NetApp, Inc.
Form 10-Q
August 27, 2010

Table of Contents

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 30, 2010**
	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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o 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 Smaller reporting company o
(Do not check if a smaller reporting company)

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 13, 2010
Common Stock	**357,081,286**

TABLE OF CONTENTS

TRADEMARKS

Table of Contents

PART I. FINANCIAL INFORMATION

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

NETAPP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions)
(Unaudited)

	July 30, 2010	April 30, 2010
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 1,612.0	$ 1,705.0
Short-term investments	2,308.9	2,019.0
Accounts receivable, net of allowances of $1.8 million and $1.6 million at July 30 and April 30, 2010, respectively	372.5	471.5
Inventories	90.4	112.9
Other current assets	210.4	228.7
Total current assets	4,594.2	4,537.1
Property and Equipment, Net	825.4	804.4
Goodwill	737.0	681.0
Other Intangible Assets, Net	43.2	25.1
Long-Term Investments and Restricted Cash	71.2	72.8
Other Non-Current Assets	374.8	374.0
	$ 6,645.8	$ 6,494.4
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 149.9	$ 184.6
Accrued compensation and related benefits	188.8	379.1
Other current liabilities	199.9	212.2
Short-term deferred revenue	1,126.8	1,135.1
Total current liabilities	1,665.4	1,911.0
1.75% Convertible Senior Notes Due 2013	1,113.4	1,101.5
Other Long-Term Liabilities	196.1	171.9
Long-Term Deferred Revenue	821.0	779.5
	3,795.9	3,963.9

Commitments and Contingencies (Note 15)

Stockholders Equity:		
Common stock, 461.2 million and 451.6 million shares issued at July 30 and April 30, 2010	0.5	0.5
Additional paid-in capital	3,629.3	3,453.7
Treasury stock at cost (104.3 million shares at July 30 and April 30, 2010)	(2,927.4)	(2,927.4)
Retained earnings	2,142.7	2,000.9
Accumulated other comprehensive income	4.8	2.8
Total stockholders equity	2,849.9	2,530.5
	$ 6,645.8	$ 6,494.4

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended July 30, 2010	Three Months Ended July 31, 2009
Revenues:		
Product	$ 720.8	$ 478.2
Software entitlements and maintenance	174.7	165.3
Service	242.3	194.4
Net revenues	1,137.8	837.9
Cost of Revenues:		
Cost of product	307.7	212.5
Cost of software entitlements and maintenance	3.4	3.1
Cost of service	102.3	99.8
Total cost of revenues	413.4	315.4
Gross profit	724.4	522.5
Operating Expenses:		
Sales and marketing	354.2	301.4
Research and development	149.5	130.3
General and administrative	56.2	59.6
Restructuring and other charges	0.0	1.5
Acquisition related (income) expense, net	0.3	(41.1)
Total operating expenses	560.2	451.7
Income from Operations	164.2	70.8
Other Expenses, Net:		
Interest income	9.8	8.6
Interest expense	(18.6)	(19.2)
Other income (expenses), net	2.2	(1.0)
Total other expenses, net	(6.6)	(11.6)
Income Before Income Taxes	157.6	59.2
Provision for Income Taxes	15.8	7.5
Net Income	$ 141.8	$ 51.7

Net Income Per share:		
Basic	$ 0.40	$ 0.15
Diluted	$ 0.38	$ 0.15
Shares Used in Net Income per Share Calculations:		
Basic	352.4	334.5
Diluted	374.3	338.9

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NETAPP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)
(Unaudited)

	Three Months Ended July 30, 2010	Three Months Ended July 31, 2009
Cash Flows from Operating Activities:		
Net income	$ 141.8	$ 51.7
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	40.7	43.0
Stock-based compensation	44.3	52.2
Accretion of discount and issuance costs on notes	12.9	13.1
Unrealized losses on derivative activities	10.8	0.0
Deferred income taxes	7.4	(2.1)
Tax benefit (charges) from stock-based compensation	(12.0)	19.0
Other non-cash items, net	3.7	0.1
Changes in assets and liabilities:		
Accounts receivable	100.0	117.2
Inventories	22.5	(0.4)
Other operating assets	9.9	12.2
Accounts payable	(34.4)	(14.5)
Accrued compensation and other current liabilities	(221.6)	(230.9)
Deferred revenue	33.2	(9.8)
Other operating liabilities	18.1	(12.6)
Net cash provided by operating activities	177.3	38.2
Cash Flows from Investing Activities:		
Purchases of investments	(726.1)	(160.9)
Redemptions of investments	432.2	394.5
Purchases of property and equipment	(40.2)	(24.7)
Acquisition of business, net of cash acquired	(74.9)	0.0
Other investing activities, net	0.1	(0.4)
Net cash provided by (used in) investing activities	(408.9)	208.5
Cash Flows from Financing Activities:		
Issuance of common stock	139.9	33.3
Net cash provided by financing activities	139.9	33.3
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(1.3)	10.2

Net Increase (Decrease) in Cash and Cash Equivalents	(93.0)	290.2
Cash and Cash Equivalents:		
Beginning of period	1,705.0	1,494.2
End of period	$ 1,612.0	$ 1,784.4

See accompanying notes to condensed consolidated financial statements.

