NetApp, Inc.
Form 10-Q
September 04, 2009

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 31, 2009**
	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 (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 31, 2009
Common Stock	**336,364,341**

TABLE OF CONTENTS

TRADEMARKS

PART I. FINANCIAL INFORMATION

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

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

	July 31, 2009	April 24, 2009
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 1,784,388	$ 1,494,153
Short-term investments	878,409	1,110,053
Accounts receivable, net of allowances of $2,491 at July 31, 2009, and $3,068 at April 24, 2009	331,661	446,537
Inventories	61,655	61,104
Prepaid expenses and other assets	112,660	119,887
Short-term deferred income taxes	164,934	207,050
Total current assets	3,333,707	3,438,784
Property and Equipment, Net	796,266	807,923
Goodwill	680,986	680,986
Intangible Assets, Net	40,136	45,744
Long-Term Investments and Restricted Cash	128,502	127,317
Long-Term Deferred Income Taxes and Other Assets	335,295	283,625
	$ 5,314,892	$ 5,384,379
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 122,187	$ 137,826
Accrued compensation and related benefits	135,810	204,168
Other accrued liabilities	170,801	190,315
Accrual for GSA settlement		128,715
Income taxes payable	2,073	4,732
Deferred revenue	1,028,851	1,013,569
Total current liabilities	1,459,722	1,679,325
1.75% Convertible Senior Notes Due 2013	1,066,770	1,054,717
Other Long-Term Obligations	153,496	164,499
Long-Term Deferred Revenue	685,771	701,649

	3,365,759	3,600,190
Commitments and Contingencies (Note 16)		
Stockholders Equity:		
Common stock (440,415 and 436,565 shares issued at July 31, 2009 and April 24, 2009, respectively)	440	437
Additional paid-in capital	3,220,410	3,115,795
Treasury stock at cost (104,325 shares at July 31, 2009 and April 24, 2009)	(2,927,376)	(2,927,376)
Retained earnings	1,652,155	1,600,491
Accumulated other comprehensive income (loss)	3,504	(5,158)
Total stockholders equity	1,949,133	1,784,189
	$ 5,314,892	$ 5,384,379

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	Three Months Ended	
	July 31, 2009	**July 25, 2008**
Revenues:		
Product	$ 478,246	$ 547,855
Software entitlements and maintenance	165,290	144,412
Service	194,425	176,509
Net revenues	837,961	868,776
Cost of Revenues:		
Cost of product	212,535	249,778
Cost of software entitlements and maintenance	3,112	2,186
Cost of service	99,821	100,164
Total cost of revenues	315,468	352,128
Gross margin	522,493	516,648
Operating Expenses:		
Sales and marketing	301,433	303,108
Research and development	130,317	125,352
General and administrative	59,551	49,463
Restructuring and other charges	1,496	
Merger termination proceeds, net	(41,120)	
Total operating expenses	451,677	477,923
Income from Operations	70,816	38,725
Other Income (Expenses), Net:		
Interest income	8,617	15,476
Interest expense	(19,201)	(9,513)
Loss on investments, net	(92)	(2,621)
Other expenses, net	(948)	(1,989)
Total other income (expense), net	(11,624)	1,353
Income Before Income Taxes	59,192	40,078
Provision for Income Taxes	7,528	5,355

Net Income	$ 51,664	$ 34,723
Net Income per Share:		
Basic	$ 0.15	$ 0.10
Diluted	$ 0.15	$ 0.10
Shares Used in Net Income per Share Calculations:		
Basic	334,537	333,855
Diluted	338,875	341,120

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	Three Months Ended July 31, 2009	July 25, 2008
Cash Flows from Operating Activities:		
Net income	$ 51,664	$ 34,723
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	43,041	41,549
Stock-based compensation	52,184	36,405
Loss on investments	298	2,621
Asset impairment and write-offs	294	179
Allowance for doubtful accounts	(135)	(36)
Accretion of discount and issue costs on notes	13,080	4,937
Deferred income taxes	(2,082)	(11,259)
Deferred rent	(395)	827
Tax benefit from stock-based compensation	19,048	19,859
Excess tax benefit from stock-based compensation		(10,142)
Changes in assets and liabilities:		
Accounts receivable	117,255	150,292
Inventories	(440)	6,742
Prepaid expenses and other assets	12,276	10,132
Accounts payable	(14,501)	(30,073)
Accrued compensation and related benefits	(73,018)	(54,439)
Other accrued liabilities	(26,630)	(1,403)
Accrual for GSA settlement	(128,715)	
Income taxes payable	(2,578)	(2,393)
Long-term other liabilities	(12,568)	(1,220)
Deferred revenue	(9,844)	52,894
Net cash provided by operating activities	38,234	250,195
Cash Flows from Investing Activities:		
Purchases of investments	(160,897)	(264,938)
Redemptions of investments	394,520	107,932
Change in restricted cash	(1,794)	225
Proceeds from (purchases of) nonmarketable securities	1,365	(125)
Purchases of property and equipment	(24,714)	(76,613)
Net cash provided by (used in) investing activities	208,480	(233,519)
Cash Flows from Financing Activities:		

Proceeds from sale of common stock related to employee stock transactions		38,503		35,527
Tax withholding payments reimbursed by employee stock transactions		(5,227)		(2,554)
Excess tax benefit from stock-based compensation				10,142
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 hedges				(254,898)
Repayment of revolving credit facility				(41,835)
Repurchases of common stock				(399,981)
Net cash provided by financing activities		33,276		749,015
Effect of Exchange Rate Changes on Cash and Cash Equivalents		10,245		225
Net Increase in Cash and Cash Equivalents		290,235		765,916
Cash and Cash Equivalents:				
Beginning of period		1,494,153		936,479
End of period	$	1,784,388	$	1,702,395
Noncash Investing and Financing Activities:				
Acquisition of property and equipment on account	$	8,814	$	10,801
Supplemental Cash Flow Information:				
Income taxes paid	$	8,984	$	6,491
Income taxes refunded	$	839	$	6,322
Interest paid on debt	$	11,069	$	1,053

See accompanying notes to condensed consolidated financial statements.

NETAPP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share amounts, 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 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 (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 24, 2009 contained in the Company s Annual Report on Form 10-K. The results of operations for the three month period ended July 31, 2009 are not necessarily indicative of the operating results to be expected for the full fiscal year or future operating periods. The Company evaluated subsequent events for disclosure through September 4, 2009, the date the financial statements were issued.

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 2010 was a 14-week, or 98-day, period and the first three month period of fiscal 2009 was a 13-week, or 91-day, period.

Effective April 25, 2009, we adopted Financial Accounting Standards Board (FASB) Staff Position (FSP) No. APB 14-1 (FSP No. APB 14-1), *Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)* , which requires retrospective adoption to previously disclosed consolidated financial statements. As such, certain prior period amounts have been revised in the unaudited condensed consolidated financial statements to reflect the adoption of the standard for all periods presented. See Note 7 for a discussion of the impact of the implementation of this standard.

Recent Accounting Pronouncements

As of April 25, 2009, we adopted Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*, for all non-financial assets and non-financial liabilities measured at fair value on a non-recurring basis and SFAS No. 165, *Subsequent Events*. These adoptions did not have a material impact on our condensed consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162*, which approved the FASB Accounting Standards Codification (ASC) as the single source of authoritative accounting principles. The codification does not change GAAP, but instead reorganizes the existing authoritative standards into a comprehensive, topically organized online database to simplify user access to all authoritative U.S. GAAP. As the codification did not change GAAP, the adoption of ASC will not have a material impact on our consolidated financial statements. Previous references to applicable literature in our disclosures will be updated with references to the ASC in our 10-Q for the three month period ending October 30, 2009.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*, which amends the consolidation guidance applicable to variable interest entities (VIEs). The scope within the guidance now includes qualifying special-purpose entities. The standard provides revised guidance on (1) determining the primary beneficiary of the VIE, (2) how power is shared, (3) consideration for kick-out, participating and protective rights, (4) reconsideration of the primary beneficiary, (5) reconsideration of a VIE, (6) fees paid to decision makers or service providers, and (7) presentation requirements. The statement is effective as of the first three month period of fiscal 2011, and early adoption is prohibited. We are currently evaluating the impact of the adoption of SFAS No. 167 on our consolidated financial statements.

In April 2009, the FASB issued three Staff Positions which became effective for the Company beginning with the three month period ended July 31, 2009: FSP No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions That Are Not Orderly*; FSP No. FAS 115-2 and FAS No. 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* and FSP No. FAS 107-1 and APB No. 28-1, *Interim Disclosures about Fair Value of Financial Instruments*. FSP FAS No. 157-4 provides guidance on how to determine the fair value of assets and liabilities under SFAS No. 157 when there is no active market and reaffirms the SFAS No. 157 definition of fair value. FSP FAS No. 115-2 and FAS No. 124-2 modifies the requirements for recognizing other-than-temporarily-impaired debt securities and revises the existing impairment model for such securities by distinguishing between credit and non-credit components of impaired debt securities that are not expected to be sold. FSP FAS No. 107-1 and APB No. 28-1 enhances disclosures about fair value for instruments under the scope of SFAS No. 157 for both interim and annual periods. We adopted these Staff Positions as of April 25, 2009, and they have not had a material impact on our condensed consolidated financial statements.

