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 October 31, 2003

or

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

For the transition period from to

Commission file number 0-27130

Network Appliance, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**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 ☑ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☑ No ☐

Number of shares outstanding of the registrant's common stock, $.001 par value, as of the latest practicable date.

Class	Outstanding at October 31, 2003
Common Stock	345,083,442

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

NETWORK APPLIANCE, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands — unaudited)

	October 31, 2003	April 30, 2003
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 315,060	$ 284,161
Short-term investments	407,035	334,677
Accounts receivable, net of allowances of $4,961 at October 31, 2003 and $5,355 at April 30, 2003	160,861	151,637
Inventories	36,831	31,559
Prepaid expenses and other	23,965	24,014
Deferred income taxes	27,942	27,444
Total current assets	971,694	853,492
Property and Equipment, net	361,955	362,862
Goodwill	48,212	48,212
Intangible Assets, net	8,641	2,954
Other Assets	53,356	51,653
	$1,443,858	$1,319,173
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 41,054	$ 39,600
Income taxes payable	11,875	30,256
Accrued compensation and related benefits	45,609	40,647
Other accrued liabilities	46,252	43,841
Deferred revenue	125,588	110,672
Total current liabilities	270,378	265,016
Long-Term Deferred Revenue	83,483	63,698
Long-Term Obligations	4,781	3,102
Total liabilities	358,642	331,816
Stockholders' Equity:		
Common stock	345	341
Additional paid-in capital	771,617	704,338
Deferred stock compensation	(1,955)	(1,363)
Treasury stock	(44,862)	—
Retained earnings	359,623	284,137
Accumulated other comprehensive income (loss)	448	(96)
Total stockholders' equity	1,085,216	987,357
	$1,443,858	$1,319,173

See accompanying notes to unaudited condensed consolidated financial statements.

NETWORK APPLIANCE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share amounts — unaudited)

	Three Months Ended		Six Months Ended	
	October 31, 2003	October 25, 2002	October 31, 2003	October 25, 2002
Revenues:				
Product revenue	$249,532	$193,357	$485,318	$380,097
Service revenue	26,018	21,814	50,741	41,902
Total revenues	275,550	215,171	536,059	421,999
Cost of Revenues:				
Cost of product revenue	88,090	67,378	173,129	131,033
Cost of service revenue	22,397	14,803	41,744	30,261
Total cost of revenues	110,487	82,181	214,873	161,294
Gross margin	165,063	132,990	321,186	260,705
Operating Expenses:				
Sales and marketing	82,185	76,207	161,541	148,109
Research and development	31,513	28,373	63,054	56,241
General and administrative	12,728	9,132	24,993	16,570
Stock compensation(1)	893	885	1,547	1,868
Restructuring charges	1,110	—	1,110	—
Total operating expenses	128,429	114,597	252,245	222,788
Income from Operations	36,634	18,393	68,941	37,917
Other Income (Expense), net:				
Interest income	2,831	2,880	5,876	6,031
Other expense, net	(1,209)	(189)	(1,256)	(1,189)
Net gain/(loss) on investments	—	—	145	(726)
Gain on sale of intangible asset	—	—	—	604
Total other income, net	1,622	2,691	4,765	4,720
Income before Income Taxes	38,256	21,084	73,706	42,637
Provision for (Benefit from) Income Taxes	(10,157)	5,271	(1,780)	10,659
Net Income	$ 48,413	$ 15,813	$ 75,486	$ 31,978
Net Income per Share:				
Basic	$ 0.14	$ 0.05	$ 0.22	$ 0.10
Diluted	$ 0.13	$ 0.05	$ 0.21	$ 0.09
Shares Used in per Share Calculations:				
Basic	343,725	336,605	342,706	336,194
Diluted	364,715	347,110	361,606	348,616

(1) Stock compensation includes:				
Sales and marketing	$ 601	$ 295	$ 959	$ 867
Research and development	188	518	380	842
General and administrative	104	72	208	159
	$ 893	$ 885	$ 1,547	$ 1,868

See accompanying notes to unaudited condensed consolidated financial statements.