Table of Contents

NETAPP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. The Company

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

2. Condensed Consolidated Financial Statements

Fiscal Year We operate on a 52-week or 53-week fiscal year ending on the last Friday in April. The first three month period of fiscal 2011 was a 13 week or 91 day period, while the first three month period of fiscal 2010 was a 14 week, or 98 day period.

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

3. Significant Accounting Policies

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

Recent Accounting Standards Not Yet Effective

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

(i) provide updated guidance on how the deliverables in an arrangement should be separated, and how the consideration should be allocated;

(ii) require an entity to allocate revenue in an arrangement using best estimate of selling prices (BESP) of deliverables if a vendor does not have vendor-specific objective evidence of selling price (VSOE) or third-party evidence of selling price (TPE);

(iii) eliminate the use of the residual method and requires an entity to allocate revenue using the relative selling price method; and

(iv) expands the disclosure requirements to provide both qualitative and quantitative information about the significant judgments made in applying the revised guidance and subsequent changes in those judgments that may significantly affect the timing or amount of revenue recognition.

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

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

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

4. Statements of Cash Flows

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

	Three Months Ended	
	July 30, 2010	**July 31, 2009**
Noncash Investing and Financing Activities:		
Acquisition of property and equipment on account	$ 20.3	$ 8.8
Acquisition of property and equipment through long-term financing	$ 12.6	$ 0.0
Options assumed for acquired business	$ 3.3	$ 0.0
Supplemental Cash Flow Information:		
Income taxes paid	$ 8.1	$ 9.0
Income taxes refunded	$ 0.1	$ 0.8
Interest paid on debt	$ 11.1	$ 11.1

5. Business Combinations

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

Bycast Acquisition

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

We acquired 100% of the outstanding shares of Bycast for a purchase price of $80.5 million in cash, including $13.1 million, which was placed in an escrow account to secure Bycast s obligations under certain indemnity provisions. Subject to any claims for indemnity, the escrow funds will be released 18 months from the closing date of the acquisition. In addition, we assumed all of the then outstanding options to purchase Bycast common stock, and converted those into options to purchase approximately 0.2 million shares of our common stock. The results of operations of Bycast are included in our Condensed Consolidated Statements of Operations beginning May 13, 2010, the closing date of the acquisition.

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

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

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

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

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

Goodwill is not deductible for income tax purposes.

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

		Useful Life (Years)
Developed technology	$ 18.0	5

Customer relationships	4.7	3
Trademarks and trade names	0.7	5
Other	0.2	2
Total identified intangible assets	$ 23.6	

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

Termination of Proposed Merger with Data Domain, Inc.

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

Table of Contents

6. Goodwill and Purchased Intangible Assets

Activity related to goodwill and identified purchased intangible assets for the three months ended July 30, 2010 consisted of the following (in millions):

	Goodwill	Identified Intangible Assets
April 30, 2010	$ 681.0	$ 25.1
Additions related to acquisition	56.0	23.6
Amortization	0.0	(5.5)
July 30, 2010	$ 737.0	$ 43.2

Identified intangible assets are summarized as follows (in millions):

	July 30, 2010			April 30, 2010		
	Gross Assets	Accumulated Amortization	Net Assets	Gross Assets	Accumulated Amortization	Net Assets
Identified Intangible Assets:						
Existing technology	$ 93.1	$ (59.9)	$ 33.2	$ 75.1	$ (55.5)	$ 19.6
Trademarks/tradenames	7.1	(4.5)	2.6	6.4	(4.3)	2.1
Customer contracts/relationships	17.1	(9.7)	7.4	12.2	(8.8)	3.4
Total identified intangible assets, net	$ 117.3	$ (74.1)	$ 43.2	$ 93.7	$ (68.6)	$ 25.1

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

	Three Months Ended		
	July 30, 2010	July 31, 2009	Statement of Operations Classifications
Existing technology	$ 4.4	$ 4.7	Cost of product revenues
Trademarks/tradenames	0.3	0.3	Sales and marketing
Customer contracts/relationships	0.8	0.6	Sales and marketing
	$ 5.5	$ 5.6	