3. Concentration of Risk

During the three month period ended July 31, 2009, Arrow and Avnet, who are U.S. distributors, each accounted for approximately 11% of our net revenues. No customer accounted for ten percent or more of our revenues during the three month period ended July 25, 2008.

4. Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting 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 valuation and contractual commitments; restructuring accruals; warranty reserve; impairment losses on investments; fair value of awards granted under our stock-based compensation plans; and loss contingencies. Actual results could differ from those estimates.

5. Significant Accounting Policies

With the exception of the adoption of certain pronouncements as described above, there have been no significant changes in our significant accounting policies for the three month period ended July 31, 2009, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended April 24, 2009.

Financial Instruments

For certain financial instruments, including cash and cash equivalents, short-term investments, accounts receivable, accounts payable and other current liabilities, the carrying amounts approximate their fair value due to the relatively short maturity of these balances. The following methods were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Cash Equivalents. We consider all highly liquid investments with an original maturity of three months or less to be cash equivalents. Cash equivalents are recognized at fair value.

Short-Term Investments. We classify short-term investments in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities.* Short-term investments consist of marketable debt or equity securities which are classified as available-for-sale and are recognized at fair value. The determination of fair value is further detailed in Note 9. We regularly review our investment portfolio to identify and evaluate investments that have indications of possible impairment. Factors considered in determining whether a loss is other-than-temporary include: the length of time and extent to which the fair market value has been lower than the cost basis, the financial condition and near-term prospects of the investee, credit quality, likelihood of recovery, and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair market value.

Unrealized gains and temporary losses, net of tax, are included with accumulated other comprehensive income (loss) (AOCI). Upon realization, those amounts are reclassified from AOCI to results of operations. The amortization of premiums and discounts on the investments and realized gains and losses are included in results of operations. Other-than-temporary impairments on available-for-sale debt securities are determined to be either credit losses or losses due to other factors. Credit losses are recognized in our results from operations and other losses are included in AOCI.

6. Termination of Proposed Merger with Data Domain, Inc.

On May 20, 2009, we announced that we had entered into a merger agreement with Data Domain, Inc. (Data Domain) under which we would acquire Data Domain in a stock and cash transaction. On July 8, 2009, Data Domain s Board of Directors terminated the merger agreement and, pursuant to the terms of the agreement, Data Domain paid us a $57,000 termination fee. We incurred $15,880 of incremental third-party costs relating to the terminated merger agreement during the same period, resulting in a net amount of $41,120 reported as Merger termination proceeds, net in the condensed consolidated statement of operations for the three month period ended July 31, 2009.

7. Convertible Notes and Credit Facilities

1.75% Convertible Senior Notes Due 2013

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 Notes are unsecured, unsubordinated obligations of the Company. Interest is payable in cash at a rate of 1.75% per annum. The net proceeds from the offering, after deducting the initial purchasers issue costs and offering expenses of $26,581, were $1,238,419.

On April 25, 2009, we adopted FSP APB No. 14-1, which applies to the $1,265,000 aggregate principal amount of 1.75% Convertible Senior Notes, and which is required to be applied retrospectively. The adoption impacted the accounting for the Notes by requiring the initial proceeds to be allocated between a liability and an equity component based on the fair value of the debt component as of the issuance date. The initial debt component of the Note was valued at $1,016,962, based on the contractual cash flows discounted at the an appropriate comparable market non-convertible debt borrowing rate at the date of issuance of 6.31%, with the equity component representing the residual amount of the Note proceeds. As a result, we recorded $248,038 as a component of equity and a corresponding debt discount as of the date of issuance.

In addition, we allocated $3,130, net of tax, of the issuance costs to the equity component of the Notes and the remaining $21,369 of the issuance costs remained classified as long-term other assets. The issuance costs were allocated pro rata based on the relative carrying amounts of the debt and equity components. The debt discount and the issuance costs allocated to the debt component are amortized as additional interest expense over the term of the Notes using the effective interest method.

The adoption of FSP APB 14-1 has no impact on total operating, investing and financing cash flows in the prior periods condensed consolidated statements of cash flows.

Upon adoption of FSP APB No. 14-1, we also recorded adjustments to our tax provision to reflect the impact of the foregoing adjustments.

Table of Contents

The following financial statement line items for the three month period ended July 25, 2008 and as of April 24, 2009 were impacted by the adoption of FSP APB No. 14-1:

	Three Months Ended July 25, 2008	
	As Previously Reported	**As Adjusted**
Interest expense	$ (4,575)	$ (9,513)
Provision for income taxes	7,344	5,355
Net income	37,672	34,723
Net income per share basic	$ 0.11	$ 0.10
Net income per share diluted	$ 0.11	$ 0.10

	As of April 24, 2009	
	As Previously Reported	**As Adjusted**
Consolidated Balance Sheet:		
Long term deferred income taxes & other assets	$ 372,065	$ 283,625
1.75% Convertible Senior Notes Due 2013	1,265,000	1,054,717
Additional paid-in capital	2,971,995	3,115,795
Retained earnings	1,622,448	1,600,491

The following table reflects the carrying value of our convertible debt as of July 31, 2009 and April 24, 2009:

	July 31, 2009	**April 24, 2009**
1.75% Convertible Notes due 2013	$ 1,265,000	$ 1,265,000
Less: Unamortized discount	(198,230)	(210,283)
Net long-term carrying amount of Notes	$ 1,066,770	$ 1,054,717

The following table presents the amount of interest cost recognized relating to both the contractual interest coupon and the amortization of the discount and issuance costs:

	Three Months Ended	
	July 31, 2009	**July 25, 2008**
Contractual interest coupon	$ 5,903	$ 2,829
Amortization of debt discount	12,053	5,120
Amortization of issuance costs	1,027	447

Total interest cost recognized	$ 18,983	$ 8,396

The remaining debt discount and issuance cost of $198,230 and $17,100, respectively, as of July 31, 2009 will be amortized over the remaining life of the Notes, which is approximately 3.8 years.

Maturity The Notes will mature on June 1, 2013 unless repurchased or converted in accordance with their terms prior to such date.

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 the Notes plus accrued and unpaid interest, if any, to, but not including, the fundamental change repurchase date.

Table of Contents

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. Upon conversion, we will satisfy our conversion obligation by delivering cash and shares of our 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 our 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 our 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 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.

As of July 31, 2009, none of the conditions allowing the holders of the Notes to convert had been met. As of July 31, 2009, we had not issued any shares related to the Notes.

Note Hedges and Warrants

Concurrent with the issuance of the Notes, we entered into note hedge transactions (the Note Hedges), 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 31, 2009, 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 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.

Table of Contents

Lehman Brothers OTC Derivatives, Inc. (Lehman OTC) is the counterparty to 20% of our Note Hedges. The bankruptcy filing by Lehman OTC on October 3, 2008 constituted an event of default under the hedge transaction that could, at our option, lead to termination under the hedge transaction to the extent we provide notice to the counterparty under such transaction. We have not terminated the Note Hedge transaction with Lehman OTC, and will continue to carefully monitor the developments impacting Lehman OTC. The event of default is not expected to have an impact on our financial position or results of operations. However, we could incur significant costs to replace this hedge transaction originally held with Lehman OTC if we elect to do so. If we do not elect to replace this hedge transaction, then we would be subject to potential dilution upon conversion of the Notes, if on the date of conversion the per-share market price of our common stock exceeds the conversion price of $31.85.

The terms of the Notes, the rights of the holders of the Notes and other counterparties to Note Hedges and Warrants were not affected by the bankruptcy filings of Lehman OTC.

Earnings per share impact on the Notes, Note Hedges and Warrants In accordance with SFAS No. 128, the Notes will have no impact on diluted earnings per share unless 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. The Note Hedges are not included for purposes of calculating earnings per share in the periods presented, as their 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 conversion of the Notes or exercise of the Note Hedges, 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.

Fair Value of Notes

As of July 31, 2009, the approximate fair value of the principal amount of our Notes was approximately $1,228,631, or 97.1% of the face value of the Notes, based upon quoted market information.

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, as syndication agent, and JPMorgan Chase Bank National Association, 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 31, 2009, 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 $638 as of July 31, 2009. As of July 31, 2009, we were in compliance with all covenants as required by the Unsecured Credit Agreement.