NETWORK APPLIANCE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands — unaudited)

	Six Months Ended	
	October 31, 2003	October 25, 2002
Cash Flows from Operating Activities:		
Net income	$ 75,486	$ 31,978
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	26,967	24,787
Amortization of patents	601	—
Amortization of intangible assets	2,728	2,750
Stock compensation	1,547	1,868
Net (gain) loss on investments	(145)	726
Gain on sale of intangible asset	—	(604)
Provision for doubtful accounts	(320)	(1,664)
Deferred income taxes	(4)	1,486
Deferred rent	324	(8)
Changes in assets and liabilities:		
Accounts receivable	(8,904)	(6,591)
Inventories	(7,893)	(11,667)
Prepaid expenses and other assets	(1,711)	(6,992)
Accounts payable	1,454	5,955
Income taxes payable	(6,452)	5,625
Accrued compensation and related benefits	4,962	(5,789)
Other accrued liabilities	4,179	(400)
Deferred revenue	34,700	23,059
Net cash provided by operating activities	127,519	64,519
Cash Flows from Investing Activities:		
Purchases of short-term investments	(251,720)	(178,829)
Redemptions of short-term investments	177,604	153,545
Purchases of property and equipment	(22,041)	(31,488)
Proceeds from disposal of fixed assets	105	—
Proceeds from sales of investments	419	—
Purchases of patents	(9,015)	—
Purchase of equity securities	(325)	(475)
Net cash used in investing activities	(104,973)	(57,247)
Cash Flows from Financing Activities:		
Proceeds from sale of common stock related to employee stock transactions	53,215	11,969
Repurchases of common stock	(44,862)	—
Net cash provided by financing activities	8,353	11,969
Net Change in Cash and Cash Equivalents	30,899	19,241
Cash and Cash Equivalents:		
Beginning of period	284,161	210,756
End of period	$ 315,060	$ 229,997
Noncash Investing and Financing Activities:		
Deferred stock compensation, net of reversals	$ 1,612	$ (1,517)
Conversion of evaluation inventory to fixed assets	$ 2,621	$ 4,058
Income tax benefit from employee stock transactions	$ 11,929	$ —
Supplemental cash flow information:		
Income taxes paid	$ 4,733	$ 4,073

See accompanying notes to unaudited condensed consolidated financial statements.

NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollar and share amounts in thousands, except per-share data — unaudited)

1. The Company

Based in Sunnyvale, California, Network Appliance was incorporated in California in April 1992, and reincorporated in Delaware in November 2001. Network Appliance is a world leader in unified storage solutions for the data-intensive enterprise. NetApp® network storage solutions and service offerings provide data-intensive enterprises with consolidated storage, improved data center operations, economical business continuance, and efficient remote data access across the distributed enterprise. Network Appliance's success to date has been in delivering highly cost-effective network storage solutions that reduce the complexity associated with conventional storage solutions. Network Appliance™ solutions are the data management and storage foundation for leading enterprises, government agencies, and universities worldwide. Since its inception in 1992, Network Appliance has pioneered technology, product, and partner firsts that continue to drive the evolution of storage™.

2. Condensed Consolidated Financial Statements

The accompanying interim unaudited condensed consolidated financial statements have been prepared by Network Appliance, Inc. without audit and reflect all adjustments, (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods presented. The statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles") for interim financial information and in accordance with the instructions to Form 10-Q and Article 10-01 of Regulation S-X. Accordingly, they do not include all information and footnotes required by generally accepted accounting principles for annual consolidated financial statements.

We operate on a 52-week or 53-week year ending on the last Friday in April. For presentation purposes we have indicated in the accompanying interim unaudited condensed consolidated financial statements that our fiscal year end is April 30. The first six months of fiscal 2004 and 2003 were 27-week and 26-week fiscal periods, respectively.

These financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended April 30, 2003. The results of operations for the three and six-month periods ended October 31, 2003 are not necessarily indicative of the operating results to be expected for the full fiscal year or future operating periods. In the following notes to our interim condensed consolidated financial statements, Network Appliance Inc. is also referred to as "we", "our" and "us".

Certain prior-period amounts have been reclassified to conform to the current period presentation. These reclassifications did not change previously reported total assets, liabilities and stockholders' equity or net income.

3. Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates include, but are not limited to revenue recognition and allowances; inventory write-down; restructuring accruals; loss contingencies; impairment losses on investments; accounting for income taxes; accounting for stock-based compensation; and derivative instruments. Actual results could differ from those estimates.

4. Summary of Significant Accounting Policies

Revenue Recognition and Allowances

We apply the provisions of Statement of Position ("SOP") 97-2, *"Software Revenue Recognition"*, and related interpretations to all revenue transactions. We recognize revenue when:

- *Persuasive Evidence of an Arrangement Exists.* It is our customary practice to have a purchase order prior to recognizing revenue on an arrangement from our end user customers, value added resellers, or distributors.

