers may have the right to call or prepay certain obligations.

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

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

	July 25, 2014			
	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)
	Total			
Assets				
Corporate bonds	\$ 1,913.9	\$ 0.0	\$ 1,913.9	\$ 0.0
U.S. Treasury and government debt securities	227.3	161.9	65.4	0.0
Commercial paper	174.5	0.0	174.5	0.0
Certificates of deposit	370.3	0.0	370.3	0.0
Auction rate securities	26.4	0.0	0.0	26.4
Equity funds	33.5	33.5	0.0	0.0
Foreign currency contracts	3.2	0.0	3.2	0.0
Total	\$ 2,749.1	\$ 195.4	\$ 2,527.3	\$ 26.4
Liabilities				
Foreign currency contracts	\$ (0.7)	\$ 0.0	\$ (0.7)	\$ 0.0

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

	July 25, 2014			
	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)
	Total			
Assets				
Cash equivalents	\$ 153.4	\$ 0.0	\$ 153.4	\$ 0.0
Short-term investments	2,532.6	161.9	2,370.7	0.0
Other current assets	8.4	5.2	3.2	0.0
Other non-current assets	54.7	28.3	0.0	26.4
Total	\$ 2,749.1	\$ 195.4	\$ 2,527.3	\$ 26.4
Liabilities				
Other current liabilities	\$ (0.7)	\$ 0.0	\$ (0.7)	\$ 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

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

review third-party pricing provider models, key inputs and assumptions and understand the pricing processes at our third-party providers in determining the overall reasonableness of the fair value of our Level 2 financial instruments. As of July 25, 2014, we have not made any adjustments to the prices obtained from our third-party pricing providers.

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

	Estimated Fair Value as of July 25, 2014	Valuation Techniques	Unobservable Inputs	Range (Weighted average)	
ARSs	\$ 26.4	Discounted cash flow	Time-to-economic maturity	6.7 yrs.	9.4 yrs. (7.5 yrs.)
			Illiquidity premium	1.3%	1.8% (1.5%)
			Coupon rate	1.1%	1.8% (1.4%)
		Market comparable securities	Discount rate	1.0%	2.0% (1.3%)

Table of Contents

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, illiquidity premium, coupon rate, discount rate or other factors 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 asset-backed securities 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	
	July 25, 2014	July 26, 2013
Balance at beginning of period	\$ 36.0	\$ 42.0
Total unrealized gains, net included in other comprehensive income (loss)	0.4	0.2
Sales	(10.0)	0.0
Balance at end of period	\$ 26.4	\$ 42.2

Fair Value of Debt

As of July 25, 2014, the fair value of our long-term debt was approximately \$1,506.4 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.

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

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

	July 25, 2014		April 25, 2014	
	Amount	Effective Interest Rate	Amount	Effective Interest Rate
2.00% Senior Notes due 2017	\$ 750.0	2.25%	\$ 750.0	2.25%
3.375% Senior Notes due 2021	500.0	3.54%	0.0	N/A
3.25% Senior Notes due 2022	250.0	3.43%	250.0	3.43%
Total principal amount	1,500.0		1,000.0	
Less: Unamortized discount	(5.9)		(4.5)	
Total long-term debt	\$ 1,494.1		\$ 995.5	

N/A - Not Applicable

Senior Notes

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

On June 5, 2014 we issued \$500.0 million aggregate par value of 3.375% Senior Notes, with a maturity date of June 15, 2021, and received proceeds of approximately \$494.7 million, net of discount and issuance costs, which will be used for general corporate purposes, including possible stock repurchases, dividends, capital expenditures, working capital and potential acquisitions and strategic transactions. Our 2.00% Senior Notes and 3.25% Senior Notes, with a par value of \$750.0 million and \$250.0 million, respectively, were issued in December 2012. We collectively refer to such long-term debt as our Senior Notes. Interest on our Senior Notes is paid semi-annually on June 15 and December 15. Our Senior Notes, which are unsecured, unsubordinated obligations, rank equally in right of payment with any future senior unsecured indebtedness.

We may redeem the Senior Notes in whole or in part at any time at our option at specified redemption prices. In addition, upon the occurrence of certain change of control triggering events, we may be required to repurchase the Senior Notes 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 July 25, 2014, we were in compliance with all covenants associated with the Senior Notes.

Table of Contents

As of July 25, 2014, our aggregate future principal debt maturities are as follows (in millions):

Fiscal Year	Amount
2018	\$ 750.0
Thereafter	750.0
Total	\$ 1,500.0

Credit Facility

In December 2012, we entered into a credit agreement with a syndicated group of lenders that is scheduled to expire on December 21, 2017 and 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 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 July 25, 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):

	July 25, 2014	April 25, 2014
Other long-term financing arrangements	\$ 14.3	\$ 13.1
Less: current portion	(7.1)	(6.6)
Non-current portion of other long-term financing arrangements	\$ 7.2	\$ 6.5

8. 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	Aggregate Intrinsic Value
---------------------	---	---	---------------------------------

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

			(Years)	
Outstanding as of April 25, 2014	14.5	\$ 34.10		
Granted	2.0	36.29		
Exercised	(0.5)	23.60		
Forfeited and expired	(0.2)	41.43		
Outstanding as of July 25, 2014	15.8	34.68	3.75	\$ 93.1
Vested and expected to vest as of July 25, 2014	15.0	34.58	3.63	91.6
Exercisable as of July 25, 2014	10.4	33.33	2.63	81.1

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.

Table of Contents

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

	Three Months Ended	
	July 25, 2014	July 26, 2013
Intrinsic value of exercises	\$ 7.2	\$ 27.4
Proceeds received from exercises	\$ 13.4	\$ 56.8
Fair value of options vested	\$ 8.7	\$ 12.0

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 25, 2014	13.2	\$ 38.35
Granted	5.3	34.93
Vested	(2.9)	38.79
Forfeited	(0.7)	38.14
Outstanding as of July 25, 2014	14.9	37.06

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	
	July 25, 2014	July 26, 2013
Shares withheld for taxes	0.9	0.9
Fair value of shares withheld	\$ 33.9	\$ 35.3

Employee Stock Purchase Plan

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

	Three Months Ended	
	July 25, 2014	July 26, 2013
Shares issued under the ESPP	1.9	2.0
Proceeds from issuance of shares	\$ 48.9	\$ 49.9

Stock-Based Compensation Expense

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

	Three Months Ended	
	July 25, 2014	July 26, 2013

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

Cost of product revenues	\$ 1.5	\$ 1.3
Cost of service revenues	4.4	4.0
Sales and marketing	27.0	30.5
Research and development	21.5	21.4
General and administrative	7.9	9.1

Total stock-based compensation expense	\$ 62.3	\$ 66.3
--	---------	---------

As of July 25, 2014, total unrecognized compensation expense related to our equity awards was \$507.8 million, which is expected to be recognized on a straight-line basis over a weighted-average remaining service period of 2.7 years.