8. Stock-Based Compensation, Equity Incentive Programs and Stockholders Equity

Stock-Based Compensation Expense

Stock-based compensation expense included in the condensed consolidated statements of operations for the three month periods ended July 31, 2009 and July 25, 2008, respectively, are as follows:

	Three Months Ended	
	July 31, 2009	July 25, 2008
Cost of product revenues	$ 1,220	$ 948
Cost of service revenues	4,519	3,041
Sales and marketing	23,965	16,342
Research and development	12,716	10,188
General and administrative	9,764	5,886
Total stock-based compensation expense	$ 52,184	$ 36,405

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

	Three Months Ended	
	July 31, 2009	July 25, 2008
Employee stock options	$ 29,397	$ 23,331
Restricted stock units (RSUs) and restricted stock awards (RSAs)	16,816	7,690
Employee Stock Purchase Plan (ESPP)	6,081	5,381
Change in amounts capitalized in inventory	(110)	3
Total stock-based compensation expense	$ 52,184	$ 36,405

For the three month periods ended July 31, 2009 and July 25, 2008, total income tax benefit associated with employee stock transactions and recognized in stockholders equity was $19,048 and $19,859, respectively.

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		ESPP	
	Three Months Ended		Three Months Ended	
	July 31,	July 25,	July 31,	July 25,

	2009	2008	2009	2008
Expected term in years(1)	3.9	4.0	1.3	1.3
Risk-free interest rate(2)	1.89% - 2.58%	2.93% - 3.69%	0.25% - 0.97%	2.05% - 2.52%
Volatility(3)	43% - 49%	38% - 44%	44% - 47%	39% - 41%
Expected dividend(4)	0%	0%	0%	0%

(1) The expected term 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 term for the ESPP is based on the term of the purchase period.

(2) The risk-free interest rate is based upon United States Treasury bills with equivalent expected terms.

(3) The volatility rate is based on the implied volatility of traded options.

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

Our forfeiture rate is based on historical termination behavior and we recognize compensation expense only for those equity awards expected to vest.

Table of Contents

Stock Option Exchange

On April 21, 2009, our stockholders approved a stock option exchange program (the Exchange) pursuant to which eligible employees were able to exchange some or all of their outstanding options with an exercise price greater than or equal to $22.00 per share that were granted before June 20, 2008, whether vested or unvested, for new RSUs. The number of RSUs granted in exchange for the options depended on the exercise price of the options exchanged. The vesting schedule of the RSUs was determined on a grant-by-grant basis and depended on the extent to which the options surrendered in exchange for such RSUs had vested at the time of such exchange and, for surrendered options that were fully vested, the exercise price. Vesting of the RSUs is conditioned upon continued service with the Company through each applicable vesting date. On May 22, 2009, we commenced the Exchange, which expired on June 19, 2009. In connection with the Exchange, we accepted for exchange options to purchase 24,484 shares of our common stock. All surrendered options were cancelled, and immediately thereafter, we issued a total of 3,226 RSUs in exchange. One share of our common stock is issuable upon the vesting of each RSU. The fair value of the RSUs issued was measured as the total of the unrecognized compensation cost of the options surrendered and the incremental value of the RSUs issued, measured as the excess of the fair value of the RSUs over the fair value of the options tendered immediately before the exchange. The incremental cost of the RSUs was $5,768. The value of the RSUs, totaling $70,110, will be amortized over the weighted average vesting period of the RSUs of 3.5 years.

In addition, under the terms of the Exchange, option holders who would have otherwise received fewer than forty RSUs for options tendered received cash payments equal to the number of RSUs otherwise issuable times the market value of our common stock as of the close of market on the day preceding the completion of the Exchange. A total of $465 in cash payments was made, and we recorded a charge to stock-based compensation expense of $508, which represented the acceleration of the unamortized expense related to the options tendered and their incremental value as of the date of the Exchange.

In connection with the incentive stock options tendered for RSUs under the Exchange, we recorded $10,013 of deferred tax benefits which had not been previously recognized related to the cumulative amortized stock-based compensation expense related to such options which had not been previously benefited for income tax purposes.

Stock Options

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

	Outstanding Options		Weighted Average Remaining	Aggregate
	Numbers of Shares	Weighted Average Exercise Price	Contractual Term (Years)	Intrinsic Value
Outstanding at April 24, 2009	66,119	$ 29.27		
Options granted	2,965	20.56		
Options exercised	(840)	15.41		
Options cancelled in the Exchange	(24,484)	39.05		
Options forfeitures and cancellations	(2,535)	34.90		
Outstanding at July 31, 2009	41,225	22.78	4.54	$ 129,567

Options vested and expected to vest as of July 31, 2009	37,778	22.94	4.41	$	118,251
Exercisable at July 31, 2009	27,643	23.94	3.80	$	81,865

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 three month periods ended July 31, 2009 and July 25, 2008 was $7.59 and $8.44, respectively. The total intrinsic value of options exercised was $4,122 and $9,717 for the three month periods ended July 31, 2009 and July 25, 2008, respectively. We received $12,952 and $9,478 from the exercise of stock options for the three month periods ended July 31, 2009 and July 25, 2008, respectively. There was $96,548 of total unrecognized compensation expense as of July 31, 2009 related to options. The unrecognized compensation expense will be

Table of Contents

amortized on a straight-line basis over a weighted-average remaining period of 2.9 years. Total fair value of options vested during the three month period ended July 31, 2009 was $46,043.

The following table summarizes activity related to our RSUs:

	Numbers of Shares	Weighted Average Grant Date Fair Value
Outstanding at April 24, 2009	5,453	$ 22.38
RSUs granted	923	20.44
RSUs issued in the Exchange	3,226	21.73
RSUs vested	(786)	27.72
RSUs forfeitures and cancellations	(201)	24.01
Outstanding at July 31, 2009	8,615	21.41

As of July 31, 2009, there was $129,657 of total unrecognized compensation expense related to RSUs. The unrecognized compensation expense will be amortized on a straight-line basis over a weighted-average remaining vesting period of 3.1 years.

The following table summarizes activity related to our restricted stock awards:

	Number of Shares	Weighted-Average Grant-Date Fair Value
Nonvested at April 24, 2009	81	$ 36.68
Awards vested	(10)	29.24
Nonvested at July 31, 2009	71	37.73

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 three month periods ended July 31, 2009 and July 25, 2008 was $292 and $390, respectively. There was $1,430 of total unrecognized compensation expense as of July 31, 2009 related to RSAs that will be amortized on a straight-line basis over a weighted-average remaining period of 1.3 years.

Employee Stock Purchase Plan Under the Employee Stock Purchase Plan (ESPP), employees are entitled to purchase shares of our common stock at 85% of the fair market value at certain specified dates over a two-year period. The weighted average fair value of purchase rights granted under the ESPP during the three month periods ended July 31, 2009 and July 25, 2008 was $7.07 and $7.82, respectively. During the three month periods ended July 31, 2009 and July 25, 2008, 2,507 and 1,257 shares, respectively, were issued under the ESPP at a weighted average price of $10.38, and $20.72, respectively.

Stock Repurchase Program

Since the inception of our stock repurchase programs on May 13, 2003 through July 31, 2009, 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. As of July 31, 2009, our Board of Directors had authorized the repurchase of up to $4,023,639 of common stock under various stock repurchase programs, and $1,096,262 remains available under these authorizations. The stock repurchase programs may be suspended or discontinued at any time.

During the three month period ended July 31, 2009, we did not repurchase any shares of our common stock. During the three month period ended July 25, 2008, we repurchased 16,960 shares of our common stock at an aggregate cost of $399,981, or a weighted average price of $23.58 per share. The repurchases were recorded as treasury stock and resulted in a reduction of stockholders equity.

Table of Contents

9. Financial Instruments and Fair Value

We measure assets and liabilities at fair value based upon exit price, representing the amount that would be received on the sale of an asset or paid to transfer a liability, as the case may be, in an orderly transaction between market participants. As such, fair value may be based on assumptions that market participants would use in pricing an asset or liability. SFAS No. 157 establishes a consistent 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.