- *Delivery has Occurred.* Our product is physically delivered to our customers, generally with standard transfer terms as FOB shipping point. We typically do not allow for re-stocking rights with any of our value added resellers or distributors. Products shipped with acceptance criteria or return rights are not recognized as revenue until all criteria are achieved. If undelivered products or services exist that are essential to the functionality of the delivered product in an arrangement, delivery is not considered to have occurred.

- *The Fee is Fixed or Determinable.* Arrangements with payment terms extending beyond our standard terms and condition practices are not considered to be fixed or determinable. Revenue from such arrangements is recognized as the fees become due and payable. We typically do not allow for price-protection rights with any of our value added resellers or distributors.

- *Collection Is Probable.* Probability of collection is assessed on a customer-by-customer basis. Customers are subjected to a credit review process that evaluates the customers' financial position and ultimately their ability to pay. If it is determined from the outset of an arrangement that collection is not probable based upon our review process, revenue is recognized upon cash receipt.

For arrangements with multiple elements, we allocate revenue to each element using the residual method based on vendor specific objective evidence of the undelivered items. We defer the portion of the arrangement fee equal to the fair value of the undelivered elements until they are delivered. Vendor specific objective evidence is based on the price charged when the element is sold separately.

A typical arrangement includes product, software subscription, and maintenance. Some arrangements include training and consulting. Software subscriptions include unspecified product upgrades and enhancements on a when-and-if-available basis, bug fixes, and patch releases, and are included in product revenues. Service maintenance includes contracts for technical support and hardware maintenance. Revenue from software subscriptions and service is recognized ratably over the contractual term, generally one to three years. Revenue from training and consulting is recognized as the services are performed.

The following table presents the components of revenues, stated as a percentage of total revenues:

	Three Months Ended		Six Months Ended	
	October 31, 2003	October 25, 2002	October 31, 2003	October 25, 2002
Product revenue:				
Products	80.8%	82.0%	81.0%	82.6%
Software subscriptions	9.8%	7.9%	9.5%	7.5%
	90.6%	89.9%	90.5%	90.1%
Service revenue	9.4%	10.1%	9.5%	9.9%
Total revenues	100.0%	100.0%	100.0%	100.0%

We record reductions to revenue for estimated sales returns at the time of shipment. These estimates are based on historical sales returns, changes in customer demand, and other factors. If actual future returns and allowances differ from past experience, additional allowances may be required.

Allowance for Doubtful Accounts

We also maintain a separate allowance for doubtful accounts for estimated losses based on our assessment of the collectibility of specific customer accounts and the aging of the accounts receivable. We analyze accounts receivable and historical bad debts, customer concentrations, customer solvency, current economic and geographic trends, and changes in customer payment terms and practices when evaluating the adequacy of the allowance for doubtful accounts. If the financial condition of our customers deteriorates, resulting in an impairment of their ability to make payments, additional allowances may be required.

Inventory Write-down

We write down inventory and record purchase commitment liabilities for estimated excess and obsolete inventory equal to the difference between the cost of inventory and the estimated fair value based upon assumptions about future demand and market conditions. Although we strive for accuracy in our forecasts of future product demand, any significant unanticipated changes in demand or technological developments could have a significant impact on the value of our inventory and commitments, and our reported results. If actual market conditions are less favorable than those projected, additional write-downs and other charges against earnings may be required. If actual market conditions are more favorable, we may realize higher gross margin in the period when the written-down inventory is sold.

We engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers. We also provide for the estimated cost of known product failures based on known quality issues when they arise. Should actual cost of product failure differ from our estimates, revisions to the estimated liability would be required.

Restructuring Accruals

In fiscal 2002, as a result of continuing unfavorable economic conditions and a reduction in Information Technology (“IT”) spending rates, we implemented two restructuring plans, which included reductions in our workforce and a consolidation of our facilities. These restructuring accruals were accounted for in accordance with Emerging Issues Task Force (“EITF”) Issue No. 94-3, *“Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring),”* and included various assumptions such as the time period over which the facilities will be vacant, expected sublease terms, and expected sublease rates. These estimates are reviewed and revised periodically and may result in a substantial change to restructuring expense should different conditions prevail than were anticipated in original management estimates. See footnote 10 — Restructuring Charges for further discussion.

Loss Contingencies

We are subject to the possibility of various loss contingencies arising in the course of business. We consider the likelihood of the loss or impairment of an asset or the incurrence of a liability as well as our ability to reasonably estimate the amount of loss in determining loss contingencies. An estimated loss contingency is accrued when it is probable that a liability has been incurred or an asset has been impaired and the amount of loss can be reasonably estimated. We regularly evaluate current information available to us to determine whether such accruals should be adjusted.

