

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the quarterly period ended January 24, 1997

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 0-27130

NETWORK APPLIANCE, INC.
(Exact name of registrant as specified in its charter)

California 77-0307520

(State or other jurisdiction of IRS Employer Identification
incorporation or organization)

2770 San Tomas Expressway, Santa Clara, California 95051

(Address of principal executive offices) (zip code)

Registrant's telephone number, including area code (408) 367-3000

Indicate by check mark whether the registrant (1) has filed all reports
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of
1934 during the preceding 12 months (or for such shorter period that the
registrant was required to file such reports), and (2) has been subject to such
filing requirements for the past 90 days.

Yes . No .

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

Class -----	Outstanding at January 24, 1997 -----
Common Stock	16,250,561

NETWORK APPLIANCE, INC.
FORM 10-Q

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NETWORK APPLIANCE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)

	January 24, 1997	April 30, 1996
	(Unaudited)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 20,938	\$ 24,637
Short-term investments	6,850	2,982
Accounts receivable, net	12,336	5,330
Inventories	9,585	4,825
Prepaid expenses and other	3,298	2,628
	53,007	40,402
PROPERTY AND EQUIPMENT, net	6,148	4,849
OTHER ASSETS	202	198
	\$ 59,357	\$ 45,449

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:		
Current portion of long-term obligations	\$ 21	\$ 19
Accounts payable	4,991	2,099
Income taxes payable	708	500
Accrued compensation and related benefits	3,131	2,015
Other accrued liabilities	2,178	1,110
Deferred revenue	1,804	378
	12,833	6,121
LONG-TERM OBLIGATIONS	233	299
SHAREHOLDERS' EQUITY:		
Common stock	41,495	39,903
Retained earnings (Accumulated deficit)	4,796	(874)
	46,291	39,029
	\$ 59,357	\$ 45,449

See accompanying notes to condensed consolidated financial statements.

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NETWORK APPLIANCE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Three Months Ended	
	January 24, 1997	January 26, 1996
NET SALES.....	\$ 24,845	\$ 13,018
COST OF SALES.....	10,116	5,749

GROSS MARGIN.....	14,729	7,269
	-----	-----
OPERATING EXPENSES:		
Sales and marketing.....	6,438	3,373
Research and development.....	2,283	1,361
General and administrative.....	1,049	765
	-----	-----
Total operating expenses.....	9,770	5,499
	-----	-----
INCOME FROM OPERATIONS.....	4,959	1,770
OTHER INCOME, net.....	241	246
	-----	-----
INCOME BEFORE PROVISION FOR INCOME TAXES.....	5,200	2,016
PROVISION FOR INCOME TAXES.....	1,820	--
	-----	-----
NET INCOME.....	\$ 3,380	\$ 2,016
	=====	=====
NET INCOME PER SHARE.....	\$ 0.19	\$ 0.12
	=====	=====
WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES.....	17,730	16,581
	=====	=====

See accompanying notes to condensed consolidated financial statements.

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NETWORK APPLIANCE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Nine Months Ended	
	January 24, 1997	January 26, 1996
	-----	-----
NET SALES	\$ 64,353	\$ 30,621
COST OF SALES	26,292	13,814
	-----	-----
GROSS MARGIN	38,061	16,807
	-----	-----
OPERATING EXPENSES:		
Sales and marketing	16,644	8,483
Research and development	5,986	3,101
General and administrative	3,201	1,819
Litigation settlement	4,300	--
	-----	-----
Total operating expenses	30,131	13,403
	-----	-----
INCOME FROM OPERATIONS	7,930	3,404
OTHER INCOME, net	793	237
	-----	-----
INCOME BEFORE PROVISION FOR INCOME TAXES	8,723	3,641

PROVISION FOR INCOME TAXES	3,053	--
NET INCOME	\$ 5,670	\$ 3,641
	=====	=====
NET INCOME PER SHARE	\$ 0.32	\$ 0.24
	=====	=====
WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES	17,636	15,389
	=====	=====

See accompanying notes to condensed consolidated financial statements.

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NETWORK APPLIANCE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	Nine Months Ended	
	January 24, 1997	January 26, 1996
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 5,670	\$ 3,641
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,907	809
Amortization of deferred stock compensation	60	99
Provision for doubtful accounts	--	110
Deferred rent	(52)	80
Changes in assets and liabilities:		
Accounts receivable	(7,006)	(1,189)
Inventories	(4,760)	(1,183)
Prepaid expenses and other	(674)	(436)
Accounts payable and income taxes payable	3,100	(724)
Accrued compensation and related benefits	1,116	278
Other accrued liabilities	1,068	698
Deferred revenue	1,426	267
	-----	-----
Net cash provided by operating activities	1,855	2,450
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of short-term investments	(13,200)	--
Redemptions of short-term investments	9,332	--
Purchases of property and equipment	(3,206)	(2,219)
	-----	-----
Net cash used in investing activities	(7,074)	(2,219)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of long-term debt	--	1,250
Repayments of long-term obligations	(12)	(1,274)
Proceeds from sale of common stock, net	1,532	26,643
	-----	-----
Net cash provided by financing activities	1,520	26,619
	-----	-----

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS (3,699) 26,850

CASH AND CASH EQUIVALENTS:

Beginning of period	24,637	1,791
End of period	\$ 20,938	\$ 28,641
	=====	=====

See accompanying notes to condensed consolidated financial statements.