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

	Three Months Ended	
	July 25, 2014	July 26, 2013
Income tax benefit associated with employee stock transactions	\$ 43.4	\$ 8.0

Table of Contents**Valuation Assumptions**

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

	Stock Options	
	Three Months Ended	
	July 25, 2014	July 26, 2013
Expected term in years	4.8	4.8
Risk-free interest rate	1.6%	1.0%
Volatility	29%	34%
Dividend yield	1.8%	1.6%
Weighted-average fair value per share granted	\$ 8.19	\$ 9.78

	ESPP	
	Three Months Ended	
	July 25, 2014	July 26, 2013
Expected term in years	1.3	1.2
Risk-free interest rate	0.2%	0.2%
Volatility	27%	32%
Dividend yield	1.8%	1.6%
Weighted-average fair value per right granted	\$ 9.71	\$ 10.53

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

	Three Months Ended	
	July 25, 2014	July 26, 2013
Grant date fair value per share	\$ 34.93	\$ 38.16
Expected dividend	1.8%	1.6%

Stock Repurchase Program

As of July 25, 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 three months ended July 25, 2014 (in millions, except per share information):

Number of shares repurchased	3.4
Average price per share	\$ 34.82
Aggregate purchase price	\$ 118.9
Remaining authorization at end of period	\$ 1,005.9

The aggregate purchase price of our stock repurchases for the three months ended July 25, 2014 consisted of \$118.9 million of open market purchases, which was allocated to additional paid-in capital.

Dividends

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

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

	Three Months Ended	
	July 25, 2014	July 26, 2013
Dividends per share declared and paid	\$ 0.165	\$ 0.150
Dividend payments allocated to retained earnings	\$ 53.4	\$ 51.4

Table of Contents

On August 13, 2014, we declared a cash dividend of \$0.165 per share of common stock, payable on October 22, 2014 to holders of record as of the close of business on October 10, 2014. 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.

Retained Earnings

A reconciliation of retained earnings for the three months ended July 25, 2014 is as follows (in millions):

Balance as of April 25, 2014	\$ 1.1
Net income	88.4
Dividends	(53.4)
Balance as of July 25, 2014	\$ 36.1

Accumulated Other Comprehensive Income

Changes in accumulated other comprehensive income (AOCI) by component, net of tax, for the three months ended July 25, 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 25, 2014	\$ 5.5	\$ (4.8)	\$ 8.9	\$ (0.5)	\$ 9.1
Other comprehensive income (loss) (OCI) before reclassifications	(0.8)	1.0	(1.6)	(0.6)	(2.0)
Amounts reclassified from AOCI, net of tax	0.0	0.1	0.2	1.7	2.0
Net OCI	(0.8)	1.1	(1.4)	1.1	0.0
Balance as of July 25, 2014	\$ 4.7	\$ (3.7)	\$ 7.5	\$ 0.6	\$ 9.1

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

OCI Components	Three Months Ended		Statements of Operations Location
	July 25, 2014	July 26, 2013	
Recognized losses on defined benefit obligations	\$ 0.1	\$ 0.0	Operating expenses
Realized (gains) losses on available-for-sale securities	0.2	(0.1)	Other expense, net
Realized (gains) losses on cash flow hedges	1.7	(1.0)	Net revenues
Total reclassifications	\$ 2.0	\$ (1.1)	

Table of Contents**9. 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):

	July 25, 2014	April 25, 2014
Cash Flow Hedges		
Forward contracts purchased	\$ 116.1	\$ 122.6
Balance Sheet Contracts		
Forward contracts sold	167.6	155.5
Forward contracts purchased	270.6	389.9

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 July 25, 2014 and April 25, 2014. We did not recognize any gains and losses in earnings due to hedge ineffectiveness for any period presented.

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 8.

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

	Three Months Ended	
	July 25, 2014	July 26, 2013
	Gain (Loss) Recognized into Income	
Foreign exchange forward contracts	\$ (0.8)	\$ 0.2

10. 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 were completed in fiscal 2014. In March 2014, we initiated a business realignment plan designed to focus our resources on key strategic initiatives and streamline our business in light of the constrained IT spending environment, resulting in a reduction of our global workforce of approximately 4%. We expect such activities to be substantially completed in the second quarter of fiscal 2015. Restructuring and other charges consisted primarily of employee severance-related costs.

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

	Three Months Ended	
	July 25, 2014 (March 2014 Plan)	July 26, 2013 (May 2013 Plan)
Balance at beginning of period	\$ 26.5	\$ 0.0
Net charges	0.0	48.4
Cash payments	(21.6)	(24.6)
Balance at end of period	\$ 4.9	\$ 23.8

The liability for our restructuring plans is included in accrued compensation and related benefits in our condensed consolidated balance sheets.

11. Income Taxes

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

	Three Months Ended	
	July 25, 2014	July 26, 2013
Effective tax rates	44.6%	11.6%

Table of Contents

Our effective tax rates reflect the impact of a significant amount of our earnings being taxed in foreign jurisdictions at rates below the U.S. statutory tax rate. In addition, our effective tax rate for the three months ended July 25, 2014 was impacted by the settlement of an income tax audit as discussed below.

In July 2014, the Internal Revenue Service (IRS) completed the examination of our fiscal 2005 to 2007 income tax returns upon approval by the Joint Committee of Taxation. We recorded a \$47.4 million income tax provision attributable to the audit settlement and related re-measurement of uncertain tax positions for tax years subject to future audits. The audit adjustments resulted in lower earnings in our foreign subsidiaries which reduced the taxability of dividends that were previously repatriated from such subsidiaries. As a result of this reduction in taxable dividends, we expect to receive a refund of \$8.0 million, excluding interest, from the conclusion of the fiscal 2005 to 2007 income tax audit.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in millions):

	Three Months Ended	
	July 25, 2014	July 26, 2013
Balance at beginning of period	\$ 235.9	\$ 189.6
Additions based on tax positions related to the current year	6.8	7.2
Additions for tax positions of prior years	98.7	1.0
Decreases for tax positions of prior years	(18.6)	(3.5)
Settlements	(45.5)	0.0
Balance at end of period	\$ 277.3	\$ 194.3

As of July 25, 2014, we had \$277.3 million of gross unrecognized tax benefits, of which \$223.6 million has been recorded in other long-term liabilities. Unrecognized tax benefits of \$172.9 million, including penalties, interest and indirect benefits, would affect our provision for income taxes if recognized.

We are currently undergoing federal income tax audits in the United States and several foreign tax jurisdictions. Transfer pricing calculations are key issues under audits in various jurisdictions, and are often subject to dispute and appeals. The IRS is currently auditing our fiscal 2008 to 2010 income tax returns. We expect the IRS examination team to complete their field audit within the next twelve months. However, the resolution of the fiscal 2008 to 2010 income tax return audits may likely occur beyond the next twelve months should we choose to appeal the IRS examination team's audit findings.

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.

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.

