NetApp, Inc.
Form 10-Q
September 03, 2008

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

# Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the quarterly period ended July 25, 2008**

**OR**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the transition period from to**

**Commission file number 0-27130**

**NetApp, Inc.**
*(Exact name of registrant as specified in its charter)*

| | |
|---|---|
| **Delaware** | **77-0307520** |
| *(State or other jurisdiction of incorporation or organization)* | *(IRS Employer Identification No.)* |

**495 East Java Drive,**
**Sunnyvale, California 94089**
*(Address of principal executive offices, including zip code)*

**Registrant s telephone number, including area code:**
**(408) 822-6000**

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

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

Large accelerated filer þ Accelerated filer o

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

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

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

| **Class** | **Outstanding at August 29, 2008** |
|---|---|
| Common Stock | 327,393,447 |

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## TRADEMARKS

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## PART I. FINANCIAL INFORMATION

**Item 1.** ***Condensed Consolidated Financial Statements (Unaudited)***

**NETAPP, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**
**(In thousands, except per share amounts - Unaudited)**

| | July 25, 2008 | April 25, 2008 |
|---|---|---|
| **ASSETS** | | |
| **Current Assets:** | | |
| Cash and cash equivalents | $ 1,702,395 | $ 936,479 |
| Short-term investments | 419,256 | 227,911 |
| Accounts receivable, net of allowances of $2,409 at July 25, 2008, and $2,439 at April 25, 2008 | 432,510 | 582,110 |
| Inventories | 63,477 | 70,222 |
| Prepaid expenses and other assets | 118,148 | 120,561 |
| Short-term restricted cash and investments | 2,857 | 2,953 |
| Short-term deferred income taxes | 126,250 | 127,197 |
| Total current assets | 2,864,893 | 2,067,433 |
| **Property and Equipment, Net** | 720,661 | 693,792 |
| **Goodwill** | 680,054 | 680,054 |
| **Intangible Assets, Net** | 81,722 | 90,075 |
| **Long-Term Investments and Restricted Cash** | 285,007 | 331,105 |
| **Long-Term Deferred Income Taxes and Other Assets** | 350,224 | 208,529 |
| | $ 4,982,561 | $ 4,070,988 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| **Current Liabilities:** | | |
| Accounts payable | $ 146,158 | $ 178,233 |
| Income taxes payable | 3,815 | 6,245 |
| Accrued compensation and related benefits | 148,823 | 202,929 |
| Other accrued liabilities | 141,479 | 154,331 |
| Deferred revenue | 914,033 | 872,364 |
| Total current liabilities | 1,354,308 | 1,414,102 |
| **Revolving Credit Facilities** | 130,765 | 172,600 |
| **1.75% Convertible Senior Notes Due 2013** | 1,265,000 | |
| **Other Long-Term Obligations** | 145,694 | 146,058 |
| **Long-Term Deferred Revenue** | 650,797 | 637,889 |

| | | |
|---|---|---|
| | 3,546,564 | 2,370,649 |
| **Commitments and Contingencies (Note 13)** | | |
| **Stockholders Equity:** | | |
| Common stock (431,289 shares issued at July 25, 2008, and 429,080 shares issued at April 25, 2008) | 431 | 429 |
| Additional paid-in capital | 2,790,579 | 2,690,629 |
| Treasury stock at cost (104,325 shares at July 25, 2008, and 87,365 shares at April 25, 2008) | (2,927,376) | (2,527,395) |
| Retained earnings | 1,573,575 | 1,535,903 |
| Accumulated other comprehensive income | (1,212) | 773 |
| Total stockholders equity | 1,435,997 | 1,700,339 |
| | $ 4,982,561 | $ 4,070,988 |

See accompanying notes to unaudited condensed consolidated financial statements.

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**NETAPP, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**
**(In thousands, except per share amounts - Unaudited)**

| | Three Months Ended July 25, 2008 | Three Months Ended July 27, 2007 |
|---|---|---|
| **Revenues:** | | |
| Product | $ 547,855 | $ 463,333 |
| Software entitlements and maintenance | 144,412 | 107,927 |
| Service | 176,509 | 117,975 |
| Total revenues | 868,776 | 689,235 |
| **Cost of Revenues:** | | |
| Cost of product | 249,778 | 192,447 |
| Cost of software entitlements and maintenance | 2,186 | 2,084 |
| Cost of service | 100,164 | 77,507 |
| Total cost of revenues | 352,128 | 272,038 |
| Gross margin | 516,648 | 417,197 |
| **Operating Expenses:** | | |
| Sales and marketing | 303,108 | 244,643 |
| Research and development | 125,352 | 106,556 |
| General and administrative | 49,463 | 41,450 |
| Total operating expenses | 477,923 | 392,649 |
| **Income from Operations** | 38,725 | 24,548 |
| **Other Income (Expenses), Net:** | | |
| Interest income | 15,476 | 17,035 |
| Interest expense | (4,575) | (1,081) |
| Net loss on investments | (2,621) | |
| Other income (expense), net | (1,989) | 832 |
| Total other income, net | 6,291 | 16,786 |
| **Income Before Income Taxes** | 45,016 | 41,334 |
| **Provision for Income Taxes** | 7,344 | 6,997 |
| **Net Income** | $ 37,672 | $ 34,337 |
| **Net Income per Share:** | | |
| Basic | $ 0.11 | $ 0.09 |

| | | |
|---|---|---|
| Diluted | $ 0.11 | $ 0.09 |
| **Shares Used in Net Income per Share Calculations:** | | |
| Basic | 333,855 | 364,457 |
| Diluted | 341,120 | 377,631 |

See accompanying notes to unaudited condensed consolidated financial statements.

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## NETAPP, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
**(In thousands Unaudited)**

| | Three Months Ended July 25, 2008 | Three Months Ended July 27, 2007 |
|---|---|---|
| | (In thousands) | |
| **Cash Flows from Operating Activities:** | | |
| Net income | $ 37,672 | $ 34,337 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 33,197 | 26,734 |
| Amortization of intangible assets and patents | 8,352 | 6,893 |
| Stock-based compensation | 36,405 | 40,411 |
| Net loss on investments | 2,621 | |
| Net loss on disposal of equipment | 179 | 117 |
| Allowance for doubtful accounts | (36) | 84 |
| Deferred income taxes | (9,128) | (22,692) |
| Deferred rent | 827 | 399 |
| Income tax benefit from stock-based compensation | 19,717 | 10,789 |
| Excess tax benefit from stock-based compensation | (10,142) | (8,339) |
| Changes in assets and liabilities: | | |
| Accounts receivable | 150,291 | 144,997 |
| Inventories | 6,742 | (3,145) |
| Prepaid expenses and other assets | 10,132 | 15,683 |
| Accounts payable | (30,073) | (14,082) |
| Income taxes payable | (2,393) | (47,707) |
| Accrued compensation and related benefits | (54,439) | (69,889) |
| Other accrued liabilities | (1,403) | (20,128) |
| Other liabilities | (1,220) | 59,889 |
| Deferred revenue | 52,894 | 46,548 |
| Net cash provided by operating activities | 250,195 | 200,899 |
| **Cash Flows from Investing Activities:** | | |
| Purchases of investments | (264,938) | (328,893) |
| Redemptions of investments | 107,932 | 461,952 |
| Change in restricted cash | 225 | (1,767) |
| Purchases of property and equipment | (76,613) | (33,586) |
| Purchases of nonmarketable securities | (125) | (4,035) |
| Net cash (used in) provided by investing activities | (233,519) | 93,671 |
| **Cash Flows from Financing Activities:** | | |
| Proceeds from sale of common stock related to employee stock transactions | 35,528 | 49,991 |
| Tax withholding payments reimbursed by restricted stock | (2,554) | (2,742) |

| | | |
|---|---|---|
| Excess tax benefit from stock-based compensation | 10,142 | 8,339 |
| Proceeds from issuance of convertible notes | 1,265,000 | |
| Payment of financing costs | (25,445) | |
| Sale of common stock warrants | 163,059 | |
| Purchase of note hedge | (254,898) | |
| Repayment of debt | | (15,960) |
| Repayment of revolving credit facility | (41,835) | |
| Repurchases of common stock | (399,982) | (200,000) |
| Net cash provided by (used in) financing activities | 749,015 | (160,372) |
| **Effect of Exchange Rate Changes on Cash and Cash Equivalents** | 225 | 713 |
| **Net Increase in Cash and Cash Equivalents** | 765,916 | 134,911 |
| **Cash and Cash Equivalents:** | | |
| Beginning of period | 936,479 | 489,079 |
| End of period | $ 1,702,395 | $ 623,990 |
| **Noncash Investing and Financing Activities:** | | |
| Acquisition of property and equipment on account | $ 10,801 | $ 18,864 |
| **Supplemental Cash Flow Information:** | | |
| Income taxes paid | $ 6,491 | $ 6,376 |
| Income taxes refunded | $ 6,322 | $ 3 |
| Interest paid on debt | $ 1,053 | $ 1,075 |

See accompanying notes to unaudited condensed consolidated financial statements.