NETWORK APPLIANCE, INC.
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (UNAUDITED)

1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The accompanying condensed consolidated financial statements have been prepared by Network Appliance, Inc. (the Company) without audit and reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the financial position and the results of operations of the Company for the interim periods. The statements have been prepared in accordance with the regulations of the Securities and Exchange Commission (SEC). Accordingly, they do not include all information and footnotes required by generally accepted accounting principles. The results of operations for the three and nine-month periods ended January 24, 1997 are not necessarily indicative of the operating results to be expected for the full fiscal year or future operating periods. The information included in this report should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended April 30, 1996 and the risk factors as set forth in the Company's Annual Report on Form 10-K, including, without limitation, risks relating to history of operating losses, fluctuating operating results, dependence on new products, rapid technological change, dependence on growth in the network file server market, expansion of international operations, product concentration, changing product mix, competition, recent management additions, management of expanding operations, dependence on high-quality components, dependence on proprietary technology, intellectual property rights, dependence on key personnel, volatility of stock price, shares eligible for future sale, concentration of stock ownership, effect of certain anti-takeover provisions and dilution. Any party interested in reviewing these publicly available documents should write to the SEC or the Chief Financial Officer of the Company.

2. INVENTORIES

Inventories consist of the following (in thousands):

	January 24, 1997	April 30, 1996
	-----	-----
Purchased components	\$ 6,645	\$ 2,161
Work in process	734	970
Finished goods	2,206	1,694
	-----	-----
	\$ 9,585	\$ 4,825
	=====	=====

3. NET INCOME PER SHARE

Net income per share is computed using the weighted average number of

common and common equivalent shares outstanding during the period. Common equivalent shares include preferred stock (using the "if converted" method) and stock options and warrants (using the treasury stock method). Common equivalent shares are excluded from the computation if their effect is anti-dilutive.

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4. LITIGATION SETTLEMENT

In July 1994, the Company and certain of its former employees were named as defendants in a lawsuit which alleged that one of the Company's founders, who left the Company in March 1995, misappropriated confidential information prior to the Company's founding in April 1992.

In August 1996, the Company reached a settlement with the plaintiffs which resulted in a charge to earnings of \$4.3 million in the first quarter of fiscal 1997, which included a \$3.5 million payment to the plaintiffs and \$800,000 of legal fees. The payment released the Company from all liabilities associated with the case. The Company has no future obligations to the plaintiffs. The Company denies any wrongdoing on its part or on the part of the founder.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Network Appliance, Inc. was incorporated in April 1992 to design, manufacture, market and support network data storage appliances. In September 1995, the Company introduced the NetApp F330, a rack-mounted, Pentium and PCI bus-based filer, and in January 1996, the Company introduced the NetApp F220, a rack-mounted, Pentium and PCI bus-based filer designed for workgroup and LAN environments. In May 1996, the Company introduced the NetApp F540, an enterprise-class file server appliance. In October 1996, the Company first shipped multiprotocol systems and also initiated the licensing of multiprotocol software to pre-existing customers. The Company's filer products combine specialized proprietary software and state-of-the-art industry standard hardware to provide a unique solution for the NFS server market.

RESULTS OF OPERATIONS

The following table sets forth certain consolidated statements of income data as a percentage of net sales for the periods indicated.

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	JANUARY 24, 1997	JANUARY 26, 1996	JANUARY 24, 1997	JANUARY 26, 1996
Net sales.....	100.0%	100.0%	100.0%	100.0%
Cost of sales.....	40.7	44.2	40.9	45.1
Gross margin.....	59.3	55.8	59.1	54.9
Operating expenses:				
Sales and marketing.....	25.9	25.9	25.8	27.7
Research and development.....	9.2	10.4	9.3	10.1
General and administrative.....	4.2	5.9	5.0	6.0
Litigation settlement.....	--	--	6.7	--
Total operating expenses.....	39.3	42.2	46.8	43.8
Income from operations.....	20.0	13.6	12.3	11.1
Other income, net.....	.9	1.9	1.2	.8
Income before provision for income taxes.....	20.9	15.5	13.5	11.9
Provision for income taxes.....	7.3	--	4.7	--
Net income.....	13.6%	15.5%	8.8%	11.9%

Net Sales. Net sales increased by 90.9% from \$13.0 million for the three months ended January 26, 1996 to \$24.8 million for the three months ended January 24, 1997. For the nine-month period ended January 24, 1997, net sales of \$64.4 million reflect an increase of 110.2% over the comparable period of fiscal 1996. The increase in net sales in these periods resulted primarily from the Company's continuing expansion of its domestic direct sales force, as well as the growth of its domestic indirect sales channel and international direct sales channel, increased market acceptance of the Company's products, the introduction of the NetApp F540, as well as the introduction of multiprotocol systems and the licensing of software to pre-existing customers.

Gross Margin. Gross margin increased from 55.8% for the three months ended January 26, 1996 to 59.3% for the three months ended January 24, 1997. Gross margin for the nine months ended January 24, 1997 was 59.1%, compared to 54.9% for the comparable period of fiscal 1996. This increase in gross margin was primarily attributable to lower costs of key components and manufacturing efficiencies achieved during the three and nine-month periods ended January 24, 1997, both of which were related to the significant increase in production volume. Also, during the quarter ended January 24, 1997, the Company recognized software licensing revenue, which bears higher margins than system sales. These factors offset the effect of increased sales of highly configured systems during these periods which generally generate lower gross margins per system due to greater disk drive and memory content.

The Company's gross margin has been and will continue to be affected by a variety of factors, including competition, product configuration, direct versus indirect sales, the mix and average selling prices of products, including software licensing, new product introductions and enhancements and the cost of components and manufacturing labor. In particular, the Company's gross margin varies based upon the configuration of systems that are sold and whether they are sold directly or through indirect channels. The Company offers products in both highly configured systems, as well as in minimally configured systems. Typically, highly configured systems generate lower overall gross margins due to greater disk drive and memory content. Highly configured systems are generally sold directly to end users.