As of July 30, 2010, future amortization expense related to identifiable intangible assets was as follows (in millions):

Fiscal Year	**Amount**
Remainder of 2011	$ 11.1
2012	12.6
2013	10.3
2014	4.4
2015 and thereafter	4.8
Total	$ 43.2

Table of Contents

7. Balance Sheet Detail

Cash and Cash Equivalents (in millions):

	July 30, 2010	April 30, 2010
Cash	$ 121.3	$ 187.8
Cash equivalents	1,490.7	1,517.2
	$ 1,612.0	$ 1,705.0

Inventories (in millions):

	July 30, 2010	April 30, 2010
Purchased components	$ 8.2	$ 9.4
Work-in-process	0.2	0.2
Finished goods	82.0	103.3
Total	$ 90.4	$ 112.9

Other Current Assets (in millions):

	July 30, 2010	April 30, 2010
Deferred tax assets	$ 52.4	$ 69.6
Prepaid expenses and other current assets	154.1	157.0
Short-term restricted cash	3.9	2.1
	$ 210.4	$ 228.7

Property and Equipment (in millions):

	July 30, 2010	April 30, 2010
Land	$ 204.7	$ 204.7
Buildings and building improvements	395.2	394.8

Leasehold improvements	75.0	73.7
Computer, production, engineering and other equipment and purchased software	669.3	628.6
Furniture	62.6	63.2
Construction-in-process	43.8	37.0
	1,450.6	1,402.0
Accumulated depreciation and amortization	(625.2)	(597.6)
	$ 825.4	$ 804.4

Long Term Investments and Restricted Cash (in millions):

	July 30, 2010	April 30, 2010
Auction rate securities	$ 67.4	$ 69.0
Nonmarketable securities	1.4	1.4
Restricted cash	2.4	2.4
	$ 71.2	$ 72.8

Other Non-Current Liabilities (in millions):

	July 30, 2010	April 30, 2010
Liability for uncertain tax positions	$ 123.8	$ 122.4
Warranty	14.1	13.7
Other	58.2	35.8
	$ 196.1	$ 171.9

8. Financial Instruments and Fair Value

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

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

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

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

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

11

Table of Contents

Investments

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

	July 30, 2010				April 30, 2010			
		Gross Unrealized		Estimated Fair		Gross Unrealized		Estimated Fair
	Cost	Gains	Losses	Value	Cost	Gains	Losses	Value
Corporate bonds	$ 1,448.3	$ 7.4	$ (1.7)	$ 1,454.0	$ 1,128.1	$ 3.4	$ (1.8)	$ 1,129.7
Auction rate securities	70.8	0.5	(3.9)	67.4	71.6	0.7	(3.3)	69.0
U.S. agency securities	712.7	1.6	0.0	714.3	775.4	1.7	(0.1)	777.0
U.S. treasuries	5.1	0.1	0.0	5.2	41.5	0.4	0.0	41.9
Commercial paper	203.4	0.0	0.0	203.4	215.9	0.0	0.0	215.9
Municipal bonds	1.5	0.0	0.0	1.5	1.5	0.0	0.0	1.5
Certificates of deposit	64.0	0.0	0.0	64.0	159.0	0.0	0.0	159.0
Money market funds	1,357.2	0.0	0.0	1,357.2	1,211.2	0.0	0.0	1,211.2
Total debt and equity securities	3,863.0	9.6	(5.6)	3,867.0	3,604.2	6.2	(5.2)	3,605.2
Less cash equivalents	1,490.7	0.0	0.0	1,490.7	1,517.2	0.0	0.0	1,517.2
Less long-term investments	70.8	0.5	(3.9)	67.4	71.6	0.7	(3.3)	69.0
Total short-term investments	$ 2,301.5	$ 9.1	$ (1.7)	$ 2,308.9	$ 2,015.4	$ 5.5	$ (1.9)	$ 2,019.0

The following table presents the contractual maturities of our debt investments as of July 30, 2010 (in millions):

Debt Investment Maturities	Cost	Fair Value
Due in one year or less	$ 740.9	$ 742.0
Due in one through five years	1,694.0	1,700.4
Due in five through ten years	0.0	0.0
Due after ten years*	70.9	67.4
	$ 2,505.8	$ 2,509.8

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

Table of Contents

Fair Value of Financial Instruments

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis as of July 30, 2010 (in millions):

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Corporate bonds	$ 1,454.0	$ 0.0	$ 1,454.0	$ 0.0
U.S. agency securities	714.3	0.0	714.3	0.0