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**NETAPP, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**(In thousands, except per share data, Unaudited)**

## 1. The Company

Based in Sunnyvale, California, NetApp, Inc. ( we or the Company ) was incorporated in California in April 1992 and reincorporated in Delaware in November 2001; in March 2008, the Company changed its name from Network Appliance, Inc. to NetApp, Inc. The Company is a supplier of enterprise storage and data management software and hardware products and services. Our solutions help global enterprises meet major information technology challenges such as managing storage growth, assuring secure and timely information access, protecting data and controlling costs by providing innovative solutions that simplify the complexity associated with managing corporate data.

## 2. Condensed Consolidated Financial Statements

The accompanying interim unaudited condensed consolidated financial statements have been prepared by NetApp, Inc. without audit and reflect all adjustments, consisting only of normal recurring adjustments which are, in the opinion of management, necessary for a fair presentation of our financial position, results of operations, and cash flows for the interim periods presented. The statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( generally accepted accounting principles ) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10-01 of Regulation S-X. Accordingly, they do not include all information and footnotes required by generally accepted accounting principles for annual consolidated financial statements. These financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the fiscal year ended April 25, 2008. The results of operations for the quarter ended July 25, 2008 are not necessarily indicative of the operating results to be expected for the full fiscal year or future operating periods.

In the first quarter of fiscal 2009, we implemented a change in the reporting format for warranty costs and reported these costs in cost of product revenues. These costs were included in cost of service revenues in previous periods. This change had no effect on the reported amounts of total costs of revenues, total gross margin, net income or cash flow from operations for any periods presented. Our Condensed Consolidated Statement of Income for the three months ended July 27, 2007 reflects a reclassification of $5,696 to conform to current period presentation.

During the quarter ended July 25, 2008, two U.S. distributors each accounted for ten percent of the company s revenues. No customers accounted for ten percent of the company s revenues during the quarter ended July 27, 2007.

We operate on a 52-week or 53-week fiscal year ending on the last Friday in April. The first three months of fiscal 2009 and 2008 were both 13-week or 91-day periods.

## 3. Use of Estimates

The preparation of the condensed consolidated financial statements is in conformity with generally accepted accounting principles and 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 condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates

NETAPP, INC.

NOTES TO UNAUDITED CONDENSED
CONSOLIDATED FINANCIAL STATEMENTS (Continued)

include, but are not limited to, revenue recognition and allowances; allowance for doubtful accounts; valuation of goodwill and intangibles; fair value of derivative instruments and related hedged items; accounting for income taxes; inventory valuation and contractual commitments; restructuring accruals; impairment losses on investments; fair value of options granted under our stock-based compensation plans; and loss contingencies. Actual results could differ from those estimates.

## 4. Stock-Based Compensation, Equity Incentive Programs and Stockholders Equity

### *Stock-Based Compensation Expense*

The stock-based compensation expense included in the Condensed Consolidated Statements of Income for the quarters ended July 25, 2008 and July 27, 2007 was as follows:

| | Three Months Ended | |
|---|---|---|
| | July 25, 2008 | July 27, 2007 |
| Cost of product revenues | $ 948 | $ 945 |
| Cost of service revenues | 3,041 | 2,671 |
| Sales and marketing | 16,342 | 17,491 |
| Research and development | 10,188 | 13,175 |
| General and administrative | 5,886 | 6,129 |
| Total stock-based compensation expense before income taxes | 36,405 | 40,411 |
| Income taxes | (7,006) | (7,282) |
| Total stock-based compensation expense after income taxes | $ 29,399 | $ 33,129 |

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

| | Three Months Ended | |
|---|---|---|
| | July 25, 2008 | July 27, 2007 |
| Employee stock options and awards | $ 31,021 | $ 36,529 |
| Employee stock purchase plan ( ESPP ) | 5,381 | 3,876 |
| Change in amounts capitalized in inventory | 3 | 6 |
| Total stock-based compensation expense before income taxes | 36,405 | 40,411 |
| Income taxes | (7,006) | (7,282) |

| | | |
|---|---|---|
| Total stock-based compensation expense after income taxes | $ 29,399 | $ 33,129 |

**NETAPP, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Valuation Assumptions***

We estimated the fair value of stock options using the Black-Scholes model on the date of the grant. Assumptions used in the Black-Scholes valuation model were as follows:

| | Stock Options Three Months Ended | | ESPP Three Months Ended | |
|---|---|---|---|---|
| | July 25, 2008 | July 27, 2007 | July 25, 2008 | July 27, 2007 |
| Expected life in years(1) | 4.0 | 4.0 | 1.3 | 0.5 |
| Risk-free interest rate(2) | 2.93% - 3.69% | 4.33% - 5.02% | 2.05% - 2.52% | 4.95% |
| Volatility(3) | 38% - 44% | 33% - 38% | 39% - 41% | 35% |
| Expected dividend(4) | 0% | 0% | 0% | 0% |

(1) The 4.0 years expected life of the options represents the estimated period of time until exercise and is based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. The expected life for the employee stock purchase plan was based on the term of the purchase period.

(2) The risk-free interest rate for the stock option awards was based upon United States ( U.S. ) Treasury bills with equivalent expected terms. The risk-free interest rate for the employee stock purchase plan was based on the U.S. Treasury bills in effect at the time of grant for the expected term of the purchase period.

(3) We used the implied volatility of traded options to estimate our stock price volatility.

(4) The expected dividend was determined based on our history and expected dividend payouts.

We estimate our forfeiture rates based on historical voluntary termination behavior and recognize compensation expense only for those equity awards expected to vest.

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NETAPP, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

*Stock Options*

A summary of the combined activity under our stock option plans and agreements is as follows:

| | Shares Available for Grant | Outstanding Options Numbers of Shares | Outstanding Options Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|---|---|---|---|---|---|
| Outstanding at April 25, 2008 | 19,642 | 70,168 | $ 28.08 | | |
| Options granted | (2,739) | 2,739 | $ 24.10 | | |
| Restricted stock units granted | (556) | 556 | $ | | |
| Options exercised | | (785) | $ 12.08 | | |
| Restricted stock units vested | | (279) | $ | | |
| Options forfeitures and cancellation | 881 | (881) | $ 34.81 | | |
| Restricted stock units forfeitures and cancellation | 48 | (48) | $ | | |
| Options expired | (87) | | $ | | |
| Outstanding at July 25, 2008 | 17,189 | 71,470 | $ 27.93 | | |
| Options vested and expected to vest as of July 25, 2008 | | 64,230 | $ 29.96 | 4.89 | $ 172,951 |
| Exercisable at July 25, 2008 | | 44,234 | $ 30.22 | 4.28 | $ 157,474 |
| RSUs vested and expected to vest as of July 25, 2008 | | 4,159 | $ | 2.01 | $ 102,302 |
| Exercisable at July 25, 2008 | | | $ | | $ |

The intrinsic value of stock options represents the difference between the exercise price of stock options and the market price of our stock on that day for all in-the-money options. The weighted-average fair value of options granted during the quarters ended July 25, 2008 and July 27, 2007 was $8.44 and $10.76, respectively. The total intrinsic value of options exercised was $9,717 and $32,619 for the quarters ended July 25, 2008 and July 27, 2007, respectively. We received $9,478, and $26,395 from the exercise of stock options for the quarters ended July 25, 2008 and July 27, 2007, respectively. There was $310,155 of total unrecognized compensation expense as of July 25, 2008 related to options and restricted stock units. The unrecognized compensation expense will be amortized on a straight-line basis over a weighted-average remaining period of 2.6 years.

The following table summarizes our nonvested shares (restricted stock awards) as of July 25, 2008:

| | Number of Shares | Weighted-Average Grant-Date Fair Value |
|---|---|---|
| Nonvested at April 25, 2008 | 145 | $ 35.40 |
| Awards granted | | |
| Awards vested | (16) | $ 28.08 |
| Awards canceled/expired/forfeited | (3) | 31.16 |
| Nonvested at July 25, 2008 | 126 | $ 36.41 |

Although nonvested shares are legally issued, they are considered contingently returnable shares subject to repurchase by the Company when employees terminate their employment. The total fair value of shares vested during the quarters ended July 25, 2008 and July 27, 2007 was $390 and $585, respectively. There was $4,231 of

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NETAPP, INC.

NOTES TO UNAUDITED CONDENSED
CONSOLIDATED FINANCIAL STATEMENTS (Continued)

total unrecognized compensation expense as of July 25, 2008 related to restricted stock awards. The unrecognized compensation expense will be amortized on a straight-line basis over a weighted-average remaining period of 2.1 years.

*Employee Stock Purchase Plan*

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at July 25, 2008 | 5,765 | $ 20.23 | 1.09 | $ 25,221 |
| Vested and expected to vest at July 25, 2008 | 5,357 | $ 20.23 | 1.07 | $ 23,431 |

The total intrinsic value of employee stock purchases was $4,597 and $5,044 for the quarters ended July 25, 2008 and July 27, 2007, respectively. The compensation cost for shares purchased under the ESPP plan was $5,381 and $3,876 for the quarters ended July 25, 2008 and July 27, 2007, respectively.