Sales and Marketing. Sales and marketing expenses consist primarily of salaries, commissions, advertising and promotional expenses and customer service and support costs. Sales and marketing expenses increased 90.9% from \$3.4 million for the three months ended January 26, 1996 to \$6.4 million for the three months ended January 24, 1997. For the nine months ended January 24, 1997, sales and marketing expenses of \$16.6 million reflect an increase of 96.2% over the comparable period of fiscal 1996. These expenses were 25.9% of

net sales for both the three months ended January 24, 1997 and the three months ended January 26, 1996 and were 25.8% and 27.7%, respectively, of net sales for the nine months then ended. The increase in absolute dollars was primarily related to the expansion of the Company's sales and marketing organization, particularly increases in the domestic and international sales forces, and increased commission expenses related to higher sales volumes. The Company expects to continue to increase its sales and marketing expenses in an effort to expand domestic and international markets, introduce new products, and establish and expand new distribution channels.

Research and Development. Research and development expenses consist primarily of salaries and benefits, prototype expenses, and fees paid to outside consultants. Research and development expenses increased 67.7% from \$1.4 million for the three months ended January 26, 1996 to \$2.3 million for the three months ended January 24, 1997. These expenses represented 9.2% and 10.4% of net sales for the quarters ended January 24, 1997 and January 26, 1996, respectively. For the nine month periods, research and development expenses increased 93.0% from \$3.1 million in fiscal 1996 to \$6.0 million in fiscal 1997 and represented 10.1% and 9.3% of net sales, respectively, for those periods. These expenses increased in absolute dollars primarily as a result of increased headcount, consulting fees, prototyping expenses associated with the development of new products and ongoing support of current and future product development and enhancement efforts. The Company believes that significant investments in research and development will be required to remain competitive and expects that such expenditures will continue to increase in absolute dollars. To date, no software development costs have been capitalized as amounts that qualify for capitalization have been immaterial.

General and Administrative. General and administrative expenses were \$1.0 million in the three months ended January 24, 1997, compared to \$0.8 million in the three months ended January 26, 1996. These expenses represented 4.2% and 5.9%, respectively, of net sales for such periods. For the nine-month periods, general and administrative expenses increased 76.0% from \$1.8 million in fiscal 1996 to \$3.2 million in fiscal 1997 and represented 6.0% and 5.0% of net sales, respectively, for those periods. Increases in general and administrative expenses related primarily to certain litigation expenses, increased staffing, professional fees, facilities expansion and related occupancy costs and information system investments necessary to manage and support the Company's growth. The Company believes that its general and administrative expenses will increase as the Company continues to build its infrastructure.

Litigation Settlement. In July 1994, the Company and certain of its former employees were named as defendants in a lawsuit which alleged that one of the Company's founders, who left the Company in March 1995, misappropriated confidential information prior to the Company's founding in April 1992. In August 1996, the Company reached a settlement with the plaintiffs which resulted in a charge to earnings of \$4.3 million in the quarter ended July 26, 1996, which included a \$3.5 million payment to the plaintiffs and \$0.8 million of legal fees. The payment released the Company from all liabilities associated with the case. The Company has no future obligations to the plaintiffs.

Other Income, net. Other income, net, was \$0.2 million for both the three months ended January 24, 1997 and January 26, 1996. During the nine months ended January 24, 1997 and January 26, 1996, other income, net, was \$0.8 million and \$0.2 million, respectively. In each of these periods, other income, net, represented less than 2% of net sales. Other income, net, increased in the nine-month period ended January 24, 1997 compared to the corresponding period of the prior year due primarily to interest income earned on the net proceeds of \$25.7 million from the Company's initial public offering that was completed in November 1995.

Provision for Income Taxes. In fiscal 1996, the Company's federal and state income tax liabilities were offset by the realization of a portion of its net deferred tax assets, and accordingly no provision for income taxes was incurred in the three and nine months ended January 26, 1996. The Company has recorded a provision for income taxes in the three and nine months ended

January 24, 1997 utilizing an income tax rate of 35%, which is the anticipated effective tax rate for fiscal 1997.

The Company's quarterly operating results have in the past varied and may in the future vary significantly depending on a number of factors, including the level of competition; the size and timing of significant orders; product configuration and mix; market acceptance of new products and product enhancements; new product announcements or introductions by the Company or its competitors; deferrals of customer orders in anticipation of new products or product enhancements; changes in pricing by the Company or its competitors; the ability of the Company to develop, introduce and market new products and product enhancements on a timely basis; hardware component costs; supply constraints; the Company's success in expanding its sales and marketing programs; technological changes in the network file server market; the mix of sales among the Company's sales channels; levels of expenditure on research and development; changes in Company strategy; personnel changes; the Company's ability to successfully expand international operations; general economic trends and other factors. Although the Company has not experienced seasonality in the past, because of the significant seasonal effects experienced within the industry and the Company's goal to expand international sales, there can be no assurance that the Company's future operating results will not be adversely affected by seasonality.

Sales for any future quarter are not predictable with any significant degree of certainty. The Company generally operates with limited order backlog because its products typically are shipped shortly after orders are received. As a result, product sales in any quarter are generally dependent on orders booked and shipped in that quarter. Product sales are also difficult to forecast because the network file server market is rapidly evolving and the Company's sales cycle varies substantially from customer to customer. A significant portion of the Company's revenues in any quarter may be derived from sales to a limited number of customers. Any significant deferral of these sales could have a material adverse effect on the Company's results of operations in any particular quarter; and to the extent that significant sales occur earlier than expected, operating results for subsequent quarters may be adversely affected. The Company's expense levels are based, in part, on its expectations as to future sales. As a result, if sales levels are below expectations, net income may be disproportionately affected. Although the Company has experienced significant revenue growth in recent periods, the Company does not believe such growth is indicative of future operating results. The Company believes that period-to-period comparisons of its results of operations are not necessarily meaningful and should not be relied upon as an indicator of future performance. Due to all of the foregoing factors, it is possible that in some future quarter the Company's operating results may be below the expectations of public market analysts and investors. In such event, the price of the Company's Common Stock would likely be materially adversely affected.

This Form 10-Q contains forward-looking statements about future results which are subject to risks and uncertainties. Network Appliance's actual results may differ significantly from the results discussed in the forward-looking statements. The Company is subject to a variety of other additional risk factors, more fully described in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission.