Investments

The following is a summary of investments at July 31, 2009 and April 24, 2009:

	July 31, 2009				April 24, 2009			
		Gross Unrealized		Estimated		Gross Unrealized		Estimated
	Cost	Gains	Losses	Fair Value	Cost	Gains	Losses	Fair Value
Corporate bonds	$ 469,841	$ 5,304	$ (268)	$ 474,877	$ 486,151	$ 2,318	$ (1,802)	$ 486,667
Auction rate securities	73,028	31	(4,108)	68,951	73,278	296	(7,037)	66,537
U.S. government agency bonds	111,872	1,301	(123)	113,050	80,359	1,415		81,774
U.S. Treasuries	41,761	635	(6)	42,390	31,862	773		32,635
Corporate securities	163,073	16	(2)	163,087	486,546	1	(464)	486,083
Certificates of deposit	110,002	11		110,013	115,002	83		115,085
Money market funds	1,699,175			1,699,175	1,327,794			1,327,794
Total debt and equity securities	2,668,752	7,298	(4,507)	2,671,543	2,600,992	4,886	(9,303)	2,596,575

Less cash equivalents	1,672,553			1,672,553	1,368,355			1,368,355
Less long-term investments	124,658	31	(4,108)	120,581	124,908	296	(7,037)	118,167
Total short-term investments	$ 871,541	$ 7,267	$ (399)	$ 878,409	$ 1,107,729	$ 4,590	$ (2,266)	$ 1,110,053

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 31, 2009:

	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	$ 474,877	$	$ 474,877	$
Trading securities	10,667	10,667		
U.S. government agency bonds	113,050		113,050	
U.S. Treasuries	42,390	42,390		
Corporate securities	163,087		163,087	
Certificates of deposit	110,013		110,013	
Money market funds	1,699,175	1,647,545		51,630
Auction rate securities	68,951			68,951
Investment in nonpublic companies	2,307			2,307
Foreign currency contracts	1,185		1,185	
Total	$ 2,685,702	$ 1,700,602	$ 862,212	$ 122,888
Liabilities				
Foreign currency contracts	$ 4,618	$	$ 4,618	$

Reported as:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash equivalents(1)	$ 1,672,553	$ 1,647,545	$ 25,008	$
Short-term investments(2)	878,409	42,390	836,019	
Trading securities(3)	10,667	10,667		
Long-term investments(4)	122,888			122,888
Foreign currency contracts(5)	1,185		1,185	
Total	$ 2,685,702	$ 1,700,602	$ 862,212	$ 122,888

Liabilities							
Foreign currency contracts(6)	$	4,618	$		$	4,618	$

(1) Included in Cash and cash equivalents in the accompanying condensed consolidated balance sheet, in addition to $111,835 of cash.

(2) Our marketable securities include U.S. Treasury securities, U.S. government agency bonds, corporate bonds, corporate securities, auction rate securities, and money market funds, including the Primary Fund (as defined below) and certificates of deposit. 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 certain money market funds, for which the carrying amounts is a reasonable estimate of fair value.

(3) Trading securities relate to a deferred compensation plan; $1,523 of the deferred compensation plan assets were included in prepaid expenses and other assets and $9,144 of the deferred compensation plan assets were

Table of Contents

included in long-term deferred income taxes and other assets in the accompanying condensed consolidated balance sheet.

(4) Included in long-term investments and restricted cash in the accompanying condensed consolidated balance sheet, in addition to $5,614 of long-term restricted cash.

(5) Included in prepaid expenses and other assets in the accompanying condensed consolidated balance sheet.

(6) Included in other accrued liabilities in the accompanying condensed consolidated balance sheet.

We classify investments within Level 1 if quoted prices are available in active markets. Level 1 investments generally include U.S. Treasury notes, trading securities with quoted prices on active markets, and money market funds, with the exception of the Primary Fund, which is classified in Level 3.

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 agency bonds, certificates of deposit, and foreign currency contracts. 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. We corroborate the prices obtained from the pricing service against other independent sources and, as of July 31, 2009, have not found it necessary to make any adjustments to the prices obtained.

The unrealized losses on our available-for-sale investments in corporate bonds, U.S. government agency bonds, U.S. Treasuries and corporate debt securities were caused by market value declines as a result of the recent economic environment, as well as fluctuations in market interest rates, and such investments have been in a continuous unrealized loss position for less than twelve months. Because the decline in market value is attributable to changes in market conditions and not credit quality, and because we do not intend to sell and we will not be likely to be required to sell those investments prior to a recovery of par value, we do not consider these investments to be other-than temporarily impaired at July 31, 2009.

Our foreign currency forward exchange contracts are also classified within Level 2. We determine the fair value of these instruments by considering the estimated amount we would pay or receive to terminate these agreements at the reporting date. We use observable inputs, including quoted prices in active markets for similar assets or liabilities. 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. In the three month period ended July 31, 2009, net gains generated by hedged assets and liabilities totaled $9,749, which were offset by losses on the related derivative instruments of $11,751. In the three month period ended July 25, 2008, net gains generated by hedged assets and liabilities totaled $320, which were offset by losses on the related derivative instruments of $2,618.

We classify items in Level 3 if the investments are valued using a pricing model or based on unobservable inputs in the market. These investments include auction rate securities, the Primary Fund and cost method investments.

The table below provides a reconciliation of our Level 3 financial assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three month period ended July 31, 2009.

	Primary Fund	Auction Rate Securities	Private Equity Fund	Nonpublic Companies

Balance at April 24, 2009	$ 51,630	$ 66,537	$ 2,023	$ 1,946
Total unrealized gains included in other comprehensive income		2,664		
Total realized gains (losses) included in earnings			110	(202)
Purchases, sales and settlements, net		(250)	(137)	(1,433)
Balance at July 31, 2009	$ 51,630	$ 68,951	$ 1,996	$ 311

As of July 31, 2009 and April 24, 2009, we had a remaining investment of $51,630, with a par value of $60,928, in the Reserve Primary Fund (the Primary Fund), which is a money-market fund that suspended redemptions in

Table of Contents

September 2008 and is in the process of liquidating its portfolio of investments. All amounts invested in the Primary Fund are included in long-term investments given the lack of liquidity of the fund and the uncertainty as to the timing and the amount of the final distributions of the fund. On December 3, 2008, the Primary Fund announced a plan for liquidation and distribution of assets that includes the establishment of a special reserve to be set aside out of its assets for pending or threatened claims, as well as anticipated costs and expenses, including related legal and accounting fees. On February 26, 2009, the Primary Fund announced a plan to set aside $3,500,000 of the fund s remaining assets as the special reserve which may be increased or decreased as further information becomes available. Our pro rata share of the $3,500,000 special reserve is approximately $41,455. The Primary Fund announced plans to continue to make periodic distributions, up to the amount of the special reserve, on a pro-rata basis. We received distributions of $546,344 in fiscal 2009 from the Primary Fund. On May 5, 2009, the SEC filed suit seeking an order to distribute the fund s remaining assets to investors expeditiously on a pro rata basis. The U.S. District Court for the Southern District of New York will hold a hearing to consider the SEC s proposed plan of distribution on September 23, 2009. We could realize additional losses in our holdings of the Primary Fund and may not receive all or a portion of our remaining balance in the Primary Fund as a result of market conditions and ongoing litigation against the fund.

As of July 31, 2009 and April 24, 2009, we had auction rate securities (ARSs) with a par value of $75,150 and $75,400, respectively, and an estimated fair value of $68,951 and $66,537, respectively, which are classified as long-term investments. Substantially all of our ARSs are backed by pools of student loans guaranteed by the U.S. Department of Education. As of July 31, 2009, we recorded cumulative temporary losses of $4,108 within other comprehensive income (loss). In addition, we recorded other-than-temporary losses of $2,122 in other income (expense), net, in October 2008 based on an analysis of the fair value and marketability of these investments. We estimated the fair value for each individual ARS using an income (discounted cash flow) approach which incorporates both observable and unobservable inputs to discount the expected future cash flows. Based on our ability to access our cash and other short-term investments, our expected operating cash flows, and our other sources of cash, we do not intend to sell these investments prior to recovery of value. We will continue to monitor our ARS investments in light of the current debt market environment and evaluate our accounting for these investments.

As of July 31, 2009 and April 24, 2009, we held equity investments in privately-held companies of $2,307 and $3,969, respectively. For the three month periods ended July 31, 2009 and July 25, 2008, other-than-temporary losses, net, related to these investments were $92 and $2,621, respectively.

10. Derivative Financial Instruments

We use derivative instruments to manage exposures to foreign currency risk. Our primary objective in holding derivatives is to reduce the volatility of earnings and cash flows associated with changes in foreign currency. The program is not designated for trading or speculative purposes. Our derivatives expose us to credit risk to the extent that the counterparties may be unable to meet the terms of the agreement. We seek to mitigate such risk by limiting our counterparties to major financial institutions. In addition, the potential risk of loss with any one counterparty resulting from this type of credit risk is monitored on an ongoing basis. We also have in place a master netting arrangement to mitigate the credit risk of our counterparty and potentially to reduce our losses due to counterparty nonperformance. All contracts have a maturity of less than six months.

We recognize derivative instruments as either assets or liabilities on the balance sheet at fair value. Changes in fair value (i.e. gains or losses) of the derivatives are recorded as revenues or other income (expense), or as AOCI. If the derivative is designated as a hedge, depending on the nature of the exposure being hedged, changes in fair value will either be offset against the change in fair value of the hedged items through earnings or recognized in AOCI until the hedged item is recognized in earnings. Any ineffective portion of the hedge is recognized in earnings immediately.