Impairment Losses on Investments

We perform periodic reviews of our investments for impairment. Our investments in publicly held companies are generally considered impaired when a decline in the fair value of an investment as measured by quoted market prices is less than its carrying value, and such a decline is not considered temporary. Our investments in privately held companies are considered impaired when a review of the investees' operations and other indicators of impairment indicate that the carrying value of the investment is not likely to be recoverable. Such indicators include, but are not limited to, limited capital resources, limited prospects of receiving additional financing, and limited prospects for liquidity of the related securities. In the six-month period ended October 25, 2002, we recorded a non-cash write down of $726 related to an impairment of our investment in a publicly traded company as its reduction in value was judged to be other than temporary. In the six-month period ended October 31, 2003, we recorded a gain of $145 related to sales of previously impaired investments.

Accounting for Income Taxes

The determination of our tax provision is subject to judgments and estimates due to operations in several tax jurisdictions outside the United States. Earnings derived from our international business are generally taxed at rates that are lower than U.S. rates, resulting in a reduction of our effective tax rate. The ability to maintain our current effective tax rate is contingent upon existing tax laws in both the United States and in the respective countries in which our international subsidiaries are located. Future changes in domestic or international tax laws could affect the continued realization of the tax benefits we are currently receiving and expect to receive from international business. In addition, a decrease in the percentage of our total earnings from our international business or in the mix of international business among particular tax jurisdictions could increase our overall effective tax rate. Also, our current effective tax rate assumes that U.S. income taxes are not provided for undistributed earnings of certain non-U.S. subsidiaries. These earnings could become subject to incremental foreign withholding or federal and state income taxes should they be either deemed or actually remitted to the U.S. For the three and six-month periods ended October 31, 2003, we recorded a non-recurring income tax benefit of $16,831 associated with a favorable foreign tax ruling, which occurred during the second quarter of fiscal 2004. This favorable ruling from the Netherlands provides for retroactive benefits dating back to fiscal year 2001 as well as future tax rate benefits. We expect to receive a substantial tax refund that relates to prior years' tax payments.

The carrying value of our net deferred tax assets, which consists primarily of income tax deductions, credits, and net operating loss carryforwards resulting from stock option exercises, assumes that we will be able to generate sufficient future income to fully utilize these tax deductions and credits. If we do not generate sufficient future income, the realization of these deferred tax assets may be impaired resulting in additional income tax expense. We have provided a valuation allowance on certain of our deferred tax assets because of uncertainty regarding their realizability due to expectation of future employee stock option exercises.

Derivative Instruments

We adopted Statement of Financial Accounting Standards ("SFAS") No. 133, *"Accounting for Derivative Instruments and Hedging Activities"* as amended by SFAS No. 149, *"Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities."* Derivatives that are not designated as hedges are adjusted to fair value through earnings. 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 asset or liability through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of the hedge is recognized in earnings immediately.

As a result of our significant international operations, we are subject to risks associated with fluctuating exchange rates. We use derivative financial instruments, principally currency forward contracts, to attempt to minimize the impact of exchange rate movements on our balance sheet relating to certain foreign currency assets and liabilities and operating results. The forward foreign exchange contracts require us to exchange foreign currencies for U.S. dollars or vice versa and generally mature in less than one year. Other than foreign exchange contracts, we have not entered into any other material financial derivative instruments.

We do not enter into derivative financial instruments for speculative or trading purposes. Currently, we do not enter into any foreign exchange forward contracts to hedge exposures related to firm commitments or equity investments. Our major foreign currency exchange exposures and related hedging programs are described below:

Balance Sheet. We utilize currency forward contracts to hedge currency exchange rate fluctuations related to certain foreign currency assets and liabilities. Gains and losses on these undesignated derivatives offset gains and losses on the assets and liabilities being hedged and the net amount is included in earnings. For the three and six-month periods ended October 31, 2003, net gains generated by hedged assets and liabilities totaled $2,298 and $4,745, respectively, and were offset by losses on the related derivative instruments of $3,458 and $6,076, respectively. For the three and six-month periods ended October 25, 2002, net gains (losses) generated by hedged assets and liabilities totaled $(159) and $3,830, respectively, and were offset by gains (losses) on the related derivative instruments of $101 and $(4,827), respectively.

Forecasted Transactions. We use currency forward contracts to hedge exposures related to forecasted sales and operating expenses denominated in Euros and British Pounds. These contracts are designated as cash flow hedges when the transactions are forecasted 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 other comprehensive income until the forecasted transaction occurs.