LIQUIDITY AND CAPITAL RESOURCES

As of January 24, 1997, the Company's liquidity primarily consisted of cash and cash equivalents of \$20.9 million and short-term investments of \$6.9 million.

The Company generated cash from operating activities totaling \$1.9 million in the nine months ended January 24, 1997 and \$2.5 million in the nine months ended January 26, 1996. Net cash provided by operating activities in the nine months ended January 24, 1997 was primarily attributable to net income of \$5.7 million during that period (which included a \$4.3 million cash charge

to settle a lawsuit) and to increases in accounts payable and income taxes payable, accrued compensation and related benefits, other accrued liabilities and deferred revenue, partially offset by increases in accounts receivable and inventories. Net cash provided by operating activities in the nine months ended January 26, 1996 principally related to net income of \$3.6 million during that period, offset by increases in accounts receivable and inventories.

The Company used \$3.2 million and \$2.2 million of cash during the nine months ended January 24, 1997 and January 26, 1996, respectively, to purchase property and equipment. In addition, the Company used \$3.9 million in the nine months ended January 24, 1997 for net purchases of short-term investments. Financing activities provided \$1.5 million and \$26.6 million during the nine months ended January 24, 1997 and January 26, 1996, respectively, due primarily to the sale of common stock in the first nine months of fiscal 1997 and to proceeds from the Company's initial public offering in fiscal 1996.

The Company currently has no significant capital commitments other than commitments under operating and capital leases. The Company believes that its existing liquidity will satisfy the Company's projected working capital and other cash requirements for the next twelve months.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS
None

ITEM 2. CHANGES IN SECURITIES
None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES
None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITYHOLDERS
None

ITEM 5. OTHER INFORMATION

During the quarter ended January 24, 1997, Jeffrey R. Allen joined the Company as its Vice President of Finance and Operations and Chief Financial Officer. He was formerly Senior Vice President of Operations at Bay Networks.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

10.1 Facility sublease, dated August 9, 1996, by and between S3, Inc. and the Registrant

27.1 Financial Data Schedule

(b) Reports on Form 8-K

None

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, as amended, the registrant duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NETWORK APPLIANCE, INC.
(Registrant)

Date: March 7, 1997

By: /s/ Jeffry R. Allen

Jeffry R. Allen
Vice President Finance and
Operations, Chief Financial Officer
(Principal Financial Officer)

SUBLEASE
2770 and 2820 San Tomas Expressway, Santa Clara

THIS SUBLEASE, dated August 9, 1996 for reference purposes only (the "Sublease Date"), is entered into by and between S3 INCORPORATED, a Delaware corporation ("Sublandlord"), and NETWORK APPLIANCE, INC., a California corporation ("Subtenant").

RECITALS

A. Sublandlord presently leases certain premises (the "2770 Premises") consisting of approximately 47,432 square feet of space located in that certain building commonly known as 2770 San Tomas Expressway, Santa Clara, California (the "2770 Building") from McCandless - San Tomas No. 2, a California general partnership (the "2770 Master Landlord") pursuant to that certain Office Lease dated May 13, 1993, and amended by that certain First Amendment to Lease dated September 9, 1993 and that certain Second Amendment to Lease dated March 30, 1994 (collectively, the "2770 Master Lease"). An accurate and complete copy of the 2770 Master Lease is attached hereto as Exhibit A.

B. Sublandlord presently leases certain premises (the "2820 Premises") consisting of approximately 47,432 square feet of space located in that certain building commonly known as 2820 San Tomas Expressway, Santa Clara, California (the "2820 Building") from McCandless - San Tomas No. 1, a California general partnership (the "2820 Master Landlord") pursuant to that certain Office Lease dated March 30, 1994, and amended by that certain First Amendment to Lease dated April 10, 1995, that certain Second Amendment to Lease dated April 10, 1995 and that certain Third Amendment to Lease dated January 26, 1996 (collectively, the "2820 Master Lease"). An accurate and complete copy of the 2820 Master Lease is attached hereto as Exhibit B.

C. The 2770 Premises and the 2820 Premises are sometimes referred to collectively herein as the "Premises." The parties agree that the Premises contain ninety-four thousand eight hundred sixty-four (94,864) square feet. The 2770 Master Landlord and the 2820 Master Landlord are sometimes referred to collectively as the "Master Landlords" and individually as a "Master Landlord." The 2770 Master Lease and the 2820 Master Lease are sometimes referred to collectively herein as the "Master Leases." Capitalized terms not otherwise defined herein and defined in the Master Leases shall have the same meaning as they have in the Master Leases.

D. Sublandlord desires to sublease to Subtenant, and Subtenant desires to Sublease from Sublandlord, the Premises, pursuant to the terms and provisions hereof.

NOW, THEREFORE, in consideration of the covenants and conditions contained herein, Sublandlord and Subtenant covenant and agree as follows:

1.

AGREEMENT

1. DEMISE. Sublandlord hereby leases to Subtenant, and Subtenant hereby leases from Sublandlord, the Premises, upon and subject to the terms and conditions set forth herein.

2. TERM. The term of this Sublease ("Term") shall commence on the later of (i) January 2, 1997 or (ii) the date on which possession of the Premises is delivered to Subtenant in accordance with Section 8(c) (the "Commencement Date") and shall expire, unless sooner terminated pursuant to the terms of the Master Leases, on May 31, 2000 (the "Expiration Date"). Subtenant

and Subtenant's employees and agents, upon prior notice to Sublandlord, shall have the right from and after the date of execution of this Sublease to enter the Premises for the purpose of performing Subtenant's space planning activities, on condition that Subtenant's entry shall not interfere with Sublandlord's activities in the Premises. Any such early entry shall be on all of the terms and conditions of this Sublease, except that Subtenant shall not be required to pay Rent (as defined below) during any period of early entry.