Currently, we do not enter into any foreign exchange forward contracts to hedge exposures related to firm commitments or nonmarketable investments. Our major foreign currency exchange exposures and related hedging programs are described below:

Balance Sheet. We utilize monthly foreign currency forward and options contracts to hedge exchange rate fluctuations related to certain foreign monetary assets and liabilities. These derivative instruments do not subject us to material balance sheet risk due to exchange rate movements because gains and losses on these derivatives are intended to offset gains and losses on the assets and liabilities being hedged and the net amount is included in earnings.

Forecasted Transactions. We use currency forward contracts to hedge exposures related to forecasted sales denominated in certain foreign currencies. These contracts are designated as cash flow hedges and in general closely match the underlying forecasted transactions in duration. The contracts are carried on the balance sheet at fair value, and the effective portion of the contracts gains and losses is recorded as AOCI until the forecasted transaction occurs. When the forecasted transaction occurs, we reclassify the related gain or loss on the cash flow hedge to revenue. If the underlying forecasted transactions do not occur, or it becomes probable that they will not occur, the gain or loss on the related cash flow hedge is recognized immediately in earnings. We measure the effectiveness of hedges of forecasted transactions on a monthly basis by comparing the fair values of the designated currency forward contracts with the fair values of the forecasted transactions. Any ineffective portion of the derivative hedging gain or loss as well as changes in the fair value of the derivative s time value (which are excluded from the assessment of hedge effectiveness) is recognized in current period earnings. During the three month period ended July 31, 2009, no ineffectiveness was recognized in earnings and the time value component in our cash flow hedges of $19 was recognized as a reduction to other income, (expenses), net.

Over the next twelve months, it is expected that $1,180 of derivative net losses recorded in AOCI as of July 31, 2009 will be reclassified into earnings as an adjustment to revenues. The maximum length of time over which forecasted foreign denominated revenues are hedged is six months.

As of July 31, 2009, we had the following outstanding currency forward contracts that were entered into to hedge forecasted foreign denominated sales and our balance sheet monetary asset and liability exposures:

Cash Flow Hedges:

Currency	Buy/Sell	Notional
Euro (EUR)	Sell	$ 56,710
British pound (GBP)	Sell	21,179

Balance Sheet contracts:

Currency	Buy/Sell	Notional
Euro (EUR)	Sell	$ 158,062
British pound (GBP)	Sell	47,888
Canadian dollar (CAD)	Sell	11,563
Other	Sell	15,413
Australia Dollar (AUD)	Buy	29,572
Other	Buy	8,329

We net derivative assets and liabilities in the consolidated balance sheets to the extent that master netting arrangements meet the requirements of FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts (Interpretation No. 39), as amended by FASB Interpretation No. 41, Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements.*

Table of Contents

The fair value of derivative instruments in our condensed consolidated balance sheets as of July 31, 2009 was as follows:

	Fair Values of Derivative Instruments					
	Asset Derivatives			Liability Derivatives		
	Balance Sheet Location		Fair Value	Balance Sheet Location		Fair Value
Derivatives designated as hedging instruments:						
Foreign exchange forward contracts	Prepaid expense and other assets	$		Accrued expenses	$	(1,186)
Derivatives not designated as hedging instruments:						
Foreign exchange forward contracts	Prepaid expense and other assets		1,691	Accrued expenses		(3,938)
Total derivatives		$	1,691		$	(5,124)

The effect of derivative instruments designated as cash flow hedges on our condensed consolidated statements of operations for the three month period ended July 31, 2009 was as follows:

Derivatives in Cash Flow Hedging Relationships	Loss Recognized in AOCI(1)	Loss Reclassified from AOCI into Income (2)	Loss Recognized in Income(3)
Foreign exchange forward contracts	$ (4,838)	$ (4,180)	$ (19)

(1) Amount recognized in AOCI (effective portion).

(2) Amount of loss reclassified from AOCI into income (effective portion) located in revenue.

(3) No ineffectiveness was recognized during the period. Amount of loss recognized in income on derivatives relate to the time value amount being excluded from the effectiveness testing. Such amount is located in other expenses, net.

The effect of derivative instruments not designated as hedges on our condensed consolidated statements of operations for the three month period ended July 31, 2009 was as follows:

	Loss

Derivatives Not Designated as Hedging Instruments	Recognized(*)
Foreign exchange forward contracts	$ (11,731)

(*) Amount of loss recognized in income located in other expenses, net.

11. Inventories

Inventories are stated at the lower of cost or market, with cost determined on a first in, first out basis. Inventories consist of the following:

	July 31, 2009	April 24, 2009
Purchased components	$ 5,156	$ 5,034
Work-in-process	78	56
Finished goods	56,421	56,014
Total	$ 61,655	$ 61,104

12. Goodwill and Purchased Intangible Assets

Goodwill as of July 31, 2009 and April 24, 2009 was $680,986. We conducted our annual goodwill impairment test in the three month period ended April 24, 2009. Based on this analysis, we determined that there was no impairment to goodwill. We will continue to monitor conditions and changes that could indicate that our recorded goodwill may be impaired.

Table of Contents

Identified intangible assets are summarized as follows:

	Amortization Period (Years)	July 31, 2009 Gross Assets	July 31, 2009 Accumulated Amortization	July 31, 2009 Net Assets	April 24, 2009 Gross Assets	April 24, 2009 Accumulated Amortization	April 24, 2009 Net Assets
Identified Intangible Assets:							
Patents	5	$ 895	$ (791)	$ 104	$ 10,040	$ (9,891)	$ 149
Existing technology	4 - 5	90,700	(58,765)	31,935	107,860	(71,210)	36,650
Trademarks/tradenames	2 - 7	6,600	(3,676)	2,924	6,600	(3,419)	3,181
Customer contracts/relationships	2 - 8	12,200	(7,027)	5,173	12,500	(6,736)	5,764
Total identified intangible assets, net		$ 110,395	$ (70,259)	$ 40,136	$ 137,000	$ (91,256)	$ 45,744

Amortization expense for identified intangible assets is summarized below:

	Three Months Ended July 31, 2009	Three Months Ended July 25, 2008	Statement of Operations Classifications
Patents	$ 45	$ 345	Research and development
Existing technology	4,715	6,748	Cost of product revenues
Other identified intangibles	848	1,259	Sales and marketing
	$ 5,608	$ 8,352	

Based on the identified intangible assets recorded at July 31, 2009, the future amortization expense of identified intangibles for the next five fiscal years is as follows:

Fiscal Year	**Amount**
Remainder of 2010	$ 15,028
2011	11,701
2012	7,150
2013	4,963
2014	554
Thereafter	740
Total	$ 40,136

13. Restructuring and Other Charges

In the three month period ended July 31, 2009, we recorded restructuring expense of $1,496, net, primarily related to employee severance costs associated with our fiscal 2009 restructuring plan.

Fiscal 2009 Restructuring Plan

In February 2009, we announced our decision to execute a worldwide restructuring program, which included a reduction in workforce, the closing or downsizing of certain facilities, and the establishment of a plan to outsource certain internal activities. In December 2008, we announced our decision to cease the development and availability of our SnapMirror® for Open Systems product, which was originally acquired through our acquisition of Topio, Inc. in fiscal 2007. As part of this decision, we also announced the closure of our engineering facility in Haifa, Israel.

As of July 31, 2009, approximately $7,596 of the costs associated with these activities was unpaid. We expect that severance-related charges and other costs will be substantially paid by January 2010 and the facilities-related lease payments to be substantially paid by January 2013.

Fiscal 2002 Restructuring Plan

As of July 31, 2009, we also have $1,092 remaining in facility restructuring reserves established as part of a restructuring plan in fiscal 2002 related to future lease commitments on exited facilities, net of expected sublease income. We expect to substantially fulfill the remaining contractual obligations related to this facility restructuring reserve by fiscal 2011.

Activities related to the restructuring reserves for the three month period ended July 31, 2009 were as follows:

	Severance-Related Charges	Facilities	Contract Cancellation Costs	Other	Total
Reserve balance at April 24, 2009	$ 10,282	$ 5,446	$ 199	$ 1,234	$ 17,161
Adjustments to accrual and other charges	993	114	(1)	390	1,496
Cash payments	(8,450)	(944)	(78)	(927)	(10,399)
Foreign currency changes	195	328	13	(106)	430
Reserve balance at July 31, 2009	$ 3,020	$ 4,944	$ 133	$ 591	$ 8,688

Of the reserve balance at July 31, 2009, $6,531 was included in other accrued liabilities, and the remaining $2,157 was classified as other long-term obligations.

14. Net Income per Share

Basic net income per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding, excluding common shares subject to repurchase 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 and common shares issuable upon exercise of stock options, restricted stock units, ESPP shares, warrants, and restricted stock awards.