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 other income. For the three and six-month periods ended October 31, 2003, we did not record any gains or losses related to forecasted transactions that did not occur or became improbable.

We measure the effectiveness of hedges of forecasted transactions on at least a quarterly basis by comparing the fair values of the designated currency forward contracts with the fair values of the forecasted transactions. No ineffectiveness was recognized in earnings during the three and six-month periods ended October 31, 2003.

Stock-Based Compensation

We account for stock-based compensation in accordance with the provisions of Accounting Principle Board Opinion ("APB") No. 25 ("APB No. 25") *"Accounting for Stock Issued to Employees,"* and comply with the disclosure provisions of SFAS No. 123 *"Accounting for Stock-Based Compensation,"* as amended by SFAS No. 148, *"Accounting for Stock-Based Compensation — Transition and Disclosures."* Deferred compensation recognized under APB No. 25 is amortized to expense using the graded vesting method. We account for stock options issued to non-employees in accordance with the provisions of SFAS No. 123 and EITF No. 96-18 *"Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services"* under the fair value based method.

We adopted the disclosure-only provisions of SFAS No. 123, and accordingly, no expense has been recognized for options granted to employees under the various stock plans. We amortize deferred stock-based compensation on the graded vesting method over the vesting periods of the applicable stock purchase rights

NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

and stock options, generally four years. The graded vesting method provides for vesting of portions of the overall awards at interim dates and results in greater vesting in earlier years than the straight-line method.

Had compensation expense been determined based on the fair value at the grant date for awards, consistent with the provisions of SFAS No. 123 our pro forma net income (loss) and net income (loss) per share would be as follows (in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	October 31, 2003	October 25, 2002	October 31, 2003	October 25, 2002
Net income as reported	$ 48,413	$ 15,813	$ 75,486	$ 31,978
Add: stock based employee compensation expense included in reported net income under APB 25, net of related tax effects	301	313	612	694
Deduct: total stock based compensation determined under fair value based method for all awards, net of related tax effects	24,186	43,183	56,333	92,688
Pro forma net income (loss)	$ 24,528	$ (27,057)	$ 19,765	$ (60,016)
				$
Basic net income per share, as reported	0.14	$ 0.05	$ 0.22	$ 0.10
				$
Diluted net income per share, as reported	0.13	$ 0.05	$ 0.21	$ 0.09
				$
Basic net income (loss) per share, pro forma	0.07	$ (0.08)	$ 0.06	$ (0.18)
				$
Diluted net income (loss) per share, pro forma	0.07	$ (0.08)	$ 0.05	$ (0.18)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model, and is not subject to revaluation as a result of subsequent stock price fluctuations. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option pricing models require the input of highly subjective assumptions, including the expected stock price volatility. We use projected volatility rates, which are based upon historical volatility rates since our initial public offering, trended into future years. Because our employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of our options.

5. Inventories

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

	October 31, 2003	April 30, 2003
Purchased components	$ 15,992	$16,277
Work in process	1,818	537
Finished goods	19,021	14,745
	$ 36,831	$31,559

6. Intangible Assets

Balances are summarized as follows:

	October 31, 2003			April 30, 2003		
	Gross Assets	Accumulated Amortization	Net Assets	Gross Assets	Accumulated Amortization	Net Assets
	(In thousands)					
Intangible assets:						
Patents	$ 9,145	$ (731)	$8,414	$ 130	$ (130)	$ —
Existing technology	$ 16,365	$ (16,138)	$ 227	$ 16,365	$ (13,411)	$2,954

During the first quarter of fiscal 2004, we acquired additional patents that will enhance our technology base to build next-generation network-attached storage (“NAS”,) storage area network (“SAN”,) and fabric-attached storage (“FAS”) systems for the benefit of our enterprise customers. The costs of such acquired intangibles for use in research and development activities that have alternative future uses have been capitalized and amortized as intangible assets in accordance with APB Opinion No. 17 *“Intangible Assets.”* Capitalized patents are amortized over five years as research and development expenses and total amortization for capitalized patents was $451 and $601 for the three and six-month periods ending October 31, 2003, respectively as compared to none for the same periods in the prior year. Estimated future patents amortization expenses are $901 for fiscal 2004, $1,803 for each of the fiscal years 2005, 2006, 2007 and 2008, and $300 thereafter.

Existing technology is amortized over three years as cost of product revenue and total amortization expense for existing technology was $1,364 and $2,728 for the three and six-month periods ending October 31, 2003, respectively, as compared to $1,364 and $2,750 for the three and six-month periods ending October 25, 2002, respectively. Estimated future amortization expense is $227 for fiscal 2004 and none thereafter.