The following table shows the shares issued and their purchase price per share for the employee stock purchase plan for the six-month ESPP purchase period ended May 30, 2008:

| | |
|---|---|
| Purchase date | May 30, 2008 |
| Shares issued | 1,257 |
| Average purchase price per share | $ 20.72 |

*Stock Repurchase Program*

Common stock repurchase activities for the three-month periods ended July 25, 2008 and July 27, 2007, were as follows:

| | Three Months Ended July 25, 2008 | July 27, 2007 |
|---|---|---|
| Common stock repurchased | 16,960 | 6,522 |
| Cost of common stock repurchased | $ 399,982 | $ 200,000 |
| Average price per share | $ 23.58 | $ 30.67 |

Since the inception of the stock repurchase program on May 13, 2003 through July 25, 2008, we have purchased a total of 104,325 shares of our common stock at an average price of $28.06 per share for an aggregate purchase price of $2,927,376. At July 25, 2008, $96,262 remained available for repurchases under the plan. The stock repurchase program may be suspended or discontinued at any time.

On August 13, 2008, our board of directors approved a new stock repurchase program in which up to an additional $1,000,000 worth of our outstanding common stock may be purchased, see Note 16. Subsequent Events.

***Other Repurchases of Common Stock***

We also repurchase shares in settlement of employee tax withholding obligations due upon the vesting of restricted stock or stock units. During the first quarter of fiscal 2009 and fiscal 2008, we withheld 109 shares and 74 shares, respectively, in connection with the vesting of employees restricted stock.

NETAPP, INC.

NOTES TO UNAUDITED CONDENSED
CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 5. Convertible Notes and Credit Facilities

***1.75% Convertible Senior Notes Due 2013***

*Principal Amount* On June 10, 2008, we issued $1,265,000 aggregate principal amount of 1.75% Convertible Senior Notes due 2013 (the Notes ) to initial purchasers who resold the Notes to qualified institutional buyers as defined in Rule 144A under the Securities Act of 1933, as amended. The net proceeds from the offering, after deducting the initial purchasers issue costs and offering expenses of $26,570, were $1,238,430. We used (i) $273,644 of the net proceeds to purchase 11,600 shares of our common stock in negotiated transactions with institutional investors and (ii) $254,898 of the net proceeds to enter into the note hedge transactions described below.

*Ranking and Interest* The Notes are unsecured, unsubordinated obligations of NetApp. We will incur interest expense of 1.75% per annum on the outstanding principal amount of the Notes. During the first quarter of fiscal 2009, we recorded interest expense of $2,829. Interest will be payable in arrears on June 1 and December 1 of each year, beginning on December 1, 2008, in cash at a rate of 1.75% per annum. We capitalized issuance costs related to the Notes of $26,570 in long-term other assets, and these amounts are being amortized as interest expense over the term of the Notes using the effective interest method. During the first quarter of fiscal 2009, $629 of the capitalized debt issuance costs was amortized as interest expense.

*Maturity* The Notes will mature on June 1, 2013 unless repurchased or converted earlier in accordance with their terms prior to such date. As of July 25, 2008, the Notes are classified as a non-current liability.

*Redemption* The Notes are not redeemable by us prior to the maturity date, but the holders may require us to repurchase the Notes following a fundamental change (as defined in the Indenture). A fundamental change will be deemed to have occurred upon a change of control, liquidation or a termination of trading. Holders of the Notes who convert their Notes in connection with a fundamental change will, under certain circumstances, be entitled to a make-whole premium in the form of an increase in the conversion rate. Additionally, in the event of a fundamental change, holders of the Notes may require us to repurchase all or a portion of their Notes at a repurchase price equal to 100% of the principal amount of Notes, plus accrued and unpaid interest, if any, to, but not including, the fundamental change repurchase date.

*Conversion* Holders of the Notes may convert their Notes on or after March 1, 2013 until the close of business on the scheduled trading day immediately preceding the maturity date. The conversion rate will be subject to adjustment in some events but will not be adjusted for accrued interest. Upon conversion, we will satisfy our conversion obligation by delivering cash and shares of Common Stock, if any, based on a daily settlement amount. Prior to March 1, 2013, holders of the Notes may convert their Notes, under any of the following conditions:

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

- during any calendar quarter beginning after June 30, 2008 (and only during such calendar quarter), if the last reported sale price of Common Stock for 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the applicable conversion price in effect for the Notes on the last trading day of such immediately preceding calendar quarter; or

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

The Notes are convertible into the right to receive cash in an amount up to the principal amount and shares of our common stock for the conversion value in excess of the principal amount, if any, at an initial conversion rate of

**NETAPP, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

31.4006 shares of common stock per one thousand principal amount of Notes, subject to adjustment as described in the indenture governing the Notes, which represents an initial conversion price of $31.85 per share.

***Note Hedges and Warrants***

Concurrent with the issuance of the Notes, we entered into note hedge transactions (the Note Hedges ) with certain financial institutions, which are designed to mitigate potential dilution from the conversion of the Notes in the event that the market value per share of our common stock at the time of exercise is greater than $31.85 per share, subject to adjustments. The Note Hedges generally cover, subject to anti-dilution adjustments, the net shares of our common stock that would be deliverable to converting Noteholders in the event of a conversion of the Notes. The Note Hedges expire at the earlier of (i) the last day on which any Notes remain outstanding and (ii) the scheduled trading day immediately preceding the maturity date of the Notes. We also entered into separate warrant transactions whereby we sold to the same financial institutions warrants (the Warrants ) to acquire, subject to anti-dilution adjustments, 39,700 shares of our common stock at an exercise price of $41.28 per share, subject to adjustment, on a series of days commencing on September 3, 2013. Upon exercise of the Warrants, we have the option to deliver cash or shares of our common stock equal to the difference between the then market price and the strike price of the Warrants. As of July 25, 2008, we had not received any shares related to the Note Hedges or delivered cash or shares related to the Warrants.

If the market value per share of our common stock at the time of conversion of the Notes is above the strike price of the Note Hedges, the Note Hedges will generally entitle us to receive net shares of our common stock (and cash for any fractional share amount) based on the excess of the then current market price of our common stock over the strike price of the Note Hedges, which is designed to offset any shares that we may have to deliver to the Noteholders. Additionally, at the time of exercise of the Warrants, if the market price of our common stock exceeds the strike price of the Warrants, we will owe the option counterparties net shares of our common stock (and cash for any fractional share amount) or cash in an amount based on the excess of the then current market price of our common stock over the strike price of the Warrants.

The cost of the Note Hedges was $254,898, or $152,200 net of deferred tax benefits, and has been accounted for as an equity transaction in accordance with Emerging Issues Task Force ( EITF ) No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock* (EITF No. 00- 19). We received proceeds of $163,059 related to the sale of the Warrants, which has also been classified as equity because the instruments meet all of the equity classification criteria within EITF No. 00-19.

*Income tax reporting on the Note Hedges* For income tax reporting purposes, we have elected to integrate in the value of the Notes a proportional amount of the Note Hedges. This creates an original issue discount (OID) debt instrument for income tax reporting purposes, and, therefore, the cost of the Note Hedges will be accounted for as interest expense over the term of the Notes for income tax reporting purposes. The associated income tax benefit of $102,698 established upon issuance of the Notes will be realized for income tax reporting purposes over the term of the Notes and was recorded as an increase to both non-current deferred tax assets and additional paid-in-capital. Over the term of the Notes, the additional interest expense deducted for income tax purposes will reduce both the non-current deferred tax asset and additional paid-in-capital established upon their issuance. During the first quarter of fiscal 2009, tax benefits of $2,201 associated with the additional interest deductions was accounted for as a reduction to both non-current deferred tax assets and additional paid-in-capital.

*Earnings per share impact on the Notes, Note Hedges and Warrants* In accordance with Statement of Financial Accounting Standard ( SFAS ) No. 128, the Notes will have no impact on diluted earnings per share until the price of our common stock exceeds the conversion price (initially $31.85 per share) because the principal amount of the Notes will be settled in cash upon conversion. Prior to conversion of the Notes, we will include the effect of the additional shares that may be issued if our common stock price exceeds the conversion price, using the treasury stock method. The Note Hedges are not included for purposes of calculating earnings per share, as their

**NETAPP, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

effect would be anti-dilutive. Upon conversion of the Notes, the Note Hedges are designed to neutralize the dilutive effect of the Notes when the stock price is above $31.85 per share. Also, in accordance with SFAS No. 128, the Warrants will have no impact on earnings per share until our common stock share price exceeds $41.28. Prior to exercise, we will include the effect of additional shares that may be issued if our common stock price exceeds the conversion price, using the treasury stock method.

*Recently issued accounting pronouncements* The Financial Accounting Standard Board ( FASB ) recently issued FASB Staff Position ( FSP ) No. APB 14-1 *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlements)* . Under the FSP, cash settled convertible securities will be separated into their debt and equity components. This change in methodology will adversely affect the calculations of our net income and earnings per share. We will be required to adopt this FSP in our first quarter of fiscal 2010. This final FSP will be applied retrospectively to all periods presented. See Note 15 for further discussion.

