

NETWORK APPLIANCE INC

Form 10-Q

September 05, 2007

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

Form 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 27, 2007**
- or**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the transition period from to**

**Commission file number 0-27130
Network Appliance, Inc.**

(Exact name of registrant as specified in its charter)

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

77-0307520
*(IRS Employer
Identification No.)*

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

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

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

Number of shares outstanding of the registrant's common stock, \$0.001 par value, as of the latest practicable date.

Class	Outstanding at August 24, 2007
Common Stock	355,820,070

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

	July 27, 2007	April 27, 2007
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 623,990	\$ 489,079
Short-term investments	706,270	819,702
Accounts receivable, net of allowances of \$2,442 at July 27, 2007, and \$2,572 at April 27, 2007	403,159	548,249
Inventories	58,019	54,880
Prepaid expenses and other assets	86,696	99,840
Short-term restricted cash and investments	103,906	118,312
Short-term deferred income taxes	106,810	110,741
Total current assets	2,088,850	2,240,803
Property and Equipment, Net	629,124	603,523
Goodwill	601,056	601,056
Intangible Assets, Net	76,115	83,009
Long-Term Restricted Cash and Investments	5,242	3,639
Long-Term Deferred Income Taxes and Other Assets	155,037	126,448
	\$ 3,555,424	\$ 3,658,478
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Current portion of long-term debt	\$ 69,150	\$ 85,110
Accounts payable	136,077	144,112
Income taxes payable	5,675	53,371
Accrued compensation and related benefits	107,377	177,327
Other accrued liabilities	89,887	97,017
Deferred revenue	663,865	630,610
Total current liabilities	1,072,031	1,187,547
Long-Term Deferred Revenue	485,970	472,423
Other Long-Term Obligations	70,288	9,487
	1,628,289	1,669,457

Stockholders Equity:

Common stock (424,353 shares at July 27, 2007, and 421,623 shares at April 27, 2007)	424	422
Additional paid-in capital	2,479,063	2,380,623
Treasury stock at cost (61,115 shares at July 27, 2007, and 54,593 shares at April 27, 2007)	(1,823,691)	(1,623,691)
Retained earnings	1,260,502	1,226,165
Accumulated other comprehensive income	10,837	5,502
 Total stockholders equity	 1,927,135	 1,989,021
	\$ 3,555,424	\$ 3,658,478

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**NETWORK APPLIANCE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(In thousands, except per share amounts - Unaudited)**

	Three Months Ended	
	July 27, 2007	July 28, 2006
Revenues		
Product	\$ 463,333	\$ 465,611
Software entitlements and maintenance	107,927	74,830
Service	117,975	80,847
Total revenues	689,235	621,288
Cost of Revenues		
Cost of product	186,751	187,965
Cost of software entitlements and maintenance	2,084	2,292
Cost of service	83,203	57,961
Total cost of revenues	272,038	248,218
Gross margin	417,197	373,070
Operating Expenses:		
Sales and marketing	244,643	195,518
Research and development	106,556	88,678
General and administrative	41,450	32,396
Restructuring recoveries		(74)
Total operating expenses	392,649	316,518
Income from Operations	24,548	56,552
Other Income (Expenses), Net:		
Interest income	17,035	16,656
Interest expense	(1,081)	(3,871)
Other income, net	832	779
Total other income, net	16,786	13,564
Income Before Income Taxes	41,334	70,116
Provision for Income Taxes	6,997	15,446
Net Income	\$ 34,337	\$ 54,670
Net Income per Share:		
Basic	\$ 0.09	\$ 0.15

Diluted	\$	0.09	\$	0.14
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Shares Used in Net Income per Share Calculations:

Basic		364,457		373,869
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Diluted		377,631		391,319
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See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**NETWORK APPLIANCE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