Certain awards outstanding, representing 44,017 and 46,230 shares of common stock, have been excluded from the diluted net income per share calculations for the three month periods ended July 31, 2009 and July 25, 2008, respectively, because their effect would have been antidilutive as their exercise prices were above the average market prices in such periods. Diluted shares outstanding do not include any effect resulting from the conversion of our Notes issued in June 2008, warrants and ESPP shares as their impact would be anti-dilutive for all periods presented.

Repurchased shares are held as treasury stock and our outstanding shares used to calculate earnings per share have been reduced by the weighted number of repurchased shares.

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 31, 2009	Three Months Ended July 25, 2008
Net Income (Numerator):		
Net income, basic and diluted	$ 51,664	$ 34,723

Shares (Denominator):		
Weighted average common shares outstanding	334,613	333,991
Weighted average common shares outstanding subject to repurchase	(76)	(136)
Shares used in basic computation	334,537	333,855
Weighted average common shares outstanding subject to repurchase	76	136
Diluted weighted average shares outstanding	4,262	7,129
Shares used in diluted computation	338,875	341,120
Net Income per Share:		
Basic	$ 0.15	$ 0.10
Diluted	$ 0.15	$ 0.10

Table of Contents

15. Comprehensive Income

The components of comprehensive income were as follows:

	Three Months Ended July 31, 2009	Three Months Ended July 25, 2008
Net income	$ 51,664	$ 34,723
Change in currency translation adjustments	2,379	(316)
Change in unrealized gain (loss) on available-for-sale investments, net of related tax effect	6,940	(2,448)
Change in unrealized gain (loss) on derivatives qualifying as cash flow hedges	(657)	779
Comprehensive income	$ 60,326	$ 32,738

The components of accumulated other comprehensive income (loss) were as follows:

	July 31, 2009	April 24, 2009
Accumulated translation adjustments	$ 2,047	$ (332)
Accumulated unrealized gain (loss) on available-for-sale investments	2,637	(4,303)
Accumulated unrealized loss on derivatives qualifying as cash flow hedges	(1,180)	(523)
Total accumulated other comprehensive income (loss)	$ 3,504	$ (5,158)

16. Commitments and Contingencies

The following summarizes our commitments and contingencies at July 31, 2009, and the effect such obligations may have on our future periods:

	2010*	2011	2012	2013	2014	Thereafter	Total
Contractual Obligations:							
Office operating lease payments	$ 20,558	$ 23,161	$ 18,142	$ 15,067	$ 12,956	$ 30,575	$ 120,459
Real estate lease payments(1)	2,776	3,701	3,701	129,473			139,651
Equipment operating lease payments	21,913	18,786	7,316	977	3		48,995
Purchase commitments with contract	60,016						60,016

manufacturers(2)							
Other purchase orders and commitments	23,408	14,085	6,994	3,779	1,200	133	49,599
Total Contractual Cash Obligations	$ 128,671	$ 59,733	$ 36,153	$ 149,296	$ 14,159	$ 30,708	$ 418,720
Other Commercial Commitments:							
Letters of credit	$ 4,263	$ 520	$ 347	$ 64	$	$ 600	$ 5,794

* Reflects the remaining nine months of fiscal year 2010.

(1) Included in real estate lease payments pursuant to four financing arrangements with BNP Paribas Leasing Corporation (BNPPLC) are (i) lease commitments of $2,776 in the remainder of fiscal 2010; $3,701 in each of the fiscal years 2011 and 2012; $2,355 in fiscal 2013, which are based on the LIBOR rate at July 31, 2009 plus a

spread or a fixed rate, for terms of five years; and (ii) at the expiration or termination of the lease, a supplemental payment obligation equal to our minimum guarantee of $127,118 in the event that we elect not to purchase or arrange for sale of the buildings.

(2) Contract manufacturer commitments consist of obligations for on hand inventories and non-cancelable purchase orders with our contract manufacturer. We record a liability for firm, noncancelable, and nonreturnable purchase commitments for quantities in excess of our future demand forecasts, which is consistent with the valuation of our excess and obsolete inventory. As of July 31, 2009, the liability for these purchase commitments in excess of future demand was approximately $1,832 and is recorded in other accrued liabilities.

Real Estate Leases

As of July 31, 2009, we have four leasing arrangements (Leasing Arrangements 1, 2, 3 and 4) with BNPPLC which requires us to lease our land to BNPPLC for a period of 99 years, and to lease approximately 564,274 square feet of office space for our headquarters in Sunnyvale costing up to $149,550. Under these leasing arrangements, we pay BNPPLC minimum lease payments, which vary based on LIBOR plus a spread or a fixed rate on the costs of the facilities on the respective lease commencement dates. We make payments for each of the leases for a term of five years. We have the option to renew each of the leases for two consecutive five-year periods upon approval by BNPPLC. Upon expiration (or upon any earlier termination) of the lease terms, we must elect one of the following options: (i) purchase the buildings from BNPPLC at cost; (ii) if certain conditions are met, arrange for the sale of the buildings by BNPPLC to a third party for an amount equal to at least 85% of the costs (residual guarantee), and be liable for any deficiency between the net proceeds received from the third party and such amounts; or (iii) pay BNPPLC supplemental payments for an amount equal to at least 85% of the costs (residual guarantee), in which event we may recoup some or all of such payments by arranging for a sale of each or all buildings by BNPPLC during the ensuing two-year period. The following table summarizes the costs, the residual guarantee, the applicable LIBOR plus spread or fixed rate at July 31, 2009, and the date we began to make payments for each of our leasing arrangements:

Leasing Arrangements	Cost	Residual Guarantee	LIBOR plus Spread or Fixed Rate	Lease Commencement Date	Term
1	$ 48,500	$ 41,225	3.99%	January 2008	5 years
2	$ 79,950	$ 67,958	1.16%	December 2007	5 years
3	$ 10,475	$ 8,904	3.97%	December 2007	5 years
4	$ 10,625	$ 9,031	3.99%	December 2007	5 years

All leases require us to maintain specified financial covenants with which we were in compliance as of July 31, 2009. Such financial covenants include a maximum ratio of Total Debt to Earnings Before Interest, Taxes, Depreciation and Amortization and a minimum amount of Unencumbered Cash and Short-Term Investments.

Warranty Reserve

We provide customers a warranty on software of ninety days and 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, distribution and labor costs. Our accrued liability for estimated future warranty costs is included in other accrued liabilities and other long-term obligations on the accompanying consolidated balance sheets. Factors that affect our warranty liability include the number of installed units, estimated material costs, estimated distribution costs and

24

Table of Contents

estimated labor costs. We periodically assess the adequacy of our warranty accrual and adjust the amount as considered necessary. Changes in product warranty liability were as follows:

	Three Months Ended	
	July 31, 2009	**July 25, 2008**
Warranty reserve at beginning of period	$ 42,325	$ 42,815
Expense accrued during the period	5,303	5,600
Warranty costs incurred	(7,331)	(6,486)
Warranty reserve at end of period	$ 40,297	$ 41,929

Recourse and Nonrecourse Leases

We have both recourse and nonrecourse lease financing arrangements with third-party leasing companies through new and 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. These arrangements are generally collateralized by a security interest in the underlying assets. 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 are received. As of July 31, 2009, the maximum recourse exposure under such leases totaled approximately $31,161. 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 our lease financing programs.

Purchase Commitments

In the normal course of business we make commitments to our third party contract manufacturers, to manage manufacturer lead times and meet product forecasts, and to other parties, to purchase various key components used in the manufacture of our products. We establish accruals for estimated losses on purchased components 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.

Indemnification agreements

We enter into standard indemnification agreements in the ordinary course of business. Pursuant to these agreements, we agree to defend and indemnify the other party, primarily our customers or business partners or subcontractors, for damages and reasonable costs incurred in any suit or claim brought against them alleging that our products sold to them infringe any U.S. patent, copyright, trade secret, or similar right. If a product becomes the subject of an infringement claim, we may, at our option: (i) replace the product with another noninfringing product that provides substantially similar performance; (ii) modify the infringing product so that it no longer infringes but remains functionally equivalent; (iii) obtain the right for the customer to continue using the product at our expense and for the reseller to continue selling the product; (iv) take back the infringing product and refund to customer the purchase price paid less depreciation amortized on a straight-line basis. We have not been required to make material payments pursuant to these provisions historically. We have not recorded any liability at July 31, 2009 related to these guarantees since the maximum amount of potential future payments under such guarantees, indemnities and warranties is not determinable, other than as described above.

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 flows, operating results, or financial condition.

In April 2009, we entered into a settlement agreement with the United States of America, acting through the United States Department of Justice (DOJ) and on behalf of the General Services Administration (the GSA), under which we paid the United States $128,000, plus interest of $715, related to a dispute regarding our discount

Table of Contents

practices and compliance with the price reduction clause provisions of GSA contracts between August 1997 and February 2005. We are currently in discussions with the U.S. government to demonstrate that we have implemented processes and procedures to ensure that we comply with federal contracting rules.