3. RENT. The rent payable by Subtenant for the Premises shall consist of base rental ("Base Rent") plus certain additional rental ("Additional Rent"), all as provided below. Base Rent, Additional Rent, and any other charges due hereunder are hereinafter referred to collectively as "Rent." In the event the first day of Subtenant's obligation to pay Base Rent hereunder shall not be the first day of a calendar month or the last day of the Term is not the last day of a calendar month, the Rent shall be appropriately prorated based on a thirty (30) day month.

(a) Commencing on the date which is forty-five (45) days after the Commencement Date and continuing throughout the Term of this Sublease (the "Rent Commencement Date"), Subtenant shall pay to Sublandlord Base Rent for the Premises in the amount of one hundred thirteen thousand eight hundred thirty-seven dollars (\$113,837) per month.

(b) Commencing on the Rent Commencement Date (except for utility costs, Subtenant's liability for which shall commence on the Commencement Date), Subtenant shall also pay, in addition to Base Rent, Additional Rent in the amount of tenant's share of direct expenses (as such is described in paragraphs 4 and 5 of the 2770 Master Lease and paragraphs 4 and 5 of the 2820 Master Lease) and any other amounts of whatever nature due to Master Landlords from Sublandlord pursuant to the Master Leases.

(c) Base Rent shall be payable to Sublandlord, in advance, without prior notice, demand, or offset except as specifically provided herein, on or before the first day of each calendar month during the term hereof. Additional Rent shall be payable to Sublandlord five (5) business days prior to the date such amounts are due under the Master Leases or upon demand by Sublandlord (in the event of a demand for sooner payment by a Master Landlord). Notwithstanding the foregoing, Subtenant shall not be obligated to pay any amount due under any Master Lease which represents a penalty, late charge or interest on any late payment by Sublandlord of "basic rent" or direct expenses under a Master Lease, unless Subtenant is in default of its obligations to pay Rent under this Sublease. All Base Rent and any additional sums payable to Sublandlord hereunder shall be paid to Sublandlord at the address specified for notice to

2.

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Sublandlord in Section 5(b)(iii) below. To the extent that Additional Rent (or Subtenant's share of direct expenses) is payable on an estimated basis pursuant to a Master Lease, the Additional Rent due hereunder shall be adjusted between the parties (with appropriate reimbursements or additional payments) when the actual Additional Rent (or Subtenant's share of direct expenses) due under such Master Lease has been determined.

4. MASTER LEASES. This Sublease shall be subject and subordinate to all of the terms and provisions of the Master Leases. Except for payments of "basic rent" (which payments shall be made by Sublandlord), Subtenant hereby assumes and agrees to perform for Sublandlord's benefit, during the term of this Sublease, all of Sublandlord's obligations under the Master Leases, including without limitation payment of all Additional Rent (or Subtenant's share of direct expenses) due under the Master Leases (hereinafter the "Assumed Obligations").

5. INCORPORATION OF TERMS OF MASTER LEASES.

(a) Except as provided below, all of the terms and provisions of the Master Leases are incorporated into and made a part of this Sublease and the rights and obligations of the parties under the Master Leases are hereby imposed upon the parties hereto with respect to the Premises, the Sublandlord being substituted for the "Landlord" in each Master Lease, the

Subtenant being substituted for the "Tenant" in each Master Lease, and this Sublease being substituted for the "Lease" in each Master Lease. Notwithstanding the foregoing, the following provisions of the Master Leases are not incorporated herein:

(i) With respect to the 2770 Master Lease, paragraphs 2, 3, 4(a), 4(c), 4(d), 4(e), 5(a), the second sentence of the second paragraph of 29, 47, 51, 52 and 53 of the Office Lease dated May 13, 1993; paragraphs 2, 3, 4 and 5 of the First Amendment to Lease dated September 9, 1993; and paragraphs 1, 2, 3, 4 and 5 of the Second Amendment to Lease dated March 30, 1994.

(ii) With respect to the 2820 Master Lease, paragraphs 2, 4(a), 4(c), 4(d), 4(e), 5(a), the second sentence of the second paragraph of 29, 47, 52 and 53 of the Office Lease dated March 30, 1994; all provisions of the First Amendment to Lease dated April 10, 1995; all provisions of the Second Amendment to Lease dated April 10, 1995; and all provisions of the Third Amendment to Lease dated January 26, 1996.

(iii) Any provisions relating to any construction obligations of "Landlord" under the Master Leases with respect to construction which occurred or was to have occurred prior to the commencement date hereof.

(b) Notwithstanding the provisions of the preceding subparagraph, for the purposes of incorporating the terms and provisions of the Master Leases into this Sublease, the Master Leases are hereby amended as follows:

(i) INSURANCE. With respect to Subtenant's insurance obligations under paragraph 11 of the 2770 Master Lease and paragraph 11 of the 2820 Master Lease, Subtenant's

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policies of liability insurance shall name both Master Landlords and Sublandlord, as additional insureds.

(ii) EVENTS OF DEFAULT. The following provisions are added as additional events of default under paragraph 19 of the Master Leases: "(iv) failure of Subtenant to make any payment of Rent within two (2) business days of when due; and (v) failure of Subtenant to renew or to maintain in full force and effect any letter of credit required as a security deposit to secure Subtenant's obligations hereunder."

(iii) NOTICES. The addresses specified in the Master Leases for receipt of notices to each of the parties are deleted and replaced with the following:

TO SUBLANDLORD AT:	2770 San Tomas Expressway Santa Clara, California 95051 Attn: Mr. George Hervey
TO SUBTENANT AT:	319 North Bernardo Mountain View, California 94043 Attn: Ms. Chris Carlton

6. SUBLANDLORD'S OBLIGATIONS.

(a) Provided Subtenant is not in default under the terms of this Sublease beyond any applicable cure period, Sublandlord agrees to make timely payments of the "basic rent" due under the Master Leases to the end that the Master Lease shall not be terminated due to the default in such payment by Sublandlord.