12. 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	
	July 25, 2014	July 26, 2013
Numerator:		
Net income	\$ 88.4	\$ 81.6

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

Denominator:		
Shares used in basic computation	323.5	350.9
Dilutive potential shares related to employee equity award plans	5.6	6.9
Dilutive impact of assumed conversion of Convertible Notes	0.0	2.1
Shares used in diluted computation	329.1	359.9
Net Income per Share:		
Basic	\$ 0.27	\$ 0.23
Diluted	\$ 0.27	\$ 0.23

Table of Contents

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	
	July 25, 2014	July 26, 2013
Employee equity award plans	8.5	6.6

13. 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 in this internal management reporting because management does not review operations or operating results, or make planning decisions, below the consolidated entity level.

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

	Three Months Ended	
	July 25, 2014	July 26, 2013
Americas (United States, Canada and Latin America)	\$ 831.2	\$ 858.5
Europe, Middle East and Africa	444.9	448.0
Asia Pacific	213.1	209.7
Net revenues	\$ 1,489.2	\$ 1,516.2

Americas revenues consist of sales to Americas commercial and U.S. public sector markets. Sales to customers inside the United States comprised \$746.2 million and \$772.8 million of Americas net revenues during the three months ended July 25, 2014 and July 26, 2013, respectively. No single foreign country accounted for 10% or more of our net revenues for any 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):

	July 25, 2014	April 25, 2014
United States	\$ 1,089.6	\$ 688.5
International	4,514.4	4,360.9
Total	\$ 5,604.0	\$ 5,049.4

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):

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

	July 25, 2014	April 25, 2014
United States	\$ 1,005.3	\$ 1,021.4
International	92.7	87.4
Total	\$ 1,098.0	\$ 1,108.8

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

	Three Months Ended	
	July 25, 2014	July 26, 2013
Arrow Electronics, Inc.	22%	21%
Avnet, Inc.	16%	16%

Table of Contents

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

	July 25, 2014	April 25, 2014
Arrow Electronics, Inc.	12%	14%
Avnet, Inc.	11%	16%

14. Commitments and Contingencies*Operating Lease Commitments*

We lease various equipment, vehicles and office space in the U.S. and internationally. As of July 25, 2014, future annual minimum lease payments under non-cancelable operating leases with an initial term in excess of one year totaled \$213.6 million.

Purchase Orders and Other Commitments

In the ordinary course of business we make commitments to third-party contract manufacturers, to manage manufacturer lead times and meet product forecasts, and to other parties, to purchase various key components used in the 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 product forecasts are not achieved, our commitments and associated accruals may change. As of July 25, 2014, we had \$239.3 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 July 25, 2014 and April 25, 2014, such liability amounted to \$10.4 million and \$11.5 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 July 25, 2014, we had \$36.4 million in capital purchase commitments and \$180.2 million in other purchase commitments.

Product Warranties

We generally provide customers a warranty on software of ninety days and a warranty on hardware of three years. The following table summarizes the activity related to product warranty liabilities (in millions):

	Three Months Ended	
	July 25, 2014	July 26, 2013
Balance at beginning of period	\$ 110.0	\$ 117.2
Expense accrued during the period	10.5	24.0
Warranty costs incurred	(16.4)	(21.4)
Balance at end of period	\$ 104.1	\$ 119.8

Product warranty liabilities were reported in our condensed consolidated balance sheets as follows (in millions):

	July 25, 2014	April 25, 2014
Other current liabilities	\$ 68.8	\$ 73.0
Other long-term liabilities	35.3	37.0

Total	\$ 104.1	\$ 110.0
-------	----------	----------

Table of Contents***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 arrangements are generally collateralized by a security interest in the underlying assets. Under the terms of the non-recourse 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.

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):

	July 25, 2014	April 25, 2014
Maximum guaranteed payment contingencies	\$ 213.2	\$ 205.8
Deferred revenue associated with financing guarantees	(196.8)	(193.1)
Net amount	\$ 16.4	\$ 12.7

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 July 25, 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, customer acceptance of and benefits from, product introductions, developments and enhancements;

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, 3.375% Senior Notes due on June 15, 2021 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

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

described herein include, but are not limited to:

the overall growth and structure of the data storage industry;

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

general global political, macroeconomic and market conditions;

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

our ability to successfully manage our backlog;

our ability to successfully execute on our strategy to generate profitable growth and stockholder return;

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

Table of Contents

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

our ability to maintain our gross profit margins;

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 gain customer acceptance of new products;

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;

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

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

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

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

our ability to resolve ongoing litigation, tax audits, government audits, inquiries and investigations in line with our expectations;

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

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

valuation and liquidity of our investment portfolio;

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

our ability to anticipate techniques used to obtain unauthorized access or to sabotage systems and to implement adequate preventative measures against cybersecurity and other security breaches; and

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

Edgar Filing: NetApp, Inc. - 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	
	July 25, 2014	July 26, 2013
Net revenues	\$ 1,489.2	\$ 1,516.2
Gross profit	\$ 938.1	\$ 909.6
Gross profit margin percentage	63.0%	60.0%
Income from operations	\$ 159.9	\$ 96.9
Income from operations as a percentage of net revenues	10.7%	6.4%
Net income	\$ 88.4	\$ 81.6
Diluted net income per share	\$ 0.27	\$ 0.23
Operating cash flows	\$ 215.5	\$ 285.8

	July 25, 2014	April 25, 2014
Deferred revenue	\$ 3,076.3	\$ 3,100.2
Days sales outstanding (DSO)	36	47

3.375% Senior Notes due 2021

On June 5, 2014 we issued \$500.0 million aggregate par value of 3.375% Senior Notes, with a maturity date of June 15, 2021 and received proceeds of \$494.7 million, net of discount and issuance costs, which will be used for general corporate purposes, including possible stock repurchases, dividends, capital expenditures, working capital and potential acquisitions and strategic transactions.

Critical Accounting Policies and Estimates

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

The summary of significant accounting policies is included 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 25, 2014. 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.

New Accounting Standards

See Note 2 of the accompanying condensed consolidated financial statements for a full description of new accounting pronouncements, including the respective expected dates of adoption and effects on results of operations and financial condition.

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	
	July 25, 2014	July 26, 2013
Revenues:		
Product	59.3%	61.4%
Software entitlements and maintenance	14.8	15.1
Service	25.9	23.5
Net revenues	100.0	100.0
Cost of revenues:		
Cost of product	26.5	29.7
Cost of software entitlements and maintenance	0.5	0.5
Cost of service	10.0	9.8
Gross profit	63.0	60.0
Operating expenses:		
Sales and marketing	32.3	30.9
Research and development	15.3	15.0
General and administrative	4.7	4.5
Restructuring and other charges		3.2
Total operating expenses	52.3	53.6
Income from operations	10.7	6.4
Other expense, net		(0.3)
Income before income taxes	10.7	6.1
Provision for income taxes	4.8	0.7
Net income	5.9%	5.4%

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

Net revenues for the three months ended July 25, 2014 were \$1,489.2 million, down \$27.0 million, or 2%, compared to the three months ended July 26, 2013, reflecting a decrease in product and software entitlements and maintenance (SEM) revenues, partially offset by an increase in hardware maintenance contract revenues.