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. The three lawsuits are currently in the discovery phase and no trial date has been set, so we are unable at this time to determine the likely outcome of these various patent litigations. Since we are unable to reasonably estimate the amount or range of any potential settlement, no accrual has been recorded as of July 31, 2009.

17. Income Taxes

Our effective tax rate for the three month period ended July 31, 2009 was 12.7%, compared with 13.4% for the three month period ended July 25, 2008. Our effective tax rate reflects the impact of a significant amount of our earnings being taxed in foreign jurisdictions at rates below the U.S. statutory tax rate.

We maintain liabilities for uncertain tax positions. These liabilities involve considerable judgment and estimation and are continuously monitored by management based on the best information available, including changes in tax regulations, the outcome of relevant court cases, and other information. We are currently under examination by various taxing authorities. Although the outcome of any tax audit is uncertain, we believe we have adequately provided in our condensed consolidated financial statements for any additional taxes that we may be required to pay as a result of such examinations. If the payment ultimately proves to be unnecessary, the reversal of these tax liabilities would result in tax benefits being recognized in the period we determine such liabilities are no longer necessary. However, if an ultimate tax assessment exceeds our estimate of tax liabilities, additional tax expense will be recorded.

As of July 31, 2009, our unrecognized tax benefits were $142,346 of which $105,435, if recognized, would affect our provision for income taxes. In the three month period ended July 31, 2009, we recognized deferred tax assets of $8,290 which had a corresponding increase to additional paid in capital to reflect the related additional recognition of tax benefits from stock options.

During fiscal year 2009, we received Notices of Proposed Adjustments from the IRS in connection with a federal income tax audit of our fiscal 2003 and 2004 tax year tax returns. We recently filed a protest with the IRS in response to the Notices of Proposed Adjustments. The Notices of Proposed Adjustments focus primarily on issues of the timing and the amount of income recognized and deductions taken during the audit years and on the level of cost allocations made to foreign operations during the audit years. If upon the conclusion of this audit, the ultimate determination of our taxes owed in the U.S. is for an amount in excess of the tax provision we have recorded in the applicable period or subsequently reserved for, our overall tax expense and effective tax rate may be adversely impacted in the period of adjustment.

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;

our restructuring plans and estimates;

competitive positions;

product introductions, development, enhancements and acceptance;

economic and industry trends or trend analyses;

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;

compliance with laws, regulations and loan covenants; and

the conversion, maturation or repurchase of the Notes,

are 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 increase revenue;

our ability to successfully execute on our strategy;

our ability to increase our customer base, market share and revenue;

our ability to successfully introduce new products;

our ability to adapt to changes in market demand;

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

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 management of our investment in people, process, and systems;

our ability to maintain our supplier and contract manufacturer relationships;

the ability of our suppliers and contract manufacturers to meet our requirements;

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

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

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

variability in our gross margins;

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

our cash requirements and terms and availability of financing;

valuation and liquidity of our investment portfolio;

our ability to finance business acquisitions, construction projects and capital expenditures through cash from operations and/or financing;

the impact of industry consolidation;

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

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

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof and are based upon information available to us at this time. These statements are not guarantees of future performance. We disclaim any obligation to update information in any forward-looking statement. Actual results could vary from our forward looking statements due to foregoing factors as well as other important factors, including those described in the Risk Factors included on page 45.

Overview

Revenue for the three month period ended July 31, 2009 was $838.0 million, down 4% from the comparable period in the prior year. Though the macroeconomic environment showed signs of moderate stabilization, capital spending by customers remained under pressure.

Gross margins strengthened during the current period due largely to improvements in product materials cost and an increase in software entitlements and maintenance services in the revenue mix.

During the three month period ended July 31, 2009, we entered into a merger agreement with Data Domain, Inc., which was subsequently terminated on July 8, 2009. In accordance with the agreement, we received a $57.0 million termination fee, which, when netted against $15.9 million of incremental third-party costs we incurred relating to the terminated merger agreement, resulted in net proceeds of $41.1 million.

During the three month period ended July 31, 2009, operating expenses, excluding restructuring charges and the net merger termination proceeds, were $491.3 million, up 3% from the comparable period of the prior year, and reflected the impact of having 14 weeks in the current three month period compared to 13 weeks in the prior year. We continue to focus on maintaining spending discipline in light of the current business conditions.

Critical Accounting Estimates and Policies

Our discussion and analysis of financial conditions and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of such statements requires us to make estimates and assumptions that affect the reported amounts of revenues and expenses during the reporting period and the reported amounts of assets

Table of Contents

and liabilities as of the date of the financial statements. Our estimates are based on historical experience and other assumptions that we consider to be appropriate in the circumstances. However, actual future results may vary from our estimates.

We believe the accounting policies and estimates discussed under Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended April 24, 2009, affect our more significant judgments and estimates used in the preparation of the condensed consolidated financial statements. There have been no material changes to the critical accounting policies and estimates as filed in such report, except for the retrospective adoption of FASB Staff Position No. APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP APB No. 14-1).

Recent Accounting Pronouncements

Information regarding recent accounting pronouncements is provided in Note 2 of the notes to condensed consolidated financial statements.

Results of Operations

The following table sets forth certain consolidated statements of operations data as a percentage of net revenues for the periods indicated:

	Three Months Ended	
	July 31, 2009	**July 25, 2008**
Revenues:		
Product	57.1%	63.1%
Software entitlements and maintenance	19.7	16.6
Service	23.2	20.3
	100.0	100.0
Cost of Revenues:		
Cost of product	25.3	28.7
Cost of software entitlements and maintenance	0.4	0.3
Cost of service	11.9	11.5
Gross Margin	62.4	59.5
Operating Expenses:		
Sales and marketing	35.9	34.9
Research and development	15.6	14.4
General and administrative	7.1	5.7
Restructuring and other charges	0.2	
Merger termination proceeds, net	(4.9)	
Total Operating Expenses	53.9	55.0
Income from Operations	8.5	4.5

Other Income (Expenses), Net:		
Interest income	1.0	1.7
Interest expense	(2.3)	(1.1)
Loss on investments, net		(0.3)
Other income (expenses), net	(0.1)	(0.2)
Total Other Income (Expenses), Net	(1.4)	0.1
Income Before Income Taxes	7.1	4.6
Provision for Income Taxes	0.9	0.6
Net Income	6.2%	4.0%

Discussion and Analysis of Results of Operations

Net Revenues Our net revenues for the three month periods ended July 31, 2009 and July 25, 2008 were as follows:

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change
	(In millions)		
Net revenues	$ 838.0	$ 868.8	(4)%

Net revenues decreased by $30.8 million in the three month period ended July 31, 2009, and were down 4% from the comparable period in the prior year. The decrease in net revenues was due to decreases in product revenues, partially offset by increases in software entitlements and maintenance revenues, as well as in service revenues.

Sales through our indirect channels represented 69% and 61% of net revenues for the three month periods ended July 31, 2009 and July 25, 2008, respectively.

During the three month period ended July 31, 2009, Arrow and Avnet, who are U.S. distributors, each accounted for approximately 11% of net revenues. No customer accounted for ten percent or more of net revenues during the three month period ended July 25, 2008.

Product Revenues

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change
	(In millions)		
Product revenues	$ 478.2	$ 547.9	(13)%

Product revenues decreased by $69.7 million for the three month period ended July 31, 2009, and were down 13% from the comparable period in the prior year. Our configured systems comprise bundled hardware and software products. Unit volume decreased by 7%, with the largest decrease related to high-end systems. During the three month period ended July 31, 2009, high-end, midrange and low-end systems generated approximately 20%, 60% and 20% of configured systems revenue, respectively, compared to approximately 30%, 50% and 20%, respectively in the prior year. This year over year trend is consistent with a shift in customer buying patterns towards smaller systems, which we believe is due to information technology (IT) spending constraints and difficult economic conditions. In addition, average selling prices declined on midrange and low-end systems, driven by lower list prices, unfavorable configuration mix (consisting of hardware and software components, disk capacity and disk price) and higher discounting during the three month period ended July 31, 2009. As a result, declines in configured systems revenues and add-on product revenues contributed to a 12% and a 2% decrease in product revenues, respectively.

Our systems are highly configurable to respond to customer requirements in the open systems storage markets that we serve. This wide variation in customer configurations can significantly impact revenue, cost of revenue, and gross margin performance. Price changes, unit volumes, and product configuration mix can also impact revenue, cost of revenue and gross margin performance. Disks are a significant component of our storage systems. Industry disk pricing continues to fall every year, and we pass along those price decreases to our customers while working to maintain relatively constant margins on our disk drives. While price per petabyte continues to decline, system performance, increased capacity and software to manage this increased capacity have an offsetting impact on product revenue.