***Unsecured Credit Agreement***

On November 2, 2007, we entered into a senior unsecured credit agreement (the Unsecured Credit Agreement ) with certain lenders and BNP Paribas ( BNP ), as syndication agent, and JPMorgan Chase Bank National Association ( JPMorgan ), as administrative agent. The Unsecured Credit Agreement provides for a revolving unsecured credit facility that is comprised of commitments from various lenders who agree to make revolving loans and swingline loans and issue letters of credit of up to an aggregate amount of $250,000 with a term of five years. Revolving loans may be, at our option, Alternative Base Rate borrowings or Eurodollar borrowings. Interest on Eurodollar borrowings accrues at a floating rate based on LIBOR for the interest period specified by us plus a spread based on our leverage ratio. Interest on Alternative Base Rate borrowings, swingline loans and letters of credit accrues at a rate based on the Prime Rate in effect on such day. The proceeds of the loans may be used for our general corporate purposes, including stock repurchases and working capital needs. As of July 25, 2008, no amount was outstanding under this facility. The amounts allocated under the Unsecured Credit Agreement to support certain of our outstanding letters of credit amounted to $450 as of July 25, 2008.

***Secured Credit Agreement***

On October 5, 2007, we entered into a secured credit agreement with JPMorgan Securities (the Secured Credit Agreement ). The Secured Credit Agreement provides for a revolving secured credit facility of up to $250,000 with a term of five years. During the quarter ended July 25, 2008, we made repayments of $41,835 on the Secured Credit Agreement. As of July 25, 2008 and April 25, 2008, the outstanding balance on the Secured Credit Agreement was $130,765 and $172,600, respectively, and was recorded in the Revolving Credit Facilities in the accompanying Condensed Consolidated Balance Sheets. The full amount is due on the maturity date of October 5, 2012. As of July 25, 2008, we have pledged $199,961 of long-term restricted investments in connection with the Secured Credit Agreement. Interest for the Secured Credit Agreement accrues at a floating rate based on the base rate in effect from time to time, plus a margin, which totaled 2.63% at July 25, 2008.

As of July 25, 2008, we were in compliance with all covenants as required by both the Unsecured Credit Agreement and Secured Credit Agreement, respectively.

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NETAPP, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 6. Short-Term Investments

The following is a summary of investments at July 25, 2008:

| | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Corporate bonds | $ 462,959 | $ 1,795 | $ (1,853) | $ 462,901 |
| Auction rate securities | 76,000 | | (4,142) | 71,858 |
| U.S. government agencies | 100,322 | 93 | (466) | 99,949 |
| U.S. Treasuries | 41,408 | 59 | (80) | 41,387 |
| Municipal bonds | 1,560 | 9 | | 1,569 |
| Corporate securities | 7,890 | | | 7,890 |
| Certificate of deposits | 2 | | | 2 |
| Money market funds | 1,625,022 | | | 1,625,022 |
| Total debt and equity securities | 2,315,163 | 1,956 | (6,541) | 2,310,578 |
| Less cash equivalents | 1,619,503 | | | 1,619,503 |
| Less long-term restricted investments | 199,509 | 822 | (370) | 199,961(1) |
| Less long-term investments | 76,000 | | (4,142) | 71,858(1) |
| Total short-term investments | $ 420,151 | $ 1,134 | $ (2,029) | $ 419,256 |

The following is a summary of investments at April 25, 2008:

| | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Corporate bonds | $ 382,528 | $ 2,066 | $ (903) | $ 383,691 |
| Auction rate securities | 76,202 | | (3,500) | 72,702 |
| U.S. government agencies | 61,578 | 352 | (150) | 61,780 |
| U.S. Treasuries | 15,375 | 107 | | 15,482 |
| Municipal bonds | 1,591 | 9 | | 1,600 |
| Certificate of deposits | 2 | | | 2 |
| Money market funds | 839,841 | | | 839,841 |
| Total debt and equity securities | 1,377,117 | 2,534 | (4,553) | 1,375,098 |
| Less cash equivalents | 831,872 | | | 831,872 |
| Less long-term restricted investments | 241,867 | 1,033 | (287) | 242,613(2) |
| Less long-term investments | 76,202 | | (3,500) | 72,702(2) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Total short-term investments | $ | 227,176 | $ | 1,501 | $ | (766) | $ | 227,911 |

(1) As of July 25, 2008, we have pledged $199,961 of long-term restricted investments for the Secured Credit Agreement (see Note 5). In addition, we have long-term restricted cash of $4,541 relating to our foreign rent, custom, and service performance guarantees. As of July 25, 2008, we also have long-term available-for-sale investments of $71,858 and investments in nonpublic companies of $8,647. These combined amounts are presented as long-term investments and restricted cash in the accompanying Condensed Consolidated Balance Sheets as of July 25, 2008.

(2) As of April 25, 2008, we have pledged $242,613 of long-term restricted investments for the Secured Credit Agreement (see Note 5). In addition, we have long-term restricted cash of $4,621 relating to our foreign rent,

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NOTES TO UNAUDITED CONDENSED
CONSOLIDATED FINANCIAL STATEMENTS (Continued)

custom, and service performance guarantees. As of April 25, 2008, we also have long-term available-for-sale investment of $72,702 and investments in nonpublic companies of $11,169. These combined amounts are presented as long-term investments and restricted cash in the accompanying Condensed Consolidated Balance Sheets as of April 25, 2008.

We record net unrealized gains or losses on available-for-sale securities in other comprehensive income (loss), which is a component of stockholders equity. Realized gains or losses are reflected in income and have not been material for all periods presented. The following table shows the gross unrealized losses and fair values of our investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at July 25, 2008:

| | Less Than 12 Months | | 12 Months or Greater | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| Corporate bonds | $ 65,648 | $ (231) | $ 140,102 | $ (1,622) | $ 205,750 | $ (1,853) |
| Auction rate securities | 71,858 | (4,142) | | | 71,858 | (4,142) |
| U.S. Treasuries | | | 24,428 | (80) | 24,428 | (80) |
| U.S. government agencies | 14,900 | (51) | 58,322 | (415) | 73,222 | (466) |
| Total | $ 152,406 | $ (4,424) | $ 222,852 | $ (2,117) | $ 375,258 | $ (6,541) |

The following table shows the gross unrealized losses and fair values of our investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at April 25, 2008:

| | Less Than 12 Months | | 12 Months or Greater | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| Corporate bonds | $ 31,716 | $ (175) | $ 99,011 | $ (728) | $ 130,727 | $ (903) |
| Auction rate securities | 72,702 | (3,500) | | | 72,702 | (3,500) |
| U.S. government agencies | 4,024 | (22) | 8,163 | (128) | 12,187 | (150) |
| Total | $ 108,442 | $ (3,697) | $ 107,174 | $ (856) | $ 215,616 | $ (4,553) |

The unrealized losses on our investments in corporate bonds and U.S. government agencies were caused by slight interest rate increases. We believe that we will be able to collect all principal and interest amounts due to us at maturity given the high credit quality of these investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because we have the ability and intent to hold those investments until a recovery of par value, which may be maturity, we do not consider these investments to be other-than temporarily impaired at July 25, 2008.

Our long-term investments include auction rate securities (ARS) with a fair value of $71,858 and $72,702 at July 25, 2008 and April 25, 2008, respectively. These ARS are securities with long term nominal maturities which, in accordance with investment policy guidelines, had credit ratings of AAA and Aaa at the time of purchase. During the fourth quarter of fiscal 2008, we reclassified all of our investments in auction rate securities from short-term investments to long-term investments as our ability to liquidate these investments in the next 12 months is uncertain. As of April 25, 2008, we recorded a temporary impairment charge of $3,500 within other comprehensive income (loss), an element of stockholders equity on our balance sheet. During the first quarter of fiscal 2009, we recorded an additional temporary impairment charge of $642 against other comprehensive income.

**NETAPP, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

## 7. Inventories

Inventories are stated at the lower of cost (first-in, first-out basis) or market. Inventories consist of the following:

| | July 25, 2008 | April 25, 2008 |
|---|---|---|
| Purchased components | $ 8,315 | $ 7,665 |
| Work-in-process | 157 | 271 |
| Finished goods | 55,005 | 62,286 |
| Total | $ 63,477 | $ 70,222 |

## 8. Goodwill and Intangible Assets

Under SFAS No. 142, *Goodwill and Other Intangible Assets,* goodwill attributable to each of our reporting units is required to be tested for impairment by comparing the fair value of each reporting unit with its carrying value. Our reporting units are the same as our operating units. On an ongoing basis, goodwill is reviewed annually for impairment (or more frequently if indicators of impairment arise). As of July 25, 2008, and April 25, 2008, there had been no impairment of goodwill or intangible assets. There have been no changes to goodwill during the first quarter of fiscal 2009.

Identified intangible assets are summarized as follows:

| | | July 25, 2008 | | | April 25, 2008 | | |
|---|---|---|---|---|---|---|---|
| | Amortization Period (Years) | Gross Assets | Accumulated Amortization | Net Assets | Gross Assets | Accumulated Amortization | Net Assets |
| **Identified Intangible Assets:** | | | | | | | |
| Patents | 5 | $ 10,040 | $ (9,757) | $ 283 | $ 10,040 | $ (9,411) | $ 629 |
| Existing technology | 4 - 5 | 126,660 | (62,843) | 63,817 | 126,660 | (56,095) | 70,565 |
| Trademarks/tradenames | 2 - 7 | 6,600 | (2,610) | 3,990 | 6,600 | (2,328) | 4,272 |
| Customer Contracts/relationships | 1.5 - 8 | 20,800 | (7,168) | 13,632 | 20,800 | (6,191) | 14,609 |
| Total Identified Intangible Assets, Net | | $ 164,100 | $ (82,378) | $ 81,722 | $ 164,100 | $ (74,025) | $ 90,075 |

Amortization expense for identified intangible assets is summarized below:

| | Three Months Ended | |
|---|---|---|
| | July 25, 2008 | July 27, 2007 |
| Patents | $ 345 | $ 495 |
| Existing technology | 6,748 | 5,278 |
| Other identified intangibles | 1,259 | 1,121 |
| | $ 8,352 | $ 6,894 |

**NETAPP, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Based on the identified intangible assets (including patents) recorded at July 25, 2008, the future amortization expense of identified intangibles for the next five fiscal years is as follows:

| Fiscal Year Ending April, | Amount |
|---|---|
| 2009* | $ 23,345 |
| 2010 | 26,728 |
| 2011 | 16,020 |
| 2012 | 8,517 |
| 2013 | 5,818 |
| Thereafter | 1,294 |
| Total | $ 81,722 |

* Reflects the remaining nine months of fiscal 2009.