	Three Months Ended	
	July 27, 2007	July 28, 2006
Cash Flows from Operating Activities:		
Net income	\$ 34,337	\$ 54,670
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	26,734	18,714
Amortization of intangible assets	6,398	4,686
Amortization of patents	495	495
Stock-based compensation	40,411	43,022
Loss on disposal of equipment	117	81
Allowance for doubtful accounts	84	144
Deferred income taxes	(17,803)	
Deferred rent	399	199
Excess tax benefit from stock-based compensation	(8,339)	(4,489)
Changes in assets and liabilities:		
Accounts receivable	188,072	69,914
Inventories	(3,145)	(520)
Prepaid expenses and other assets	(27,392)	(26,337)
Accounts payable	(14,082)	(1,139)
Income taxes payable	18,434	(6,914)
Accrued compensation and related benefits	(69,889)	(38,964)
Other accrued liabilities	(20,480)	(10,980)
Deferred revenue	46,548	61,982
Net cash provided by operating activities	200,899	164,564
Cash Flows from Investing Activities:		
Purchases of investments	(328,893)	(874,416)
Redemptions of investments	447,022	906,423
Redemptions of restricted investments	14,930	16,322
Change in restricted cash	(1,767)	252
Proceeds from sales of nonmarketable securities		17
Purchases of property and equipment	(33,586)	(23,056)
Purchases of nonmarketable securities	(4,035)	(1,183)
Net cash provided by investing activities	93,671	24,359
Cash Flows from Financing Activities:		
Proceeds from sale of common stock related to employee stock transactions	49,991	36,831
Excess tax benefit from stock-based compensation	8,339	4,489
Repayment of debt	(15,960)	(27,866)

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Tax withholding payments reimbursed by restricted stock	(2,742)	(980)
Repurchases of common stock	(200,000)	(220,000)
Net cash used in financing activities	(160,372)	(207,526)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	713	(324)
Net Increase in Cash and Cash Equivalents	134,911	(18,927)
Cash and Cash Equivalents:		
Beginning of period	489,079	461,256
End of period	\$ 623,990	\$ 442,329
Noncash Investing and Financing Activities:		
Acquisition of property and equipment on account	\$ 18,864	\$ 6,524
Income tax benefit from employee stock transactions	20,702	29,987
Supplemental Cash Flow Information:		
Income taxes paid	\$ 6,376	\$ 22,453
Interest paid on debt	\$ 1,075	\$ 2,666

See accompanying notes to unaudited condensed consolidated financial statements.

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NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per-share data)

(Unaudited)

1. The Company

Based in Sunnyvale, California, Network Appliance was incorporated in California in April 1992 and reincorporated in Delaware in November 2001. Network Appliance, Inc. 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. Network Appliance™ solutions are the data management and storage foundation for many of the world's leading corporations and government agencies.

2. Condensed Consolidated Financial Statements

The accompanying interim unaudited condensed consolidated financial statements have been prepared by Network Appliance, 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.

In the first quarter of fiscal 2008, we began to classify sales-related tax receivable balances from our customers within prepaid expenses and other current assets. These balances were included in accounts receivable, net, in previous periods (\$43,075 at April 27, 2007) and such amounts have been reclassified in the accompanying financial statements to conform to the current period classification. This reclassification had no effect on the reported amounts of net income or cash flow from operations for any period presented. In addition, we have chosen to use the term software entitlements and maintenance in our statements of income to describe the arrangements under which we provide our customers the right to receive unspecified software product upgrades and enhancements on a when-and-if-available basis, bug fixes and patch releases; these were previously described as software upgrade and maintenance arrangements.

We operate on a 52-week or 53-week year ending on the last Friday in April. The first quarters of fiscal 2007 and 2006 were both 13-week fiscal periods.

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 year ended April 27, 2007. The results of operations for the quarter ended July 27, 2007, are not necessarily indicative of the operating results to be expected for the full fiscal year or future operating 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 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 reserves and write-down; 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.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Effective April 29, 2006, we adopted the fair value recognition provision of Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payments* (SFAS No. 123R) under the modified prospective method.

Stock-Based Compensation Expense

The stock-based compensation expenses included in the Condensed Consolidated Statement of Income for the quarter ended July 27, 2007, and July 28, 2006, are as follows:

Three Months Ended	
July 27, 2007	July 28, 2006