(b) To the extent that the provision of any services or the performance of any maintenance or any other act (collectively "Master Landlord Obligations") is the responsibility of a Master Landlord, Sublandlord, upon Subtenant's request, shall make reasonable efforts to cause the relevant Master Landlord to perform such Master Landlord Obligations; provided, however, that in no event shall Sublandlord be liable to Subtenant for any liability,

loss or damage whatsoever in the event that a Master Landlord should fail to perform the same, nor shall Subtenant be entitled to withhold the payment of Rent or terminate this Sublease. If, after receipt of written request from Subtenant, Sublandlord shall fail or refuse to take such reasonable efforts for the enforcement of Sublandlord's rights against the relevant Master Landlord with respect to the Premises ("Action"), Subtenant shall have the right to take such Action in its own name, and for that purpose and only to such extent, all relevant rights of Sublandlord as tenant under the Master Lease are hereby conferred upon and assigned to Subtenant, and Subtenant shall be subrogated to such rights to the extent that the same shall apply to the Premises. If any Action against a Master Landlord in Subtenant's name shall be barred by reason of lack of privity, nonassignability or otherwise, Subtenant may take such Action in Sublandlord's name; provided that Subtenant has obtained the prior written consent of Sublandlord, which consent shall not be unreasonably withheld or delayed; and provided, further, that Subtenant shall indemnify, protect, defend by counsel reasonably satisfactory to Sublandlord and hold Sublandlord harmless from and

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against any and all claims, demands, actions, suits, proceedings, liabilities, obligations, losses, damages, judgments, costs and expenses (including, without limitation, reasonable attorneys' fees) which Sublandlord may incur or suffer by reason of such Action. If a default by a Master Landlord under the terms of a Master Lease shall result in the excuse of Sublandlord from the performance of any of its obligations to be performed under the Master Lease or result in any reduction or abatement in the Base Rent or Additional Rent to be paid by Sublandlord thereunder, then Subtenant shall be excused from the performance of a corresponding obligation and/or shall be entitled to a corresponding reduction in or abatement of the Rent to be paid by Subtenant hereunder.

(c) Except as provided in this Section 6, Sublandlord shall have no other obligations to Subtenant with respect to the Premises or the performance of the Master Landlords' Obligations.

(d) Sublandlord covenants and agrees that, without the prior written consent of Subtenant, which consent Subtenant agrees not to unreasonably withhold or delay, Sublandlord shall not terminate either Master Lease or amend or otherwise modify the terms of either Master Lease.

7. ACKNOWLEDGMENT OF CERTAIN RIGHTS NOT GRANTED. Subtenant acknowledges that nothing herein shall be deemed to convey or assign to Subtenant any "option to extend term" as set forth in paragraph 53 of the 2770 Master Lease or the "option to extend term" or "first right to lease" set forth in paragraphs 53 or 54 of the 2820 Master Lease (collectively, the "Option Rights"). Notwithstanding the foregoing, in the event that at any time prior to that date five (5) business days prior to Sublandlord's deadline for exercise of any Option Rights, Subtenant notifies Sublandlord in writing that it has entered into a binding lease or binding letter of intent with Master landlords covering the Premises for a term commencing immediately following the Term of this Sublease, Sublandlord agrees that it will not exercise the Option Rights.

8. ADDITIONAL PROVISIONS. The following additional provisions shall apply to the Sublease:

(a) FIRST MONTH'S RENT. Concurrently with Subtenant's execution of this Sublease, Subtenant shall pay to Sublandlord the sum of one hundred thirteen thousand eight hundred thirty-seven dollars (\$113,837) as Base Rent for the first month of this Sublease.

(b) SECURITY DEPOSIT. At least forty-five (45) days prior to the Commencement Date, Subtenant shall deliver to Sublandlord an irrevocable stand-by letter of credit as additional security for the full and faithful performance by Subtenant of all of the terms, covenants and conditions of this Sublease to be kept and performed by Subtenant (the "Letter of Credit"). The Letter of Credit shall be in the stated amount of six hundred thousand dollars (\$600,000), shall have a maturity date not earlier than (or shall be annually renewable for a total term expiring not earlier than) thirty (30) days after the Expiration Date, shall be issued by a commercial lender

acceptable to Sublandlord and shall be in a form acceptable to Sublandlord. Provided that there is then no Event of Default under this Sublease (and no event of which Sublandlord has notified

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Subtenant, which event, with notice or passage of time, or both, would constitute an Event of Default), from and after January 1, 1998, Subtenant may reduce the stated amount of the Letter of Credit to four hundred thousand dollars (\$400,000); and provided further that there is then no Event of Default under this Sublease (and no event of which Sublandlord has notified Subtenant, which event, with notice or passage of time, or both, would constitute an Event of Default), from and after January 1, 1999, Subtenant may reduce the stated amount of the letter of Credit to two hundred fifty thousand dollars (\$250,000). If Subtenant defaults with respect to any provision of this Sublease, including but not limited to Subtenant's obligations to pay Base Rent or to make other payments, Sublandlord may (but shall not be required to) draw on the Letter of Credit, and/or use, apply or retain all or any part of the security deposit for the payment of any amount which Sublandlord may spend by reason of Subtenant's default or to compensate Sublandlord for any other loss or damage which Sublandlord may suffer by reason of Subtenant's default. If any portion of such security deposit is so used, Subtenant shall, within ten (10) days after written demand therefor, deposit cash with Sublandlord in an amount sufficient to restore the security deposit to its original amount; and Subtenant's failure to do so shall be a material breach of this Sublease. Sublandlord shall not be required to keep the cash portion of the security deposit separate from its general funds and Subtenant shall not be entitled to interest on such amount. At the expiration or earlier termination of this Sublease, the unapplied balance of the security deposit shall be returned to Subtenant after Subtenant has vacated the Premises and Master Landlords have returned Sublandlord's security deposit to Sublandlord pursuant to the terms of the Master Leases.