## 9. Fair Value of Financial Instruments

***Fair Value Measurements***

Effective April 26, 2008, we adopted SFAS No. 157, *Fair Value Measurements* (SFAS No. 157), except as it applies to the non-financial assets and non-financial liabilities subject to Financial Staff Position SFAS No. 157-2.

SFAS No. 157 defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing assets or liabilities. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, we consider the principal or most advantageous market in which these assets and liabilities would be transacted.

***Fair Value Hierarchy:***

SFAS No. 157 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The hierarchy which prioritizes the inputs used to measure fair value from market based assumptions to entity specific assumptions are as follows:

Level 1: observable inputs such as quoted prices in active markets;

Level 2: inputs other than the quoted prices in active markets that are observable either directly or indirectly in active markets; and

Level 3: unobservable inputs in which there is little or no market data, which require us to develop our own assumptions.

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**NETAPP, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis in accordance with SFAS No. 157 as of July 25, 2008:

| | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| **Assets** | | | | |
| Corporate bonds | $ 462,901 | $ | $ 462,901 | $ |
| Corporate securities | 7,890 | | 7,890 | |
| Auction rate securities | 71,858 | | | 71,858 |
| U.S. government agencies | 99,949 | | 99,949 | |
| U.S. Treasuries | 41,387 | 41,387 | | |
| Municipal bonds | 1,569 | | 1,569 | |
| Certificate of deposits | 2 | 2 | | |
| Money market funds | 1,625,022 | 1,625,022 | | |
| Investment in nonpublic companies | 8,647 | | | 8,647 |
| Total | $ 2,319,225 | $ 1,666,411 | $ 572,309 | $ 80,505 |
| **Liabilities** | | | | |
| Foreign currency contracts | $ 4,010 | $ | $ 4,010 | $ |

Reported as:

| | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| | | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs |

| | Total | (Level 1) | (Level 2) | (Level 3) |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash equivalents(1) | $ 1,619,503 | $ 1,619,503 | $ | $ |
| Short-term investments | 419,256 | 41,389 | 377,867 | |
| Long-term investments and restricted investments(2) | 280,466 | 5,519 | 194,442 | 80,505 |
| Total | $ 2,319,225 | $ 1,666,411 | $ 572,309 | $ 80,505 |
| **Liabilities** | | | | |
| Foreign currency contracts(3) | $ 4,010 | $ | $ 4,010 | $ |

(1) Included in Cash and cash equivalents in the accompanying Condensed Consolidated Balance Sheet as of July 25, 2008, in addition to $82,892 of cash.

(2) Included in Long-term investments and restricted cash in the accompanying Condensed Consolidated Balance Sheet as of July 25 2008, in addition to $4,541 long-term restricted cash.

(3) Included in Other accrued liabilities in the accompanying Condensed Consolidated Balance Sheet as of July 25, 2008.

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**NETAPP, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Our available-for-sale securities include U.S. treasury securities, U.S. agencies, municipal bonds, corporate bonds, corporate securities, auction rate securities, and money market funds. Cash equivalents consist of instruments with remaining maturities of three months or less at the date of purchase. The remaining balance of cash equivalents consists primarily of money market funds, for which the carrying amounts is a reasonable estimate of fair value. We classify investments within Level 1 if quoted prices are available in active markets. Level 1 investments generally include money market funds and U.S. Treasury notes with quoted prices on active markets.

We classify items in Level 2 if the investments are valued using observable inputs to quoted market prices, benchmark yields, reported trades, broker/dealer quotes or alternative pricing sources with reasonable levels of price transparency. These investments include: corporate bonds, corporate securities, U.S. government agencies, and municipal bonds. Investments are held by a custodian who obtains investment prices from a third party pricing provider that uses standard inputs to models which vary by asset class.

Foreign currency contracts consist of forward foreign exchange contracts for primarily the Euro, British Pounds, Canadian Dollar, and Australian Dollars. Our foreign currency derivative contracts are classified within Level 2 as the valuation inputs are based on quoted market prices of similar instruments in active markets. For the quarter ended July 25, 2008, net gains generated by hedged assets and liabilities totaled $320, which were offset by losses on related derivative instruments of $2,618. For the quarter ended July 27, 2007, net gains generated by hedged assets and liabilities totaled $681 and were offset by losses on related derivative instruments of $70.

Our investments in auction rate securities are classified within Level 3 because they are valued using a pricing model and some of the inputs to this model are unobservable in the market. As of July 25, 2008, we had auction rate securities with a par value of $76,000 and an estimated fair value of $71,858, which reflected temporary impairments of $4,142 in these investments recorded during the first quarter of fiscal 2009 and the fourth quarter of fiscal 2008.

The carrying values of cash and cash equivalents, and restricted cash reported in the Condensed Consolidated Balance Sheets approximate their fair value. The fair value of our debt also approximates its carrying value as of July 25, 2008, and April 25, 2008 (level 2.) The $1,265,000 of Notes are carried at cost. The estimated fair value of the Notes was approximately $1,279,257 at July 25, 2008, based upon quoted market information (level 2.)

At July 25, 2008, we held $8,647 of other investments carried at cost consisting of a private equity fund and direct investments in technology companies. These investments (level 3) are valued based on unobservable inputs including valuations received from third party fund managers. Our direct investments in privately-held companies are accounted for using the cost method under Accounting Principles Board ( APB ) Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock.* During the first quarter of fiscal 2009, we recorded $2,621 of impairment charges on certain of our cost method investments and adjusted the carrying amount of those investments to fair value, as we deemed the decline in the value of those assets to be other-than-temporary. These cost method investments fall within level 3 of the fair value hierarchy, due to the use of significant unobservable inputs to determine fair value, as the investments are in privately held technology entities without quoted market prices.

NETAPP, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The table below provides a reconciliation of our financial assets measured at fair value on a recurring basis, consisting of auction rate securities, private equity fund and non-publicly held companies, using significant unobservable inputs (level 3) for the quarter ended July 25, 2008:

| | Available-for-sale | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Private Equity Fund | Nonpublic Companies |
|---|---|---|---|
| Beginning balance at April 25, 2008 | $ 72,600 | $ 2,584 | $ 8,585 |
| Total unrealized losses included in other comprehensive income | (642) | | |
| Total realized losses included in earnings | | (190) | (2,431) |
| Purchases, sales and settlements, net | (100) | 99 | |
| Ending balance at July 25, 2008 | $ 71,858 | $ 2,493 | $ 6,154 |

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). SFAS No. 159 provides companies the option (fair value option) to measure certain financial instruments and other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, although earlier adoption is permitted. Currently, we have elected not to adopt the fair value option under this pronouncement.

**10. Net Income per Share**

During all periods presented, we had certain options outstanding, which could potentially dilute basic earnings per share in the future, but were excluded in the computation of diluted earnings per share in such periods, as their effect would have been anti-dilutive. These certain options were anti-dilutive in the quarters ended July 25, 2008, and July 27, 2007, as these options exercise prices were above the average market prices in such periods. For the quarters ended July 25, 2008, and July 27, 2007, 46,230 and 30,402 shares of common stock options with a weighted average exercise price of $35.82 and $42.57, respectively, were excluded from the diluted net income per share computation.

As of July 25, 2008, our Board of Directors had authorized the repurchase of up to $3,023,639 of common stock under the stock repurchase program. The repurchased shares were held as treasury stock and our outstanding shares used to calculate earnings per share have been reduced by the weighted number of repurchased shares.

## NETAPP, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following is a reconciliation of the numerators and denominators of the basic and diluted net income per share computations for the periods presented:

| | Three Months Ended July 25, 2008 | July 27, 2007 |
|---|---|---|
| **Net Income (Numerator):** | | |
| Net income, basic and diluted | $ 37,672 | $ 34,337 |
| **Shares (Denominator):** | | |
| Weighted average common shares outstanding | 333,991 | 364,713 |
| Weighted average common shares outstanding subject to repurchase | (136) | (256) |
| Shares used in basic computation | 333,855 | 364,457 |
| Weighted average common shares outstanding subject to repurchase | 136 | 256 |
| Common shares issuable upon exercise of stock options | 7,129 | 12,918 |
| Shares used in diluted computation | 341,120 | 377,631 |
| **Net Income per Share:** | | |
| Basic | $ 0.11 | $ 0.09 |
| Diluted | $ 0.11 | $ 0.09 |

Basic net income per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding, excluding unvested restricted stock for that period. Diluted net income per share is computed giving effect to all dilutive potential shares that were outstanding during the period. Dilutive potential common shares consist of incremental common shares subject to repurchase, common shares issuable upon exercise of stock options, warrants and restricted stock awards.