7. Stock Compensation

We record stock compensation in accordance with provisions of APB No. 25, for employee awards and SFAS No. 123, for non-employee awards. Accordingly, we recognize the intrinsic value for employees and the fair value for non-employees as stock compensation expense over the vesting terms of the awards.

We recorded $502 and $1,021 of deferred compensation for the three and six month periods ended October 31, 2003, respectively and $521 and $1,157 for the three and six month periods ended October 25, 2002, respectively, primarily related to the recognition of stock compensation of unvested options assumed in the WebManage acquisition in fiscal 2001, the grant of stock options to certain highly compensated employees and the award of restricted stocks to certain employees. We reversed $56 and $116 of deferred compensation in the three and six month periods ended October 31, 2003, respectively and $1,393 and $1,517 in the three and six month periods ended October 25, 2002, respectively, all due to employee terminations.

We recorded $391 and $526 in compensation expense in the three and six-month periods ending October 31, 2003, respectively, and $97 and $443 in the three and six-month periods ending October 25, 2002, for the fair value of options granted to a member of the Board of Directors in recognition for services performed outside of the normal capacity of a board member. The 100,000 common shares under the 1999 Plan were granted at an exercise price of $15.72 per share, the fair market value per share on the grant date. The option has a term of 10 years measured from the grant date, subject to earlier termination following his cessation of board service, and will vest in a series of 48 successive equal monthly installments upon his completion of each month of board service over the 48 month period measured from the grant date.

For the three and six month periods ended October 25, 2002, under terms of the acquisition agreement with Orca Systems Inc. ("Orca"), we released 33 shares of common stock to former Orca shareholders upon meeting certain performance criteria. The fair market value of the shares of $267 was measured on the date the performance criteria were met and was recognized as stock compensation. In fiscal 2004, there are no more restricted milestones shares remaining under the Orca acquisition agreement.

8. Earnings 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 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 using the treasury stock method upon exercise of stock options.

During all periods presented, we had certain options outstanding, which could potentially dilute basic earnings per share in the future, but were excluded in the computation of diluted earnings per share in such periods, as their effect would have been antidilutive. These certain options were antidilutive in the three and six-month periods ended October 31, 2003 and October 25, 2002 as these options' exercise prices were above the average market prices in such periods. For the three-month period ended October 31, 2003 and October 25, 2002, 16,234 and 54,903 shares of common stock options with a weighted average exercise price of $53.66 and $27.92, respectively, were excluded from the diluted net income per share computation. For the six-month period ended October 31, 2003 and October 25, 2002, 23,998 and 52,026 shares of common stock options with a weighted average exercise price of $43.16 and $29.18, respectively, were excluded from the diluted net income per share computation.

NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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

	Three Months Ended		Six Months Ended	
	October 31, 2003	October 25, 2002	October 31, 2003	October 25, 2002
Net Income (Numerator):				
Net income, basic and diluted	$ 48,413	$ 15,813	$ 75,486	$ 31,978
Shares (Denominator):				
Weighted average common shares outstanding	343,806	336,701	342,769	336,306
Weighted average common shares outstanding subject to repurchase	(81)	(96)	(63)	(112)
Shares used in basic computation	343,725	336,605	342,706	336,194
Weighted average common shares outstanding subject to repurchase	81	96	63	112
Common shares issuable upon exercise of stock options	20,909	10,409	18,837	12,310
Shares used in diluted computation	364,715	347,110	361,606	348,616
Net Income Per Share:				
Basic	$ 0.14	$ 0.05	$ 0.22	$ 0.10
Diluted	$ 0.13	$ 0.05	$ 0.21	$ 0.09

9. Comprehensive Income

The components of comprehensive income, net of tax, were as follows:

	Three Months Ended		Six Months Ended	
	October 31, 2003	October 25, 2002	October 31, 2003	October 25, 2002
Net income	$ 48,413	$ 15,813	$ 75,486	$ 31,978
Currency translation adjustment	512	(96)	1,914	248
Unrealized loss on derivatives	(96)	—	(382)	—
Unrealized gain (loss) on investments	82	(144)	(988)	815
Comprehensive income	$ 48,911	$ 15,573	$ 76,030	$ 33,041

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

	October 31, 2003	April 30 2003
Accumulated translation adjustments, net	$ 676	$(1,238)
Accumulated realized loss on derivatives	(411)	$ (29)
Accumulated unrealized gain on available-for-sale investments, net	183	1,171
Total accumulated other comprehensive income (loss)	$ 448	$ (96)

10. Restructuring Charges

Fiscal 2002 Second Quarter Restructuring Plan

In fiscal 2002, as a result of continuing unfavorable economic conditions and a reduction in IT spending rates, we implemented two restructuring plans, which included reductions in workforce and a consolidation of facilities. As a result of the restructuring in August 2001, we recorded a charge of $7,980. The restructuring charge included $4,796 of severance-related amounts, $2,656 of committed excess facilities and facility closure expenses, and $528 in fixed assets write-offs. The reserve balance of $829 at October 31, 2003 was included in other accrued liabilities.