Software Entitlements and Maintenance Revenues

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change
	(In millions)		
Software entitlements and maintenance revenues	$ 165.3	$ 144.4	15%

Software entitlements and maintenance (SEM) revenues increased by $20.9 million for the three month period ended July 31, 2009, were up 15% from the comparable period in the prior year. This year over year increase in SEM revenues was driven by an increase in the aggregate contract value of the installed base under SEM contracts and the timing of the recognition of the related revenue.

Service Revenues

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change
	(In millions)		
Service revenues	$ 194.4	$ 176.5	10%

Service revenues increased by $17.9 million for the three month period ended July 31, 2009, and were up 10% from the comparable period in the prior year. Service revenues include service maintenance, professional services and educational and training services. Service maintenance contract revenues increased 19%, driven by an increase in the installed base under service contract and the timing of the recognition of the related revenue, partially offset by a 4% decline in professional services and educational and training services revenues.

Revenues by Geographic Area

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change
	(In millions)		
International	$ 364.8	$ 399.5	(9)%
United States	473.2	469.3	1%
Net revenues	$ 838.0	$ 868.8	

Total international revenues (including U.S. exports) were approximately 44% of net revenues for the three month period ended July 31, 2009, compared to 46% for the comparable period in the prior year.

Cost of Revenues

Our cost of revenues includes: (1) cost of product revenues, which includes the costs of manufacturing and shipping of our storage systems, and amortization of purchased intangible assets, inventory write-downs, and warranty costs; (2) cost of software maintenance and entitlements, which includes the costs of providing software entitlements and maintenance and third party royalty costs, and (3) cost of service, which reflects costs associated with providing services for support center activities and global service partnership programs.

Our gross margins are impacted by a variety of factors including pricing and discount practices, channel sales mix, revenue mix and the margin profile of new products. Service gross margin is also typically impacted by factors such as changes in the size of our installed base of products, as well as the timing of support service initiations and renewals, and incremental investments in our customer support infrastructure. If our shipment volumes, product and services mix, average selling prices and pricing actions that impact our gross margin are adversely affected, whether by the economic downturn or for other reasons, our gross margin could decline.

Cost of Product Revenues

	Three Months Ended		
	July 31, 2009	**July 25, 2008**	**% Change**
	(In millions)		
Cost of product revenues	$ 212.5	$ 249.8	(15)%

Cost of product revenues decreased by $37.3 million for the three month period ended July 31, 2009, and was down 15% from the comparable period in the prior year, primarily due to decreased materials cost of $32.7 million resulting from lower unit volume and lower average per unit materials costs across all of our systems. Cost of

Table of Contents

product revenues represented 44% and 46% of product revenue for the three month periods ended July 31, 2009 and July 25, 2008, respectively.

Cost of product revenues decreased due to the following:

	Percent Change 2009 to 2010
Materials costs	(13)%
Excess and obsolete inventory	1
Other	(3)
Total change	(15)%

Cost of Software Entitlements and Maintenance Revenues

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change
	(In millions)		
Cost of software entitlements and maintenance revenues	$ 3.1	$ 2.2	42%

Cost of software entitlements and maintenance revenues (SEM) increased $0.9 million for the three month period ended July 31, 2009, and was up 42% from the comparable period in the prior year, due to an increase in field service engineering costs. Cost of SEM revenue represented 2% of SEM revenue for each of the three month periods ended July 31, 2009 and July 25, 2008.

Cost of Service Revenues

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change
	(In millions)		
Cost of service revenues	$ 99.8	$ 100.2	%

Cost of service revenues decreased by $0.4 million for the three month period ended July 31, 2009 compared to the three month period ended July 25, 2008. Cost of service revenues represented 51% and 57% of service revenue for the three month periods ended July 31, 2009 and July 25, 2008, respectively, reflecting improved productivity.

Operating Expenses

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

Compensation costs comprise the largest component of operating expenses. Included in compensation costs are salaries and related benefits, stock-based compensation costs and performance based employee incentive plan compensation costs. The increase in compensation costs during the three month period ended July 31, 2009 as compared to the three month period ended July 25, 2008 related primarily to an increase in stock-based compensation, employee incentive compensation, and a minor increase in headcount. In addition, operating expenses were higher due to additional employee compensation related to the additional week of spending in the three month period ended July 31, 2009 compared to the comparable period in the prior year.

Sales and Marketing

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change
	(In millions)		
Sales and marketing expenses	$ 301.4	$ 303.1	(1)%

Table of Contents

Sales and marketing expense consists primarily of compensation costs, commissions, allocated facilities and IT costs, advertising and marketing promotional expense, travel and entertainment expense. Sales and marketing expenses decreased due to the following:

	% Change 2009 to 2010
Compensation costs	3%
Commissions	(1)
IT expenses related to software implementations and IT support	2
Advertising and marketing promotional expense	(2)
Travel and entertainment expense	(2)
Other	(1)
Total change	(1)%

Research and Development

	Three Months Ended July 31, 2009	July 25, 2008 (In millions)	% Change
Research and development expenses	$ 130.3	$ 125.4	4%

Research and development expense consists primarily of compensation costs, allocated facilities and IT costs, depreciation and amortization, and prototype, non-recurring engineering (NRE) charges and other outside services costs. Research and development expenses increased due to the following:

	% Change 2009 to 2010
Compensation costs	4%
Facilities and IT support costs	2
NRE charges	1
Outside services	(2)
Other	(1)
Total change	4%

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

General and Administrative

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change
	(In millions)		
General and administrative expenses	$ 59.6	$ 49.5	20%

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

	% Change 2010 to 2009
Compensation costs	16%
Professional and corporate legal fees	2
IT costs	3
Other	(1)
Total change	20%

Restructuring and Other Charges

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change
	(In millions)		
Restructuring and other charges	$ 1.5	$	

In the three month period ended July 31, 2009, we recorded restructuring expense of $1.5 million, net, primarily related to employee severance costs associated with our restructuring plan announced in fiscal 2009, which included a program for a reduction in workforce, the closing or downsizing of certain facilities, and the establishment of a plan to outsource certain internal activities.

As of July 31, 2009, approximately $8.7 million of the costs associated with restructuring activities were unpaid. We expect that severance-related charges and other costs will be substantially paid by the three month period ending January 29, 2010 and the facilities-related lease payments to be substantially paid by January 2013.

See Note 13 to our condensed consolidated financial statements for further discussion of our restructuring activities.

Merger Termination Proceeds, Net

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change
	(In millions)		
Merger termination proceeds, net	$ (41.1)	$	

On May 20, 2009, we announced that we had entered into a merger agreement with Data Domain, Inc. (Data Domain) under which we would acquire Data Domain in a stock and cash transaction. On July 8, 2009, Data Domain s Board of Directors terminated the merger agreement 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 agreement during the same period, resulting in net proceeds of $41.1 million recorded in the condensed consolidated statement of operations for the three month period ended July 31, 2009.

Other Income and Expense

Interest Income Interest income for the three month periods ended July 31, 2009 and July 25, 2008 was as follows:

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change
	(In millions)		
Interest income	$ 8.6	$ 15.5	(44)%

34

Table of Contents

The decrease in interest income for the three month period ended July 31, 2009 compared to the three month period ended July 25, 2008 was primarily due to lower market yields on our cash and investment portfolio, in part due to a shift of our portfolio to more liquid, lower yielding investments during the period.

Interest Expense Interest expense for the three month periods ended July 31, 2009 and July 25, 2008 was as follows:

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change
	(In millions)		
Interest expense	$ (19.2)	$ (9.5)	102%

On April 25, 2009, we adopted FSP APB No. 14-1, which was retrospectively applied. The adoption of FSP APB No. 14-1 affected the accounting for our 1.75% Convertible Notes Due 2013 (the Notes) by requiring the initial proceeds from their sale to be allocated between a liability component and an equity component in a manner that results in interest expense on the debt component at our nonconvertible debt borrowing rate on the date of issuance. As a result of the adoption of FSP APB No. 14-1, we recognized approximately $13.1 million in incremental non-cash interest expense during the three month period ended July 31, 2009 from the amortization of debt discount and issuance costs; and we adjusted interest and other expense, net for the three month period ended July 25, 2008 to include $4.9 million of incremental non-cash interest expense.

Interest expense increased $9.7 million for the three month period ended July 31, 2009 compared to the three month period ended July 25, 2008 (as restated for the retrospective application of FSB APB 14-1), primarily due to interest expense on our Notes, issued on June 10, 2008, which were outstanding for the full three month period ended July 31, 2009 but only a partial period in the comparable period of the prior year.

Loss on Investments, Net

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change
	(In millions)		
Loss on investments, net	$ (0.1)	$ (2.6)	(97%)

During the three month periods ended July 31, 2009 and July 25, 2008, we recognized net impairments on investments in privately held companies of $0.1 million and $2.6 million, respectively.

Other Income (Expense), Net

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change
	(In millions)		

Other income (expense), net	$ (0.9)	$ (2.0)	(52)%

Other income (expense), net, consists of primarily net exchange losses a