See Note 5 on the potential impact of the Notes, Note Hedges and Warrants on diluted earnings per share.

### 11. Comprehensive Income

The components of comprehensive income were as follows:

| | Three Months Ended July 25, 2008 | July 27, 2007 |
|---|---|---|

| | | | | |
|---|---|---|---|---|
| Net income | $ | 37,672 | $ | 34,337 |
| Change in currency translation adjustment | | (316) | | 448 |
| Change in unrealized gain (loss) on available-for-sale investments, net of related tax effect | | (2,448) | | 1,046 |
| Change in unrealized gain on derivatives | | 779 | | 3,841 |
| Comprehensive income | $ | 35,687 | $ | 39,672 |

NETAPP, INC.

NOTES TO UNAUDITED CONDENSED
CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The components of accumulated other comprehensive income were as follows:

| | July 25, 2008 | April 25, 2008 |
|---|---|---|
| Accumulated translation adjustments | $ 4,116 | $ 4,432 |
| Accumulated unrealized loss on available-for-sale investments | (4,765) | (2,317) |
| Accumulated unrealized loss on derivatives | (563) | (1,342) |
| Total accumulated other comprehensive income (loss) | $ (1,212) | $ 773 |

## 12. Restructuring Charges

As of July 25, 2008, we have $1,761 in facilities restructuring reserves related to future lease commitments, net of expected sublease income. We reevaluate our estimates and assumptions periodically and make adjustments as necessary based on the time period over which the facilities will be vacant, expected sublease terms, and expected sublease rates. In the quarter ended July 25, 2008, we did not record any charge or reduction to the restructuring reserves.

The following table summarizes the activity related to the facilities restructuring reserves, net of expected sublease terms (in thousands) as of July 25, 2008:

| | Facilities Restructuring Reserves |
|---|---|
| Reserve balance at April 25, 2008 | $ 1,924 |
| Cash payments | (163) |
| Reserve balance at July 25, 2008 | $ 1,761 |

Of the reserve balance at July 25, 2008, $669 were included in other accrued liabilities, and the remaining $1,092 were classified as long-term obligations.

NETAPP, INC.

NOTES TO UNAUDITED CONDENSED
CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**13. Commitments and Contingencies**

The following summarizes our commitments and contingencies at July 25, 2008, and the effect such obligations may have on our future periods:

| | 2009* | 2010 | 2011 | 2012 | 2013 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| **Contractual Obligations:** | | | | | | | |
| Office operating lease payments(1) | $ 22,737 | $ 28,174 | $ 23,777 | $ 18,248 | $ 15,272 | $ 43,894 | $ 152,102 |
| Real estate lease payments(2) | 5,426 | 10,155 | 11,239 | 11,239 | 136,291 | 155,400 | 329,750 |
| Equipment operating lease payments(3) | 14,275 | 13,821 | 7,196 | 1,590 | 1,261 | | 38,143 |
| Venture capital funding commitments(4) | 161 | 202 | 190 | 16 | | | 569 |
| Purchase commitments(5) | 23,982 | | | | | | 23,982 |
| Capital expenditures(6) | 19,075 | | | | | | 19,075 |
| Communications and maintenance(7) | 21,038 | 18,901 | 5,701 | 1,121 | 105 | | 46,866 |
| **Total Contractual Cash Obligations** | $ 106,694 | $ 71,253 | $ 48,103 | $ 32,214 | $ 152,929 | $ 199,294 | $ 610,487 |
| **Other Commercial Commitments:** | | | | | | | |
| Letters of credit(8) | $ 2,239 | $ 201 | $ | $ 379 | $ 71 | $ 368 | $ 3,258 |

* Reflects the remaining nine months of fiscal 2009.

(1) We enter into operating leases in the normal course of business. We lease sales offices, research and development facilities, and other property and equipment under operating leases throughout the United States and internationally, which expire on various dates through fiscal year 2019. Substantially all lease agreements have fixed payment terms based on the passage of time and contain payment escalation clauses. Some lease agreements provide us with the option to renew or terminate the lease. Our future operating lease obligations would change if we were to exercise these options and if we were to enter into additional operating lease agreements. Facilities operating lease payments exclude the leases impacted by the restructurings described in Note 12.

(2)

Included in the above contractual cash obligations pursuant to seven financing arrangements with BNP are (a) lease commitments of $5,426 in the remainder of fiscal 2009; $10,155 in fiscal 2010; $11,239 in each of the fiscal years 2011, and 2012; $9,173 in fiscal 2013; and $6,692 thereafter, which are based on the LIBOR rate at July 25, 2008 plus a spread or a fixed rate, for terms of five years, and (b) at the expiration or termination of the lease, a supplemental payment obligation equal to our minimum guarantee of $275,825 in the event that we elect not to purchase or arrange for sale of the buildings.

(3) Equipment operating leases include servers and IT equipment used in our engineering labs and data centers.

(4) Venture capital funding commitments include a quarterly committed management fee based on a percentage of our committed funding to be payable through June 2011.

(5) Amounts included in purchase commitments are (a) agreements to purchase components from our suppliers and/or contract manufacturers that are non-cancelable and legally binding; and (b) commitments related to utilities contracts. Purchase commitments and other exclude (a) products and services we expect to consume in the ordinary course of business in the next 12 months; (b) orders that represent an authorization to purchase

**NETAPP, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

rather than a binding agreement; (c) orders that are cancelable without penalty and costs that are not reasonably estimable at this time.

(6) Capital expenditures include worldwide contractual commitments to purchase equipment and to construct building and leasehold improvements, which will be recorded as property and equipment.

(7) Communication and maintenance represent payments we are required to make based on a minimum volume under certain communication contracts with major telecommunication companies as well as maintenance contracts with multiple vendors. Such obligations expire in September 2012.

(8) The amounts outstanding under these letters of credit relate to workers compensation, a customs guarantee, a corporate credit card program, and foreign rent guarantees.

***Real Estate Leases***

As of July 25, 2008, we have commitments relating to three financing, construction, and leasing arrangements with BNP for office space and a parking structure to be located on land in Sunnyvale, California that we currently own. These arrangements require us to lease our land to BNP for a period of 99 years to construct approximately 569,697 square feet of office space costing up to $162,450. After completion of construction, we will pay minimum lease payments, which vary based on the LIBOR plus a spread or a fixed rate (2.82% for two leases, and 3.49% for the third lease, respectively, at July 25, 2008) on the cost of the facilities. We began to make lease payments on the first building in January 2008 and expect to begin making lease payments on the second and third buildings in January 2009 and January 2010, respectively, each for terms of five years. We have the option to renew the leases for two consecutive five-year periods upon approval by BNP. Upon expiration (or upon any earlier termination) of the lease terms, we must elect one of the following options: (i) purchase the buildings from BNP for $48,500, $65,000, and $48,950, respectively; (ii) if certain conditions are met, arrange for the sale of the buildings by BNP to a third party for an amount equal to at least $41,225, $55,250 and $41,608, respectively, and be liable for any deficiency between the net proceeds received from the third party and such amounts; or (iii) pay BNP supplemental payments of $41,225, $55,250 and $41,608, respectively, in which event we may recoup some or all of such payments by arranging for a sale of either or both buildings by BNP during the ensuing two-year period.

As of July 25, 2008, we have a commitment relating to a fourth financing, construction, and leasing arrangement with BNP for facility space to be located on land currently owned by us in Research Triangle Park, North Carolina. This arrangement requires us to lease our land to BNP for a period of 99 years to construct approximately 120,000 square feet for a data center costing up to $61,000. After completion of construction, we will pay minimum lease payments, which vary based on the LIBOR plus a spread (2.82% at July 25, 2008) on the cost of the facility. We expect to begin making lease payments on the completed building in January 2009 for a term of five and a half years. We have the option to renew the lease for two consecutive five-year periods upon approval by BNP. Upon expiration (or upon any earlier termination) of the lease term, we must elect one of the following options: (i) purchase the building from BNP for $61,000; (ii) if certain conditions are met, arrange for the sale of the building by BNP to a third party for an amount equal to at least $51,850, and be liable for any deficiency between the net proceeds received from the third party and $51,850; or (iii) pay BNP a supplemental payment of $51,850, in which event we may recoup some or all of such payment by arranging for the sale of the building by BNP during the ensuing two-year period.

As of July 25, 2008, we have commitments relating to financing and operating leasing arrangements with BNP for three buildings of approximately 374,274 square feet located in Sunnyvale, California costing up to $101,050. These arrangements require us to pay minimum lease payments, which may vary based on the LIBOR plus a spread or a fixed rate (2.82% for the first building, 3.47% and 3.49% for the last two buildings at July 25, 2008). We began to make lease payments on two buildings in December 2007 and the third building in January 2008 for terms of five years. We have the option to renew the leases for two consecutive five-year periods upon approval by BNP. Upon expiration (or upon any earlier termination) of the lease terms, we must elect one of the following options:

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**NETAPP, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(i) purchase the buildings from BNP for $101,050; (ii) if certain conditions are met, arrange for the sale of the buildings by BNP to a third party for an amount equal to at least $85,893, and be liable for any deficiency between the net proceeds received from the third party and $85,893; or (iii) pay BNP a supplemental payment of $85,893, in which event we may recoup some or all of such payment by arranging for the sale of the buildings by BNP during the ensuing two-year period.