During fiscal 2002, we purchased our Sunnyvale headquarters site and terminated the operating leases. As a result, an adjustment was made to reduce the previously recorded estimated facilities lease losses by $1,509. During fiscal 2002 and 2003, we recorded a net restructuring adjustment increase of $95 and a decrease of $334, respectively, due to changes in the estimated costs of certain actions and final resolution of certain restructuring activities. In the event that the foreign facilities are not subleased, we will be obligated for additional total lease payments of approximately $555 to be payable through January 2006.

The following analysis sets forth the significant components of the second quarter fiscal 2002 restructuring at October 31, 2003:

	Severance-Related Amounts	Fixed Assets Write-off	Facility	Total
Restructuring charge	$ 4,796	$ 528	$ 2,656	$ 7,980
Cash payments and others	(4,444)	—	(885)	(5,329)
Non-cash portion	—	(528)	(46)	(574)
Adjustments	315	—	(1,585)	(1,270)
Reserve balance at April 30, 2003	667	—	140	807
Cash payments and others	11	—	(9)	2
Non-cash portion	—	—	(1)	(1)
Reserve balance at August 1, 2003	678	—	130	808
Cash payments and others	19	—	3	22
Non-cash portion	—	—	(1)	(1)
Reserve balance at October 31, 2003	$ 697	$ —	$ 132	$ 829

Fiscal 2002 Fourth Quarter Restructuring Plan

In April 2002, we completed a restructuring related to the closure of an engineering facility and consolidation of resources to the Sunnyvale headquarters. As a result of this restructuring, we incurred a charge of $5,850. The restructuring charge included $813 of severance-related amounts, $4,564 of committed excess facilities and facility closure expenses, and $473 in fixed assets write-offs. Of the reserve balance at October 31, 2003, $832 was included in other accrued liabilities and the remaining $4,441 was classified as long-term obligations.

In January 2003 and October 2003, we updated our assumptions and estimates based on certain triggering events, which resulted in additional net charges of $923 and $1,110 respectively, primarily relating to our engineering facility lease. Our estimates are reviewed and revised periodically and may result in a substantial charge to restructuring expense should different conditions prevail than were anticipated in original management estimates. Such estimates included various assumptions such as the time period over which the facilities will be vacant, expected sublease terms, and expected sublease rates. In the event that the engineering facility is not subleased, we will be obligated for additional total lease payments of $2,275 to be payable through November 2010.

The following analysis sets forth the significant components of the fourth quarter fiscal 2002 restructuring at October 31, 2003:

	Severance-Related Amounts	Fixed Assets Write-off	Facility	Total
Restructuring charge	$ 813	$ 473	$ 4,564	$ 5,850
Net cash payments	(706)	—	(1,023)	(1,729)
Non-cash portion	—	(473)	—	(473)
Adjustments	(107)	—	1,030	923
Reserve balance at April 30, 2003	—	—	4,571	4,571
Net cash payments	—	—	(205)	(205)
Reserve balance at August 1, 2003	—	—	4,366	4,366
Net cash payments	—	—	(203)	(203)
Adjustments	—	—	1,110	1,110
Reserve balance at October 31, 2003	$ —	$ —	$ 5,273	$ 5,273

11. Short-Term Investments

All our investments are classified as available for sale at October 31, 2003 and April 30, 2003. Available-for-sale investments with original maturities of greater than three months are classified as short-term investments, as these investments generally consist of highly marketable securities that are intended to be available to meet current cash requirements. Investment securities classified as available-for-sale are reported at fair market value, and net unrealized gains or losses are recorded in accumulated other comprehensive income (loss), a separate component of stockholders’ equity, net of taxes. Any gains or losses on sales of investments are computed based upon specific identification. For all periods presented, realized gains and losses on available-for-sale investments were not material. Management evaluates investments on a regular basis to determine if an other-than-temporary impairment has occurred.