Gross profit as a percentage of net revenues increased 3% during the three months ended July 25, 2014, compared to the three months ended July 26, 2013, primarily due to lower average unit materials costs due to product mix, partially offset by a lower average selling price (ASP) for all configured systems platforms. Additionally, gross profit was favorably impacted by lower OEM revenues and higher margins on service revenues.

Sales and marketing, research and development, and general and administrative expenses for the three months ended July 25, 2014 totaled \$778.2 million, up 2% as a percentage of net revenues, compared to the three months ended July 26, 2013, primarily due to increases in compensation costs.

Net Revenues (in millions, except percentages):

	Three Months Ended		
	July 25, 2014	July 26, 2013	% Change
Net revenues	\$ 1,489.2	\$ 1,516.2	(2)%

The decrease in net revenues for the three months ended July 25, 2014 was primarily due to a decrease in product and SEM revenues of \$48.2 million and \$7.2 million, respectively, partially offset by an increase in service revenues of \$28.4 million. Product revenues comprised 59% of net revenues for the three months ended July 25, 2014 compared to 61% of net revenues for the three months ended July 26, 2013.

Table of Contents

Sales through our indirect channels represented 79% of net revenues for the three months ended July 25, 2014, compared to 80% of net revenues for the three months ended July 26, 2013. Included in indirect channel sales were \$128.7 million and \$166.5 million of OEM revenue during the three months ended July 25, 2014 and July 26, 2013, respectively.

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

	Three Months Ended	
	July 25, 2014	July 26, 2013
Arrow Electronics, Inc.	22%	21%
Avnet, Inc.	16%	16%

Product Revenues (in millions, except percentages):

	Three Months Ended		
	July 25, 2014	July 26, 2013	% Change
Product revenues	\$ 882.6	\$ 930.8	(5)%

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 \$526.2 million decreased by \$10.8 million for the three months ended July 25, 2014 compared to the three months ended July 26, 2013. Revenues from FAS mid-range, high-end systems and E-Series (which includes our all flash EF systems) increased, offset by decreases in FAS entry level systems. Total configured systems unit volume decreased 2% during the three months ended July 25, 2014, compared to the three months ended July 26, 2013, primarily due to a unit volume decrease in the FAS entry level systems, partially offset by increases in unit volume of the FAS mid-range and high-end systems and E Series systems. These changes in unit volume reflect a shift in customer demand to our newer FAS mid-range and high-end products and higher demand for our E-Series systems, and away from our older FAS entry level systems. The average selling prices (ASPs) decreased across all FAS system and E Series platforms in the three months ended July 25, 2014, compared to the three months ended July 26, 2013, due to higher demand of newer lower priced products within their respective platform. However, overall ASPs of configured systems were relatively flat during the three months ended July 25, 2014 compared to the corresponding period in the prior year due to favorable product mix towards higher priced platforms.

Non-configured product revenues of \$356.4 million decreased \$37.4 million, or 10%, during the three months ended July 25, 2014 compared to the three months ended July 26, 2013. This decrease was primarily due to lower revenues from non-configured OEM products, which declined 23%, and add-on storage, which declined 13%, but was partially offset by a 82% increase in revenues from add-on software. The decrease in add-on storage and increase in add-on software are largely due to the change in our pricing strategy that was effective in the fourth quarter of fiscal 2014, whereby we now charge for operating system software for storage capacity but have lowered prices on storage hardware.

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. 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	
	July	% Change

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

	25, 2014	July 26, 2013	
Software entitlements and maintenance revenues	\$ 221.3	\$ 228.5	(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.

Table of Contents

The decrease in SEM revenues for the three months ended July 25, 2014 was due to a decrease in the aggregate contract value of the installed base under SEM contracts.

Service Revenues (in millions, except percentages):

	Three Months Ended		
	July 25, 2014	July 26, 2013	% Change
Service revenues	\$ 385.3	\$ 356.9	8%

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

Hardware maintenance contract revenues comprised 79% of service revenues for the three months ended July 25, 2014, compared to 77% for the three months ended July 26, 2013. These revenues increased \$29.2 million, or 11%, during the three months ended July 25, 2014, compared to the corresponding period 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 21% and 23% of service revenues for the three months ended July 25, 2014 and July 26, 2013, respectively.

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

	Three Months Ended		
	July 25, 2014	July 26, 2013	% Change
Americas (United States, Canada and Latin America)	\$ 831.2	\$ 858.5	(3)%
Europe, Middle East and Africa	444.9	448.0	(1)%
Asia Pacific	213.1	209.7	2%
Net revenues	\$ 1,489.2	\$ 1,516.2	

Americas revenues consist of sales to Americas commercial and U.S. public sector markets. Sales to customers inside the United States comprised 90% of Americas net revenues during each of the three months ended July 25, 2014 and July 26, 2013. No single foreign country accounted for 10% or more of our net revenues for any 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 maintenance, 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.

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

	Three Months Ended		
	July 25, 2014	July 26, 2013	% Change
Cost of product revenues	\$ 394.2	\$ 449.9	(12)%

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

	Three Months Ended Fiscal 2015 to Fiscal 2014 Percentage Change Points
Materials cost	(8)
Warranty	(3)
Excess and obsolete inventory	(1)
Total change	(12)

Cost of product revenues represented 45% and 48% of product revenues for the three months ended July 25, 2014 and July 26, 2013, respectively.

Materials cost represented 85% and 83% of product costs for the three months ended July 25, 2014 and July 26, 2013, respectively.

Materials cost decreased \$36.7 million in the three months ended July 25, 2014 compared to the three months ended July 26, 2013. Material costs were favorably impacted by a 2% unit volume decrease in configured systems in the three months ended July 25, 2014, compared to the corresponding period of the prior year. The average unit materials costs decreased for our FAS entry level and mid-range systems, but increased for our FAS high-end and E Series systems. Our overall materials unit cost for configured systems decreased due to favorable changes in product mix. Additionally, materials cost was favorably impacted by lower OEM product volume compared to the corresponding period in the prior year and to lower materials cost of add-on hardware, partially offset by higher materials cost of add-on storage. As a result of these factors, we experienced higher gross margins on products in the three months ended July 25, 2014 compared to the three months ended July 26, 2013. In addition, cost of product revenues in the three months ended July 25, 2014 was favorably impacted by a \$13.4 million decrease in warranty expense and a \$3.7 million decrease in excess and obsolete inventory write-downs compared to the corresponding period in the prior year.

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

	Three Months Ended		
	July 25, 2014	July 26, 2013	% Change
Cost of software entitlements and maintenance revenues	\$ 8.2	\$ 7.5	9%

Cost of SEM revenues increased primarily due to higher royalty costs in the three months ended July 25, 2014 compared to the three months ended July 26, 2013. Cost of SEM revenues represented 4% and 3% of SEM revenues for the three months ended July 25, 2014 and July 26, 2013, respectively.