(c) POSSESSION. Sublandlord shall deliver possession of the Premises to Subtenant by January 2, 1996. If for any reason Sublandlord cannot deliver possession of the Premises to Subtenant by such date, this Sublease shall not be void or voidable, Sublandlord shall not be liable to Subtenant for any loss or damage on account thereof; and, in such case, Subtenant shall not be liable for Rent until forty-five (45) days after possession has been delivered to Subtenant. If the Premises are not delivered to Subtenant on or before March 1, 1997, Subtenant, as its sole remedy, may elect to terminate this Sublease upon written notice to Sublandlord, Sublandlord shall return the Letter of Credit and any payments made hereunder by Subtenant to Sublandlord, and the parties shall have no further obligations hereunder. Sublandlord agrees to use its reasonable best efforts to keep Subtenant apprised of the date Sublandlord will be able to deliver possession of the Premises to Subtenant.

(d) CONDITION. The Premises shall be delivered in "as-is" condition, broom clean, with no representations or warranties whatsoever as to condition, except as specifically set forth in this Sublease.

(e) SUBLANDLORD'S REPRESENTATIONS AND WARRANTIES. Sublandlord represents and warrants as follows: (i) each Master Lease is in full force and effect and neither Sublandlord nor, to the best knowledge of Sublandlord, either Master Landlord is in default hereunder; (ii) Sublandlord knows of no claims or defenses or circumstances which with the passage of time or notice or both, would lead to claims or defenses by a Master Landlord against Sublandlord as tenant under a Master Lease; and (iii) all building systems and subsystems in the Premises will be in good working order and repair on the date the Premises are delivered to Sublandlord.

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(f) BROKERS. Each party represents to the other party

that it has not had dealings in any manner with any real estate broker, finder or other person with respect to the Premises and the negotiations and execution of this Sublease except for CPS and Cornish & Carey Commercial, Oncor International (the "Brokers"). Sublandlord shall pay any fees and commissions payable to the Brokers in connection with this Sublease. Except as to commissions and fees to be paid to the Brokers, each party shall indemnify and hold harmless the other party from all damage, loss, liability and expense (including attorneys' fees and related costs) arising out of or resulting from any claims for commissions or fees that may or have been asserted against the other party by any broker, finder or other person with whom Subtenant or Sublandlord has or purportedly has dealt with in connection with the Premises and the negotiation and execution of this Sublease. Sublandlord shall indemnify and hold harmless the Subtenant from all damage, loss, liability and expense to Subtenant (including attorneys' fees and related costs) arising out of or resulting from any claims by the Brokers for commissions or fees in connection with this Sublease.

(g) CONSENT TO SUBTENANT IMPROVEMENTS. Sublandlord hereby consents to the installation of the improvements to the Premises described in Exhibit C (the "Subtenant Improvements"), subject to approval of the Subtenant Improvements by Master Landlords. Provided that the Subtenant Improvements are not required to be removed by a Master Landlord pursuant to the terms of a Master Lease, Sublandlord agrees that Subtenant shall not be obligated, upon the expiration or earlier termination of the Term of the Sublease, to remove the Subtenant Improvements from the Premises.

(h) SIGNAGE. Subject to any consents by Master Landlords required by the Master Leases, Sublandlord agrees that Subtenant shall have the right, during the Term of the Sublease, to replace Sublandlord's name on the monument sign or any other sign associated with the Premises with the name of Subtenant. In connection therewith, Sublandlord agrees, at Sublandlord's expense and prior to the Commencement Date, to remove any and all letters, insignia and other material identifying Subtenant from the Premises.

(i) USE. Subject to any consents required by Master Landlords required by the Master Leases, Sublandlord agrees that Subtenant shall have the right to use the first floor of the 2820 Building for light manufacturing purposes, in addition to the "Permitted Uses" described in the 2820 Master Lease.

9. EARLY TERMINATION OF MASTER LEASE. If, without the fault of Sublandlord or Subtenant, a Master Lease should terminate prior to the expiration of this Sublease, neither party shall have any liability to the other party. To the extent that a Master Lease grants Sublandlord any discretionary right to terminate the Master Lease, whether due to casualty, condemnation, or otherwise, Sublandlord agrees to give Subtenant prompt written notice of such option. Provided that there has not theretofore occurred any Event of Default more than twice during the term of this Sublease, and there is not at that time existing any Event of Default or any event which with notice or passage of time or both would constitute an Event of Default, Sublandlord agrees that it will not exercise such option (i) unless so directed in writing by Subtenant at any time within five business (5) days of the deadline for exercise of such option by Sublandlord, or (ii) unless

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Subtenant has failed to notify Subtenant within such period of its desire to have such Master Lease continue.

10. CONSENT OF A MASTER LANDLORD. If Subtenant desires to take any action which requires the consent of a Master Landlord pursuant to the terms of the Master Lease, including, without limitation, making any alterations or entering into a further sublease or assignment of this Sublease, then, notwithstanding anything to the contrary herein, (a) Sublandlord shall have the same rights of approval or disapproval as that Master Landlord has under the Master Lease, (b) Subtenant shall not take any such action until it obtains the consent of both Sublandlord and the relevant Master Landlord, (c) Subtenant shall request that Sublandlord obtain the relevant Master Landlord's consent on Subtenant's behalf, unless Sublandlord agrees that Subtenant may contact Master Landlord directly with respect to the specific action for which

such Master Landlord's consent is required and (d) Sublandlord shall not unreasonably withhold its consent.

11. NO THIRD PARTY RIGHTS. The benefit of the provisions of this Sublease is expressly limited to Sublandlord and Subtenant and their respective permitted successors and assigns. Under no circumstances will any third party be construed to have any rights as a third party beneficiary with respect to any of said provisions; provided, however, that Master Landlords shall be entitled to the benefit of Subtenant's assumption of Sublandlord's obligations, as "Tenant" under the Master Leases, pursuant to Section 4 above.