All leases require us to maintain specified financial covenants with which we were in compliance as of July 25, 2008. Such specified financial covenants include a maximum ratio of Total Debt to Earnings Before Interest, Taxes, Depreciation and Amortization ( EBITDA ) and a minimum amount of Unencumbered Cash and Short Term Investments.

***Warranty Reserve***

We provide customers a warranty on hardware with terms ranging from one to three years. Estimated future warranty costs are expensed as a cost of product revenues when revenue is recognized, based on estimates of the costs that may be incurred under our warranty obligations including material and labor costs. Our accrued liability for estimated future warranty costs is included in other accrued liabilities and long-term other obligations on the accompanying Condensed Consolidated Balance Sheets. Factors that affect our warranty liability include the number of installed units, estimated material costs and estimated labor costs. We periodically assess the adequacy of our warranty accrual and adjust the amount as considered necessary. Changes in product warranty liability for the quarter ended July 25, 2008 were as follows:

| | Three Months Ended July 25, 2008 | |
|---|---|---|
| Beginning balance at April 25, 2008 | $ | 42,815 |
| Liabilities accrued for warranties issued during the period | | 5,506 |
| Warranty reserve utilized during the period | | (6,486) |
| Adjustment to pre-existing warranties during the period | | 94 |
| Ending balance at July 25, 2008 | $ | 41,929 |

***Foreign Exchange Contracts***

As of July 25, 2008, the notional fair value of our foreign exchange forward and foreign currency option contracts totaled $400,698. We do not believe that these derivatives present significant credit risks, because the counterparties to the derivatives consist of major financial institutions, and we manage the notional amount of contracts entered into with any one counterparty. We do not enter into derivative financial instruments for speculative or trading purposes. Other than the risk associated with the financial condition of the counterparties, our maximum exposure related to foreign currency forward and option contracts is limited to the premiums paid on purchased options.

***Nonrecourse Lease***

We have both recourse and nonrecourse lease financing arrangements with third party leasing companies through preexisting relationships with customers. 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 company in the event that any customers default. For these recourse arrangements, revenues on the sale of our product to the leasing company are deferred and recognized into income as payments to the leasing company come due. As of July 25, 2008, and April 25, 2008, the maximum recourse exposure under such leases totaled approximately $23,671 and $24,842, respectively. Under the terms of the nonrecourse leases, we do not have any continuing obligations or liabilities. To date, we have not experienced material losses under both lease financing programs.

**NETAPP, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Purchase Commitments***

From time to time, we have committed to purchase various key components used in the manufacture of our products. We establish accruals for estimated losses on purchased components for which we believe it is probable that they will not be utilized in future operations. To the extent that such forecasts are not achieved, our commitments and associated accruals may change.

***Legal Contingencies***

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

We received a subpoena from the Office of Inspector General for the General Services Administration ( GSA ) seeking various records relating to GSA contracting activity by us during the period beginning in 1995 and ending in 2005. The subpoena is part of an investigation being conducted by the GSA and the Department of Justice regarding potential violations of the False Claims Act in connection with our GSA contracting activity. The subpoena requested a range of documents including documents relating to our discount practices and compliance with the price reduction clause provisions of its GSA contracts. The Department of Justice has advised us that it believes that the Company has liability in that it failed to comply with the price reduction clause in certain of its contracts with the government. We are cooperating with the investigation and have produced documents and met with the Department of Justice on several occasions. Violations of the False Claims Act could result in the imposition of a damage remedy which includes treble damages plus civil penalties, and could also result in us being suspended or debarred from future government contracting, any or a combination of which could have a material adverse effect on our results of operations or financial condition. However, as the investigation and negotiations with the government are still ongoing and we are unable at this time to determine the likely outcome of this matter, no provision has been recorded as of July 25, 2008.

On September 5, 2007, we filed a patent infringement lawsuit in the Eastern District of Texas seeking compensatory damages and a permanent injunction against Sun Microsystems. On October 25, 2007, Sun Microsystems filed a counter claim against us in the Eastern District of Texas seeking compensatory damages and a permanent injunction. On October 29, 2007, Sun filed a second lawsuit against us in the Northern District of California asserting additional patents against us. The Texas court granted a joint motion to transfer the Texas lawsuit to the Northern District of California on November 26, 2007. On March 26, 2008, Sun filed a third lawsuit in federal court that extends the patent infringement charges to storage management technology we acquired in January 2008. We are unable at this time to determine the likely outcome of these various patent litigations. We are unable to reasonably estimate the amount or range of any potential settlement, no accrual has been recorded as of July 25, 2008.

## 14. Income Taxes

In June 2006, the FASB issued FASB Interpretation ( FIN ) No. 48, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. We adopted FIN No. 48 at the beginning fiscal 2008. As of the end of the first quarter of fiscal 2009, there were no material changes to either the nature or the amounts of the uncertain tax positions previously determined and disclosed pursuant to FIN No. 48 as the end of our fiscal year 2008.

**NETAPP, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

Effective September 27, 2007, the Internal Revenue Service s Large and Mid-Sized Business Division released a Coordinated Issues Paper ( CIP ) with respect to qualified cost sharing arrangements ( CSAs ). Specifically, this CIP provides guidance to IRS personnel concerning methods that may be applied to evaluate the arm s length charge for internally developed as well as acquisition-related intangible property that is made available to a qualified CSA. We have evaluated the IRS s positions in this CIP and believe that it will not have a material adverse impact upon our consolidated financial position and the results of operations and cash flows.

Effective March 20, 2008, the IRS also released a CIP with respect to the cost sharing of stock based compensation. Specifically, this CIP provides guidance to IRS personnel concerning stock based compensation related to a CSA by providing that the parties to a CSA will share all costs related to intangible development of the covered intangibles, including but not limited to, salaries, bonuses, and other payroll costs and benefits, and that taxpayers should include all forms of compensation in the cost pool, including those costs related to stock-based compensation. We have evaluated the IRS s positions in this CIP and have concluded that it will not have a material adverse impact upon our consolidated financial position and the results of operations and cash flows.

During the first quarter of fiscal year 2009, in connection with the federal income tax audits conducted with respect to our 2003 and 2004 fiscal years, we received a Notice of Proposed Adjustment from the IRS. While the outcome of the issues and adjustments raised in the Notice of Proposed Adjustment is uncertain at this time, our management believes that we have made adequate provisions in the accompanying Condensed Consolidated Financial Statements for any finally determined adjustment with respect to these returns. We believe, based upon information currently known to us, that the final resolution of any of our audits will not have a significant impact upon our consolidated financial position and the results of operations and cash flows. In addition, we believe that we will not have a significant increase or decrease in the amount of unrecognized tax benefits related to this matter.

## 15. New Accounting Pronouncements

In June 2008, the FASB issued EITF Issue No. 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock* ( EITF No. 07-5 ). EITF No. 07-5 provides guidance on determining whether an equity-linked financial instrument, or embedded feature, is indexed to an entity s own stock. EITF No. 07-5 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. We have not yet adopted EITF No. 07-5, but are currently assessing the impact that EITF No. 07-5 may have on our financial position, results of operations, and cash flows.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS No. 162). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. This standard will be effective 60 days following SEC s approval of the Public Company Accounting Oversight Board ( PCAOB ) amendments to U.S. Auditing Standards ( AU ) Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles.* We are in the process of determining the impact the adoption of SFAS No. 162 will have on our consolidated financial statements.

**NETAPP, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In May 2008, the FASB issued FSP No. APB 14-1 (FSP APB 14-1), *Accounting for Convertible Debt Instruments that May be Settled in Cash Upon Conversion* . FSP APB 14-1 requires that the liability and equity components of convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) be separately accounted for in a manner that reflects an issuer s non-convertible debt borrowing rate. Upon adoption of FSP APB 14-1, we will be required to allocate a portion of the proceeds received from the issuance of the convertible notes between a liability component and equity component by determining the fair value of the liability component using our non-convertible debt borrowing rate. The difference between the proceeds of the notes and the fair value of the liability component will be recorded as a discount on the debt with a corresponding offset to paid-in-capital (the equity component). The resulting discount will be accreted by recording additional non-cash interest expense over the expected life of the convertible notes using the effective interest rate method. FSP APB 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years; however, early adoption is not permitted. Retrospective application to all periods presented is required. Due to the retrospective application, the notes will reflect a lower principal balance and additional non-cash interest expense based on our non-convertible debt borrowing rate. This change in methodology will affect the calculations of net income and earnings per share for many issuers of cash settled convertible securities. We are currently evaluating the impact FSP APB 14-1 will have on our results of operations and our financial position.