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

	Three Months Ended		
	July 25, 2014	July 26, 2013	% Change
Cost of service revenues	\$ 148.7	\$ 149.2	%

Cost of service revenues were relatively flat during the three months ended July 25, 2014 compared to the three months ended July 26, 2013, primarily due to an increase in spares materials costs, largely offset by lower logistics, materials rework and service delivery costs. Costs represented 39% and 42% of service revenues for the three months ended July 25, 2014 and July 26, 2013, respectively.

Operating Expenses

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

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

Total compensation costs included in operating expenses increased \$1.7 million for the three months ended July 25, 2014 compared to the corresponding period in the prior year, reflecting relatively flat headcount compared to the prior year period.

Table of Contents

Sales and Marketing (in millions, except percentages):

	Three Months Ended		
	July 25, 2014	July 26, 2013	% Change
Sales and marketing expenses	\$ 480.2	\$ 467.8	3%

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

	Three Months Ended Fiscal
	2015 to Fiscal 2014 Percentage Change Points
Commissions	1
Sales events	1
Other	1
Total change	3

Commissions expense increased during the three months ended July 25, 2014 reflecting higher bookings achievement compared to the corresponding period in the prior year. The increase in sales events represents activities to communicate the corporate strategy to the world-wide sales force at the beginning of fiscal 2015.

Research and Development (in millions, except percentages):

	Three Months Ended		
	July 25, 2014	July 26, 2013	% Change
Research and development expenses	\$ 228.0	\$ 228.1	%

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 (decreased) due to the following:

	Three Months Ended Fiscal
	2015 to Fiscal 2014 Percentage Change Points
Compensation costs	1
Outside services	1
Development projects	(2)

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

Total change

The increase in compensation costs during the three months ended July 25, 2014 is primarily due to higher incentive compensation, reflecting stronger operating performance against goals. Outside services expense during the three months ended July 25, 2014 increased due to higher spending on contractors. The decrease in development projects expense during the three months ended July 25, 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		
	July 25, 2014	July 26, 2013	% Change
General and administrative expenses	\$ 70.0	\$ 68.4	2%

Table of Contents

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 (decreased) due to the following:

	Three Months Ended Fiscal 2015 to Fiscal 2014 Percentage Change Points
Compensation costs	(1)
Professional and legal fees and outside services	2
Bad debt expense	1
 Total change	 2

The decrease in compensation costs for the three months ended July 25, 2014 is primarily due to lower payroll taxes and stock-based compensation expense, partially offset by higher salaries, reflecting an increase in headcount, and incentive compensation expense, reflecting stronger operating performance against goals. The increase in professional and legal fees and outside services for the three months ended July 25, 2014 reflects higher spending levels on contractors and professional services. Bad debt expense for the three months ended July 25, 2014 increased \$1.0 million compared to the corresponding period in the prior year.

Restructuring and other charges:

	Three Months Ended		
	July 25, 2014	July 26, 2013	% Change
Restructuring and other charges	\$	\$ 48.4	(100)%

In March 2014 and May 2013, we initiated business realignment plans designed to focus our resources on key strategic initiatives and streamline our business in light of the constrained IT spending environment, resulting in a reduction of our global workforce. The charges for the three months ended July 26, 2013 represent employee severance costs recognized in connection with the May 2013 restructuring plan. We incurred no additional costs in connection with either of our restructuring plans in the three months ended July 25, 2014. We completed all activities under the May 2013 plan during fiscal 2014, and expect to complete activities under the March 2014 plan in the second quarter of fiscal 2015, with no significant additional charges.

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

	Three Months Ended		
	July 25, 2014	July 26, 2013	% Change
Interest income	\$ 8.3	\$ 10.0	(17)%

The decrease in interest income during the three months ended July 25, 2014 was primarily due to a decrease in our average investment portfolio compared to the corresponding prior year period.

Interest Expense (in millions, except percentages):

	Three Months Ended		
	July 25, 2014	July 26, 2013	% Change
Interest expense	\$ (9.0)	\$ (16.5)	(45)%

Table of Contents

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	
	July 25, 2014	July 26, 2013
Senior Notes	\$ 8.8	\$ 6.3
Convertible Notes		10.2
Total	\$ 8.8	\$ 16.5

The increase in interest expense related to our Senior Notes reflects the issuance of our 3.375% Senior Notes due 2021 in June 2014, and the decrease in interest expense related to our Convertible Notes reflects their maturity in June 2013.

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

	Three Months Ended		
	July 25, 2014	July 26, 2013	% Change
Other income, net	\$ 0.5	\$ 1.9	(74)%

The decrease in other income, net for the three months ended July 25, 2014 compared to the corresponding period in the prior year is primarily due to higher net foreign exchange losses.

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

	Three Months Ended		
	July 25, 2014	July 26, 2013	% Change
Provision for income taxes	\$ 71.3	\$ 10.7	566%

Our effective tax rate for the three months ended July 25, 2014 was 44.6% compared to an effective tax rate of 11.6% for the three months ended July 26, 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 months ended July 25, 2014 and July 26, 2013, respectively, were favorably impacted by the geographic mix of profits. Our effective tax rate increased for the three months ended July 25, 2014 compared to the corresponding period in the prior year primarily as a result of the discrete provision charge related to the Internal Revenue Service (IRS) audit settlement as discussed below. Higher pre-tax profits and a lapse of the federal research credit statute also contributed to the increase in the effective tax rate.

In July 2014, the IRS completed the examination of our fiscal 2005 to 2007 income tax returns upon approval by the Joint Committee of Taxation. We recorded a \$47.4 million tax provision attributable to the audit settlement and related re-measurement of uncertain tax positions for tax years subject to future audits. We expect to receive a refund of \$8.0 million, excluding interest, from the conclusion of the fiscal 2005 to 2007 income tax audit.

As of July 25, 2014, we had \$277.3 million of gross unrecognized tax benefits, of which \$223.6 million has been recorded in other long-term liabilities. Unrecognized tax benefits of \$172.9 million, including penalties, interest and indirect benefits, would affect our provision for income taxes if recognized. During the three months ended July 25, 2014, there was an increase in our unrecognized tax benefits of \$6.8 million for tax positions related to the current year, a gross increase of \$98.7 million and a gross decrease, including statute lapses, of \$18.6 million for tax positions related to prior years. We also recorded a gross decrease of \$45.5 million related to settlements with taxing authorities during the period.

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

We continue to monitor the progress of ongoing discussions with tax authorities and the impact, if any, of the expected expiration of the statute of limitations in various taxing jurisdictions.

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 July 25, 2014.