12. CONDITION PRECEDENT. Notwithstanding anything to the contrary herein, this Sublease is conditioned upon Subtenant's receipt, on or before the date that is ten (10) days after the Sublease Date of written evidence satisfactory to Subtenant that the Master Landlords have executed and delivered the Consent to Sublease forms attached hereto. If such condition precedent has not been fulfilled prior to the relevant deadline, Subtenant may terminate this Sublease upon written notice thereof to Sublandlord within five (5) days thereafter, and neither party shall have any continuing obligation to the other with respect to the Premises; provided Sublandlord shall return the Letter of Credit and any other prepaid amounts, if previously delivered to Sublandlord, to Subtenant.

13. MISCELLANEOUS.

(a) SUBORDINATION. Sublandlord agrees that Subtenant shall be entitled to seek subordination of the Master Leases and the rights of Subtenant thereunder pursuant to the terms of this Sublease to any to any existing or future mortgages, deeds of trust, other security interest or leases shall be subject to the terms of the Master Leases.

(b) TIME OF ESSENCE. It is expressly understood and agreed that time is of the essence with respect to each and every provision of this Sublease.

(c) ENTIRE AGREEMENT. This Sublease contains all of the covenants, conditions and agreements between the parties concerning the Premises, and shall supersede all prior correspondence, agreements and understandings concerning the Premises, both oral and

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written. No addition or modification of any term or provision of this Sublease shall be effective unless set forth in writing and signed by both Sublandlord and Subtenant.

(d) CAPTIONS. All captions and headings in this Sublease are for the purposes of reference and convenience and shall not limit or expand the provisions of this Sublease.

(e) AUTHORITY. Each person executing this Sublease on behalf of a party hereto represents and warrants that he or she is authorized and empowered to do so and to thereby bind the party on whose behalf he or she is signing.

(f) ATTORNEYS' FEES. In the event either party shall bring any action or proceeding for damages or for an alleged breach of any provision of this Sublease to recover rents, or to enforce, protect or establish any right or remedy hereunder, the prevailing party shall be entitled to recover reasonable attorneys' fees and court costs as part of such action or proceeding.

IN WITNESS WHEREOF, the parties have executed this Sublease as of the date first written above.

"SUBLANDLORD"

"SUBTENANT"

By: /s/ George A. Hervey

By: /s/ Chris Carlton

Its: CFO

Its: Vice President Human Resources

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ADDENDUM TO SUBLEASE
BETWEEN S3 INCORPORATED, AS SUBLANDLORD,
AND NETWORK APPLIANCE, INC., AS SUBTENANT,
DATED AUGUST 9, 1996 FOR REFERENCE PURPOSES ONLY
RELATING TO
2700 AND 2820 SAN TOMAS EXPRESSWAY, SANTA CLARA

The following provisions are incorporated as provisions of the Sublease, and, in the event of any conflict between the provisions of the Sublease and the provisions of this Addendum, the provisions of this Addendum shall govern and control.

12. DEFINED TERMS. Capitalized terms used in this Addendum without definition have the meanings ascribed to them in the Sublease.

13. ALTERATIONS. Notwithstanding anything to the contrary contained or implied in the Sublease, Subtenant agrees as follows:

(a) All work (the "Work") done in connection with the Subtenant Improvements shall be performed and completed in a good and workman-like manner and in accordance with (i) the preliminary plans and specifications prepared by Alex L. Ingram & Associates, Inc. dated June 21, 1996 and (ii) the specifications for the enviro-chamber shown on Exhibit B to that certain letter agreement between Sublandlord and 2820 Master Landlord dated August 1, 1996 containing 2820 Master Landlord's consent to the Subtenant Improvements (collectively, the "Plans and Specifications"). The Work shall be subject to Master Landlords' final approval of construction documentation prior to commencement of any Work. No Work shall be done which is not described in the Plans and Specifications without the prior written consent of the Master Landlords. Prior to commencing any Work or receiving any materials in connection therewith, Subtenant shall give Sublandlord not less than fifteen (15) days notice to enable Subtenant to notify Master Landlords so that they may post a notice of nonresponsibility.

(b) The Work shall be performed by a general contractor or such other contractors as have been approved in writing by Master Landlords prior to commencement of any Work.

(c) All work shall be done pursuant to appropriate building permits and in accordance with applicable governmental laws and regulations. Subtenant shall be solely responsible for obtaining and satisfying such permits, laws and regulations.

(d) All costs and expenses incurred in connection with the Work shall be at the sole expense of Subtenant.

(e) Subtenant shall indemnify, defend and hold harmless Sublandlord and its agents, officers and directors, from and against all costs, expenses, claims, damages and liability (including but not limited to reasonable attorneys' fees) arising from (i) the acts or omissions of Subtenant or its contractors or subcontractors in performing the Work, (ii) the failure of Subtenant to abide by the terms of this Addendum, (iii) the design, specifications or material utilized in the

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Work, and (iv) any damages to the premises of the building in which the premises are located (including roof) arising from the Work. The obligation of Subtenant hereunder shall survive the completion of the Work. Subtenant agrees

to name Master Landlords as additional insured on Subtenant's certificate of liability and certificate of workman's compensation insurance.

(f) In the event that a Master Landlord shall require Sublandlord to take any or all of such actions prior to termination of the Master Leases, Subtenant shall be obligated to do the following, at its sole expense, (i) restore the carpeting (with new carpet) in all areas of the premises where carpeting was removed in connection with the Work; (ii) restore the loading dock area to its condition existing prior to commencement of the Work; and (iii) remove the enviro-chamber and restore all areas affected by the installation of the enviro-chamber to the condition existing prior to the commencement of the Work. Such restoration shall be completed by no later than the last date of the term of the Master Leases.

IN WITNESS WHEREOF, the parties have executed this Addendum as of the Sublease Date.

"SUBLANDLORD"

"SUBTENANT"

S3 INCORPORATED

NETWORK APPLIANCE, INC.

By /s/ George A. Hervey

By /s/ Chris Carlton

Title CFO

Title Vice President Human Resources

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