In April 2008, the FASB issued FSP No. 142-3, *Determination of the Useful Life of Intangible Assets* (FSP No. 142-3). FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets. The intent of the position is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the intangible asset. FSP No. 142-3 is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the impact of the pending adoption of FSP No. 142-3 on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities An Amendment of FASB Statement No. 133* (SFAS No. 161). SFAS No. 161 requires additional disclosures about the objectives of using derivative instruments, the method by which the derivative instruments and related hedged items are accounted for under FASB Statement No. 133 and its related interpretations, and the effect of derivative instruments and related hedged items on financial position, financial performance, and cash flows. SFAS No. 161 also requires disclosure of the fair value of derivative instruments and their gains and losses in a tabular format. This statement is effective for our fourth quarter of fiscal 2009. We are currently evaluating the effect, if any, that the adoption of SFAS No. 161 will have on our consolidated financial statements.

In February 2008, the FASB issued FSP No. 157-1, *Application of FASB Statement 157 to FASB Statement 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* (FSP No. 157-1) and FSP No. 157-2, *Effective Date of FASB Statement 157* (FSP No. 157-2). FSP No. 157-1 amends SFAS No. 157 to remove certain leasing transactions from its scope. FSP No. 157-2 delays the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of the first quarter of fiscal year 2010. We are currently evaluating the impact that these provisions of SFAS No. 157 will have on our consolidated financial statements when it is applied to non-financial assets and non-financial liabilities that are not measured at fair value on a recurring basis beginning in the first quarter of fiscal year 2010.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS No. 141(R)). SFAS No. 141(R) establishes principles and requirements for how the acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at the acquisition date fair value. SFAS No. 141(R) determines what information

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**NETAPP, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. We are required to adopt SFAS No. 141(R) at the beginning of the first quarter of fiscal 2010, which begins on April 25, 2009. We are currently evaluating the effect that the adoption of SFAS No. 141(R) will have on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* (SFAS No. 160). SFAS No. 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. We are required to adopt SFAS No. 160 at the beginning of the first quarter of fiscal 2010, which begins on April 25, 2009. We are currently evaluating the effect, if any, that the adoption of SFAS No. 160 will have on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). SFAS No. 159 provides companies the option (fair value option) to measure certain financial instruments and other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, although earlier adoption is permitted. Currently, we have elected not to adopt the fair value option under this pronouncement.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157), which enhances existing guidance for measuring assets and liabilities using fair value. SFAS No. 157 defines fair value, provides a framework for measuring fair value, and expands disclosures required for fair value measurement. We adopted this standard in the first quarter of fiscal 2009. See Fair Value Measurements in Note 9 for further discussion.

**16. Subsequent Event**

On August 13, 2008, our board of directors approved a new stock repurchase program in which up to an additional $1,000,000 worth of our outstanding common stock may be purchased. This amount is in addition to $96,262 remaining from all prior authorizations. Under the program, NetApp can purchase shares of common stock through open market and privately negotiated transactions at prices deemed appropriate by management. The timing and amount of repurchase transactions under this program will depend on market conditions, corporate considerations, and regulatory requirements. The purchases will be funded from available working capital.

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

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

- our future financial and operating results;
- our business strategies;
- management s plans, beliefs and objectives for future operations, research and development, acquisitions and joint ventures, growth opportunities, investments and legal proceedings;
- competitive positions;
- product introductions, development, enhancements and acceptance;
- future cash flows and cash deployment strategies;
- short-term and long-term cash requirements;
- the impact of completed acquisitions;
- our anticipated tax rate;
- the continuation of our stock repurchase program; and
- industry trends or trend analyses

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

- the amount of orders received in future periods;
- our ability to ship our products in a timely manner;
- our ability to achieve anticipated pricing, cost, and gross margins levels;
- our ability to maintain or increase backlog and revenue;
- our ability to successfully execute on our strategy to invest in additional sales personnel and our global brand awareness campaign in order to increase our customer base, market share and revenue;

our ability to successfully introduce new products;

our ability to capitalize on changes in market demand;

acceptance of, and demand for, our products;

demand for our global service and support and professional services;

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

our ability to realize our financial objectives through increased investment in people, process, and systems;

our ability to maintain our supplier and contract manufacturer relationships;

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

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our ability to expand direct and indirect sales and global service and support;

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

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

our ability to finance construction projects and capital expenditure through cash from operations and/or financing;

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

those factors discussed under Risk Factors elsewhere in this Quarterly Report on Form&ber 31, 2015 that we filed with the SEC. You should make your request in writing to:

Finjan Holdings, Inc.
Attention: Investor Relations
2000 University Avenue, Suite 600,
East Palo Alto, CA 94303

Other Matters to Come Before the 2016 Annual Meeting of Stockholders

No other matters are to be presented for action at the annual meeting other than as set forth in this proxy statement. If other matters properly come before the meeting, however, the persons named in the accompanying proxy will vote all proxies solicited by this proxy statement as recommended by the Board, or, if no recommendation is given, in their own discretion.

Stockholder Proposals and Nominations for the 2017 Annual Meeting of Stockholders

Any stockholder proposal pursuant to Rule 14a-8 of the rules promulgated under the Exchange Act to be considered for inclusion in our proxy materials for the next annual meeting of stockholders must be received at our principal executive offices no later than 120 days before the one year anniversary of the date on which we first mailed our proxy statement to stockholders in connection with the previous year’s annual meeting of stockholders, which will be December 30, 2016 for our 2017 Annual Meeting of Stockholders.

Our bylaws include advance notice procedures and requirements for stockholder proposals to be brought before an annual meeting of the stockholders, including the nomination of directors. Stockholders desiring to nominate persons for election to our Board at, or to bring business before, the next annual meeting of stockholders other than business to be included in the Company’s proxy materials pursuant to Rule 14a-8, will be required to deliver written notice to our Secretary, at the principal executive offices of the Company, within the timeframe determined in accordance with the advance notice provisions more fully described under “Director Nominees - Stockholder Proposals and Recommendations of Director Nominees.”

* * * *

By Order of the Board of Directors
/s/ Philip Hartstein
Name: Philip Hartstein
Title: President and Chief Executive Officer

Palo Alto, California
April 29, 2016

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| | |
|---|---|
| | VOTE BY INTERNET - www.proxyvote.com<br>Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 PM Eastern Time (8:59 PM Pacific Daylight Time) on June 21, 2016. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form. |
| FINJAN HOLDINGS, INC.<br>ATTN: INVESTOR RELATIONS<br>2000 UNIVERSITY AVENUE, SUITE 600<br>EAST PALO ALTO, CA 94303 | ELECTRONIC DELIVERY OF FUTURE PROXY MATERIALS<br>If you would like to reduce the costs incurred by our company in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access proxy materials electronically in future years. |
| | VOTE BY PHONE - 1-800-690-6903<br>Use any touch-tone telephone to transmit your voting instructions up until 11:59 PM Eastern Time (8:59 PM Pacific Daylight Time) on June 21, 2016. Have your proxy card in hand when you call and then follow the instructions. |
| | VOTE BY MAIL<br>Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717. |

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS:

M92103-P64698 KEEP THIS PORTION FOR YOUR RECORDS

| | |
|---|---|
| THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED. | DETACH AND RETURN THIS PORTION ONLY |

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| FINJAN HOLDINGS, INC. | For All | Withhold All | For All Except | To withhold authority to vote for any individual nominee(s), mark "For All Except" and write the number(s) of the nominee(s) on the line below. |
|---|---|---|---|---|
| The Board of Directors recommends you vote FOR the following: | | | | |
| 1. To elect three Class 1 directors to serve three-year terms ending in 2019; and | o | o | o | |

Nominees:
01) Daniel Chinn (Class 1)
02) Eric Benhamou (Class 1)
03) Michael Southworth (Class 1)

| The Board of Directors recommends you vote FOR the following proposal: | For | Against | Abstain |
|---|---|---|---|
| 2. To ratify the appointment of Marcum LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2016. | o | o | o |

NOTE: Such other business as may properly come before the meeting or any adjournment thereof.

| Please indicate if you plan to attend this meeting. | o | o |
|---|---|---|
| | Yes | No |

Please sign exactly as your name(s) appear(s) hereon. When signing as attorney, executor, administrator, or other fiduciary, please give full title as such. Joint owners should each sign personally. All holders must sign. If a corporation or partnership, please sign in full corporate or partnership name by authorized officer.

| | | | |
|---|---|---|---|
| Signature [PLEASE SIGN WITHIN BOX] | Date | Signature (Joint Owners) | Date |

Important Notice Regarding the Availability of Proxy Materials for the 2016 Annual Meeting:
The Notice and Proxy Statement and Form 10-K are available at www.proxyvote.com.
M92104-P64698
FINJAN HOLDINGS, INC.
2016 Annual Meeting of Stockholders
June 22, 2016 9:00 AM (PDT)
This proxy is solicited by the Board of Directors

The stockholder(s) hereby appoint(s) Philip Hartstein and Michael Noonan, or either of them, as proxies, each with the power to appoint his substitute, and hereby authorize(s) them to represent and to vote, as designated on the reverse side of this ballot, all of the shares of common stock of FINJAN HOLDINGS, INC. that the stockholder(s) is/are entitled to vote at the 2016 Annual Meeting of Stockholders to be held at 9:00 AM, PDT, on June 22, 2016, at 2000

University Avenue, Suite 600, East Palo Alto, CA 94303, and any adjournment or postponement thereof.

This proxy, when properly executed, will be voted in the manner directed herein. If no such direction is made, this proxy will be voted in accordance with the Board of Directors' recommendations.

Continued and to be signed on reverse side

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