Table of Contents**Liquidity, Capital Resources and Cash Requirements**

(\$ in Millions)	July 25, 2014	April 25, 2014
Cash and cash equivalents and short-term investments	\$ 5,564.2	\$ 5,003.3
Principal amount of Senior Notes	1,500.0	1,000.0
Debt as a % of stockholders' equity	39%	26%

The following is a summary of our cash flow activities:

(In Millions)	Three Months Ended	
	July 25, 2014	July 26, 2013
Net cash provided by operating activities	\$ 215.5	\$ 285.8
Net cash provided by investing activities	133.0	325.9
Net cash provided by (used in) financing activities	391.6	(2,084.7)
Effect of exchange rate changes on cash and cash equivalents	0.5	(7.3)
Net increase (decrease) in cash and cash equivalents	\$ 740.6	\$ (1,480.3)

Cash Flows

As of July 25, 2014, our cash, cash equivalents and short-term investments increased by \$0.6 billion from April 25, 2014 to \$5.6 billion. The increase was primarily due to \$494.7 million of net proceeds received from the issuance of long-term debt and \$215.5 million of cash provided by operating activities, partially offset by \$118.9 million in cash paid for the repurchase of our common stock. We derive our liquidity and capital resources primarily from our operating cash flows and from working capital. Accounts receivable days sales outstanding as of July 25, 2014 decreased to 36 days from 47 days as of April 25, 2014, reflecting historical seasonality in shipment linearity. Working capital increased by \$570.5 million to \$4.3 billion as of July 25, 2014 primarily as a result of the \$560.9 million increase in cash, cash equivalents and short-term investments.

Cash Flows from Operating Activities

During the three months ended July 25, 2014, we generated cash from operating activities of \$215.5 million. The primary sources of cash from operating activities during the three months ended July 25, 2014 consisted of net income of \$88.4 million, adjusted by depreciation and amortization of \$77.5 million, stock-based compensation of \$62.3 million and other adjustments to net income of \$45.1 million, partially offset by excess tax benefit from stock-based compensation of \$42.6 million.

Changes in assets and liabilities as of July 25, 2014 included the following:

Accounts receivable decreased \$271.5 million in the three months ended July 25, 2014 and decreased \$265.2 million in the three months ended July 26, 2013, reflecting seasonally high collections, as well as seasonal improvement of shipment linearity, in the first quarter of our fiscal years compared to the fourth quarter of our fiscal years.

Accrued compensation and related benefits decreased \$227.1 million due to employee compensation payouts related to fiscal year 2014 commissions, incentive compensation plans and restructuring obligations, compared to \$175.4 million for the corresponding period of the prior year, reflecting higher incentive compensation plan payouts in the current period.

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 three months ended July 25, 2014, we generated \$191.2 million from maturities and sales of investments, net of purchases, and paid \$58.4 million for capital expenditures, compared to \$390.0 million and \$65.3 million, respectively, in the corresponding period of the prior year.

Table of Contents*Cash Flows from Financing Activities*

During the three months ended July 25, 2014, we generated \$494.7 million, net, from the issuance of long-term debt and used \$118.9 million for the repurchase of 3.4 million shares of our common stock and \$53.4 million for the payment of dividends, compared to \$849.5 million used for the repurchase of common stock and \$51.4 million for the payment of dividends in the corresponding period of the prior year. In addition, we repaid \$1,264.9 million of our Convertible Debt in the prior year.

Liquidity

Our principal sources of liquidity as of July 25, 2014 consisted of cash, cash equivalents and short-term investments, as well as cash we expect to generate from operations.

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

	July 25, 2014	April 25, 2014
Cash and cash equivalents	\$ 3,031.6	\$ 2,291.0
Short-term investments	2,532.6	2,712.3
Total	\$ 5,564.2	\$ 5,003.3

As of July 25, 2014 and April 25, 2014, \$4.5 billion and \$4.3 billion, respectively, of cash, cash equivalents and short-term investments was held by various foreign subsidiaries and was generally based in U.S. dollar-denominated holdings, while \$1.1 billion and \$0.7 billion, respectively, was available in the United States. 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, state income and foreign withholding 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, the timing and amount of stock repurchases and payment of cash dividends, our ability to effectively integrate acquired products, businesses and technologies and the timing of repayments of our debt. Based on past performance and our current business outlook, we believe that our sources of liquidity, including potential future issuances of debt, equity or other securities, will satisfy our working capital needs, capital expenditures, investment requirements, stock repurchases, cash dividends, contractual obligations, commitments, principal and interest payments on our debt and other liquidity requirements associated with operations and meet our cash requirements for at least the next 12 months. However, in the event our liquidity is insufficient, we may be required to curtail spending and implement additional cost saving measures and restructuring actions or enter into new financing arrangements. We cannot be certain that we will continue to generate cash flows at or above current levels or that we will be able to obtain additional financing, if necessary, on satisfactory terms, if at all.

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. We utilize a variety of planning and financing strategies in an effort to ensure our worldwide cash is available when and where it is needed. Based on past performance and current expectations, we believe our cash and cash equivalents, investments, cash generated from operations, and ability to access capital markets and committed credit lines will satisfy, through at least the next 12 months, our liquidity requirements, both in total and domestically, including the following: working capital needs, capital expenditures, stock repurchases, cash dividends, contractual obligations, commitments, principal and interest payments on debt, and other liquidity requirements associated with our operations. We routinely monitor our financial exposure to both sovereign and non-sovereign borrowers and counterparties.

Table of Contents*Senior Notes*

The following table summarizes the principal amount of our Senior Notes as of July 25, 2014 (in millions):

2.00% Senior Notes Due 2017	\$ 750.0
3.375% Senior Notes Due 2021	500.0
3.25% Senior Notes Due 2022	250.0
 Total	 \$ 1,500.0

Interest on the Senior Notes is payable semi-annually. For further information on the underlying terms, see Note 7 of the accompanying condensed consolidated financial statements.

Credit Facility

Our credit facility, under which we may borrow up to \$250.0 million, provides another potential source of liquidity. The credit facility is an unsecured 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 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 July 25, 2014, no borrowings were outstanding under the facility and we were in compliance with all covenants associated with the facility.

We also have an automatic shelf registration statement on file with the SEC. We may in the future offer an additional unspecified amount of debt, equity and other securities.

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. Our capital expenditures were \$58.4 million during the three months ended July 25, 2014. We anticipate capital expenditures for the remainder of fiscal 2015 to be between \$125.0 million and \$175.0 million.

Dividends and Stock Repurchase Program

On August 13, 2014, we declared a cash dividend of \$0.165 per share of common stock, payable on October 22, 2014 to holders of record as of the close of business on October 10, 2014.

Our Board of Directors has authorized the repurchase of up to \$7.1 billion of our common stock under our stock repurchase program. 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 July 25, 2014, we repurchased a total of 187.7 million shares of our common stock at an average price of \$32.59 per share, for an aggregate purchase price of \$6.1 billion. As of July 25, 2014, the remaining authorized amount for stock repurchases under this program was \$1.0 billion with no termination date, which we plan to complete by May 2015.

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*

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

As of July 25, 2014, future annual minimum lease payments under non-cancelable operating leases with an initial term in excess of one year totaled \$213.6 million.

Table of Contents

Purchase Orders and Other Commitments

In the ordinary course of business we make commitments to our third-party contract manufacturers, to manage manufacturer lead times and meet product forecasts, and to other parties, to purchase various key components used in the manufacture of our products. 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 product forecasts are not achieved, our commitments and associated accruals may change. As of July 25, 2014, we had \$239.3 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 July 25, 2014 and April 25, 2014, such liability amounted to \$10.4 million and \$11.5 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 July 25, 2014, we had \$36.4 million in capital purchase commitments and \$180.2 million in other purchase commitments.

Unrecognized Tax Benefits

As of July 25, 2014, our liability for uncertain tax positions was \$202.7 million, including penalties, interest and indirect benefits. 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.

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 14 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 July 25, 2014, our financial guarantees of \$11.0 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 July 25, 2014, the maximum guaranteed payment contingencies under our financing arrangements totaled \$213.2 million and the related deferred revenue totaled \$196.8 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 July 25, 2014, we had debt investments of \$2.6 billion. Our investment portfolio primarily consists of investments with original maturities greater than three months at the date of purchase, 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 July 25, 2014 would have resulted in a decrease in the fair value of our fixed-income securities of approximately \$23 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 July 25, 2014, our holdings in these securities had a par value of \$26.9 million and an estimated fair value of \$26.4 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 July 25, 2014, we have outstanding \$1.5 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 7 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 July 25, 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 July 25, 2014 and April 25, 2014 (in millions):

	July 25, 2014	April 25, 2014
	Notional	Notional
	Contract	Contract
	Amount	Amount
Forward contracts sold	\$ 167.6	\$ 155.5
Forward contracts purchased	386.7	512.5

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 July 25, 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 first quarter of fiscal 2015 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.

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

Our industry and the markets in which we compete have historically experienced significant growth due to the increase in the demand for storage solutions by consumers, enterprises and government bodies around the world, and the resultant purchases of storage solutions to address this demand. However, despite continued data growth, the storage market did not experience growth in calendar year 2013 due to a combination of customers delaying purchases in the face of technology transitions, increased storage efficiency, and changing economic and business environments. Recent technology trends, such as the emergence of cloud storage, software as a service (SaaS) and flash storage and converged architectures are driving significant changes in storage architectures and solution requirements. The impact of these trends on both short-term and long-term growth patterns is uncertain. If the general historical rate of industry growth declines, if the growth rates of the specific market in which we compete decline, or if the consumption model of storage changes and our new and existing products and solutions do not receive customer acceptance, our business, operating results and financial condition could suffer.

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

The continuing global economic uncertainty and political and fiscal challenges in the United States (U.S.) and abroad due to the financial 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, and the timing and nature of any ultimate resolution of these matters remain highly uncertain. Additionally, budgetary constraints and shifts in government spending priorities have caused, and may in the future again cause, governments, including the U.S. government, to decrease purchases of storage equipment. 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 and to achieve historical levels of revenue growth.

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

Our operating results have fluctuated in the past and will continue to do so, sometimes materially. All of the matters discussed in this Risk 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 three months ended July 25, 2014, revenues generated from sales through our indirect channel accounted for 79% 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, operating results and financial condition 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.

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 is 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, operating results and financial condition.

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

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

The potential for binding price or purchase commitments with our suppliers 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

Such risks have in the past and could again in the future subject us to supply constraints, price increases and minimum purchase requirements and our business, operating results and financial condition could be harmed. The risks associated with our 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 mix 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 mix or decreased volume could harm our revenues, gross margins or earnings. Our gross margins are also impacted by the cost of any materials that are of poor quality and our sales and distribution activities, including, without limitation, pricing actions, rebates, sales initiatives and discount levels, and the timing of service contract renewals.

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

If we are unable to develop, introduce and gain market acceptance for clustered Data ONTAP-based products 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 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-Mode and potentially required by our customers, and maintaining service, support and customer relationships as we replace Data ONTAP 7-Mode with cDOT.

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.

Table of Contents

New or additional product introductions, including new software and flash product offerings, subject us to additional financial and operational risks, including our ability to forecast customer preferences or demand, our ability to expand production capacity to meet the demand for new products, our ability to successfully manage the transition from older products, and our ability to forecast the impact of customers' demand for new products or the products being replaced. In addition, as new or enhanced products are introduced, we must also avoid excessive levels of older product inventories and related components and ensure that enough supplies of new products can be delivered to meet customers' demands. Further risks inherent in new product introductions include the uncertainty of price-performance relative to products of competitors, competitors' responses to the introductions and the desire by customers to evaluate new products for extended periods of time. 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.

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

The storage and data management markets are intensely competitive and are characterized by rapidly changing technology and fragmentation. We compete with many companies in the markets we serve, including companies that offer a broad spectrum of IT products and services (full-stack vendors) and others that offer a more limited set of storage and data management products or services. Several key competitors have greater financial resources and offer a more diverse portfolio of products and services.

By extending our flash and software-defined storage offerings, we are competing in new segments with both traditional competitors and new competitors, particularly smaller emerging storage vendors. In cloud and converged infrastructure, we also compete with large well established competitors. The longer-term potential and competitiveness of these emerging vendors remains to be determined.

For information regarding our competitors, see the section entitled "Competition" contained in *Item 1. Business* of this report. It is possible that new competitors or alliances among competitors might emerge and rapidly acquire significant market share.

An increase in industry consolidation might result in stronger competitors that are better able to compete as sole-source vendors for customers. In addition, current and potential competitors have established or might establish cooperative relationships among themselves or with third parties, including some of our partners.

Our OEM relationships may not generate significant revenues.

We have OEM relationships with several companies, which collectively accounted for 9% of our net revenues during the three months ended July 25, 2014, compared to 11% during the corresponding period of the prior year. 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 and our total revenues may decline. 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.

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 three months ended July 25, 2014, sales to distributors Arrow Electronics, Inc. and Avnet, Inc. accounted for 22% 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.

Table of Contents

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

The U.S. government is an important customer for us. However, government demand is uncertain, as it is subject to political and budgetary fluctuations and constraints. 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, and has recently resulted in lower sales to these customers. 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 business, operating results and financial condition.

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, operating results and financial condition.

Due to the global nature of our business, we are subject to import and export restrictions and regulations, including the Export Administration Regulations administered by the Commerce Department's Bureau of Industry and Security (BIS) and the trade and economic sanctions regulations administered by the Treasury Department's Office of Foreign Assets Control (OFAC). The U.S., through the BIS and OFAC, places restrictions on the sale or export of certain products and services to certain countries and persons. Violators of these export control and sanctions laws may be subject to significant penalties, which may include significant monetary fines, criminal proceedings against them and their officers and employees, a denial of export privileges, and suspension or debarment from selling products to the federal government. 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 asserted that certain of our products were delivered to Syria through a third-party possibly in violation of U.S. export-control laws. Following these media reports, we met with U.S. government officials, provided information at their request, and expressed our willingness to continue cooperating with any further inquiry or investigation. In April 2014, we were notified by the U.S. government that it had completed its review of the matter and determined that we did not violate the U.S. export laws and that the government had closed its inquiry into the matter. However, if in the future we are ever found to have violated U.S. export control laws, we may be subject to various penalties available under the laws, any of which could have a material and adverse impact on our business, operating results and financial condition. As in the case of the media reports regarding Syria described above, 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 expense and reputational harm and distract senior executives from managing our normal day-to-day operations. Such collateral consequences could have a material adverse impact on our business, operating results and financial condition.

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

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

Table of Contents

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

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. Quality issues have and could again in the future cause customers to experience outages or disruptions in service, data loss or data corruption. If we fail to remedy a product defect, we may experience a failure of a product line, temporary or permanent withdrawal from a product or market, damage to our reputation, loss of revenue, inventory costs or product reengineering expenses and higher ongoing warranty and service costs, and these occurrences could have a material impact on our gross margins, business and operating results. Customers and we may experience losses that may result from or are alleged to result from defects in our products, which could subject us to claims for damages, including consequential damages.

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 three months ended July 25, 2014, our international revenues accounted for 50% 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 condition.

We face exposure to adverse movements in foreign currency exchange rates as a result of our international operations. These exposures may change over time as business practices evolve, and they could have a material adverse impact on our financial results and cash flows. We utilize forward and option contracts in an attempt to reduce the adverse earnings impact from the effect of exchange rate fluctuations on certain assets and liabilities 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.

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, operating results and financial condition.

Table of Contents

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

Our effective tax rate is influenced by a variety of factors, many of which are outside of our control. These factors include among other things, fluctuations in our earnings and financial results in the various countries and states in which we do business, the outcome of income tax audits and changes to the tax laws in such jurisdictions. 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 11 to our consolidated financial statements. The U.S. and foreign tax authorities have questioned our intercompany transfer pricing arrangements during these audits. In recent years, several other U.S. companies have had their transfer pricing 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 audits being conducted in any other tax jurisdiction results in an amount in excess of the tax provision we have recorded or reserved for, our operating results, cash flows and financial condition would be adversely affected. In July 2014, the IRS completed the examination of our fiscal 2005 to 2007 income tax returns upon approval by the Joint Committee of Taxation. We recorded a \$47.4 million tax provision attributable to the audit closure and related re-measurement of uncertain tax positions for tax years subject to future audits.

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.

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

Our acquisitions may not achieve expected benefits, and may 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 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 the 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.

Table of Contents

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

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 non-recourse financing leasing arrangements using third-party leasing companies. Under the terms of recourse leases, which are generally three years or less, we remain liable for the aggregate unpaid remaining lease payments to the third-party leasing companies in the event of end-user customer default.

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 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.

A repatriation of cash held by our foreign subsidiaries to fund U.S. operations, strategic opportunities or debt service may subject us to a significant tax liability.

As of July 25, 2014, \$4.5 billion of cash, cash equivalents and short-term investments was held by our foreign subsidiaries. Under current law, repatriation of this cash may 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, operating results and financial condition will be harmed. Moreover, covenants associated with our Senior Notes may unduly restrict our business.

We have Senior Notes outstanding as of July 25, 2014 in an aggregate principal amount of \$1.5 billion that mature at specific dates in calendar 2017, 2021 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 July 25, 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, operating results 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 have in the past and may in the future incur restructuring charges and asset impairment in response to changing market conditions or cost-cutting initiatives.

We have in the past undertaken cost savings initiatives in response to changes in market conditions and market demand for our products. For example, in May 2013 and March 2014 we executed restructuring events designed to focus our resources on key strategic initiatives and streamline our business in light of the constrained IT spending environment. As a result, we recognized substantial restructuring expenses. We may in the future undertake initiatives that 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. In addition to the costs associated with these activities, we may not realize any of the anticipated benefits of the underlying restructuring activities.

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

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

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

Our continued success depends, in part, on our ability to hire and retain qualified personnel and to preserve the key aspects of our corporate culture. Because our future success is dependent on our ability to continue to enhance and introduce new products, we are particularly dependent on our ability to hire and retain qualified engineers. 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.

Table of Contents

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, operating results 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 condition.

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

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 markets will increasingly be subject to infringement claims as the number of products and competitors in our industry segment grows and the functionality of products in different industry segments overlaps. Any such claims could be time consuming, result in costly litigation, cause product shipment delays, require us to redesign our products, or require us to enter into royalty or licensing agreements, any of which could materially and adversely affect our operating results. Such royalty or licensing agreements, if required, may not be available on terms acceptable to us or at all.

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.

Table of Contents

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

We store and transmit sensitive and proprietary data related to our employees, customers, clients and partners (including third-party vendors such as data centers and providers of SaaS, cloud computing, and Internet infrastructure and bandwidth), and their respective customers, including intellectual property, books of record and personally identifiable information. In the current environment there are numerous and evolving risks to cybersecurity and privacy, including criminal hackers, state-sponsored intrusions, industrial espionage, human error and technological vulnerabilities. Cybersecurity incidents or other security breaches could result in 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 and public perception of the security and reliability of our products. 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.

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 customer confidence in the effectiveness of our data security measures, negatively impact our ability to attract new customers, cause existing customers to elect not to renew their support contracts, or 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, operating results and financial condition.

Table of Contents

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

A change in accounting standards or practices and varying interpretations of existing accounting pronouncements, the increased use of fair value measures, changes to revenue recognition, lease accounting, financial instruments and other accounting standards could have a significant effect on our reported financial results or the way we conduct our business.

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

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.*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 July 25, 2014:

Period	Total Number of Shares Purchased (Shares in thousands)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program ⁽¹⁾ (Shares in thousands)	Approximate Dollar Value
				of Shares That May Yet Be Purchased Under The Repurchase Program ⁽¹⁾ (Dollars in millions)
April 26, 2014 – May 23, 2014	3,413	\$ 34.82	187,738	\$ 1,005.9
May 24, 2014 – June 20, 2014		\$	187,738	1,005.9
June 21, 2014 – July 25, 2014		\$	187,738	1,005.9
Total	3,413	\$ 34.82		

⁽¹⁾ As of July 25, 2014, our Board of Directors had authorized the repurchase of up to \$7.1 billion of our common stock under a stock repurchase program. Since the May 13, 2003 inception of this program through July 25, 2014, we repurchased a total of 187.7 million shares of our common stock at an average price of \$32.59 per share, for an aggregate purchase price of \$6.1 billion. As of July 25, 2014, the remaining authorized amount for stock repurchases under this program was \$1.0 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, Finance and Operations and
Chief Financial Officer

Dated: August 28, 2014

Table of Contents**EXHIBIT INDEX**

Exhibit		Incorporation by Reference			
		No	Description	Form	File No.
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
4.1	Underwriting Agreement dated June 2, 2014 by and between the Company and Goldman, Sachs & Co. and J.P. Morgan Securities LLC as Managers of the Underwriters.	8-K	000-27130	1.1	June 5, 2014
4.2	Second Supplemental Indenture dated June 5, 2014 by and between the Company and U.S. Bank National Association.	8-K	000-27130	4.1	June 5, 2014
10.1	Form of Indemnification Agreement by and between the Company and each of its current and future directors and certain executive officers.				
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				