Our investments in publicly held companies are generally considered impaired when a decline in the fair value of an investment as measured by quoted market prices is less than its carrying value, and such a decline is not considered temporary. In the six-month period ended October 25, 2002, we recorded a non-cash write down of $726 related to the impairment of our investment in a publicly traded company as its reduction in value was judged to be other than temporary. In six-month period ended October 31, 2003, we recorded a gain of $145 related to sales of previously impaired investments.

12. New Accounting Pronouncements

In December 2002, the EITF reached a consensus on EITF 00-21, *“Revenue Arrangements with Multiple Deliverables.”* This issue addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. In some arrangements, the different revenue-generating activities (deliverables) are sufficiently separable and there exists sufficient evidence of their fair values to separately account for some or all of the deliverables (that is, there are separate units of accounting). In other arrangements, some or all of the deliverables are not independently functional, or there is not sufficient evidence of their fair values to account for them separately. This issue addresses when and, if so, how an arrangement involving multiple deliverables should be divided into separate units of accounting. This issue does not change otherwise applicable revenue recognition criteria. The guidance in this issue is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The adoption of this accounting standard did not have a significant impact on our financial position and results of operations.

In January 2003, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 46 ("FIN 46"), *"Consolidation of Variable Interest Entities."* FIN 46 requires an investor with a majority of the variable interests in a variable interest entity to consolidate the entity and also requires majority and significant variable interest investors to provide certain disclosures. A variable interest entity is an entity in which the equity investors do not have a controlling interest or the equity investment at risk is insufficient to finance the entity's activities without receiving additional subordinated financial support from the other parties. As of October 31, 2003, we had no investments which would require consolidation under FIN 46.

In April 2003, the FASB issued SFAS No. 149, *"Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities."* SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. In particular, this Statement clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative. It also clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS No. 149 is generally effective for contracts entered into or modified after June 30, 2003. The adoption of this accounting standard did not have a significant impact on our financial position, results of operations and cash flow.

In May 2003, the FASB has issued SFAS No. 150, *"Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity."* The Statement improves the accounting for certain financial instruments that, under previous guidance, issuers could account for as equity. The new Statement requires that those instruments be classified as liabilities in statements of financial position. This statement is effective for interim periods beginning after June 15, 2003. As of October 31, 2003, we had no financial instruments within the scope of this pronouncement.

13. Commitments and Contingencies

In May 2000, we entered into a split dollar insurance arrangement with Daniel J. Warmenhoven. Under the arrangement, we will pay the annual premiums on several insurance policies on the life of the survivor of Mr. Warmenhoven and his wife Charmaine Warmenhoven, and Mr. Warmenhoven will pay us each year for a portion of those premiums equal to the economic value of the term insurance coverage provided him under the policies. For each of the 2001, 2002, 2003 and 2004 fiscal years, we paid an aggregate net annual premium on these split dollar polices in the amount of approximately $2,050. Under the arrangement, we will be reimbursed for all premium payments made on those policies, and it is intended that we will be reimbursed not later than May 2005. The policies are owned by a family trust established by Mr. Warmenhoven, and upon the death of the survivor of Mr. Warmenhoven and his wife or any earlier cash-out of the policies, we will be entitled to a portion of the insurance proceeds or cash surrender value of the policies equal to the net amount of cumulative premiums paid on those policies by us, and the balance will be paid to the trust. We have obtained a collateral assignment of the policies as a security interest for our portion of the proceeds or cash surrender value payable to us under the policies, and neither Mr. Warmenhoven nor the trust may borrow against the policies while that security interest remains in effect. The arrangement is terminable by us upon thirty (30)-days prior notice, and such termination will trigger a refund of the net cumulative premiums paid by us on the policies.

From time to time, we have committed to purchase various key components used in the manufacture of our products. Our loss accrual for such commitments to these key component vendors is based on our current forecasts of inventory usage. 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.

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

14. Guarantees

As of October 31, 2003, our financial guarantees consisted of standby letters of credit outstanding, bank guarantee and restricted cash, which were related to facility lease requirements, product performance guarantees, customs and duties guarantees, VAT requirements and workers' compensation plans. The maximum amount of potential future payments under all of the foregoing arrangements was $2,516. Of this maximum exposure, $964 of restricted cash was classified under Other Assets and Prepaid Expenses and Other on our balance sheet at October 31, 2003. We have not recorded any liability at October 31, 2003 related to these guarantees.

We provide both recourse and non-recourse lease financing options to our customers. Under the terms of recourse leases, which are generally 3 years or less, we remain liable for the aggregate unpaid remaining lease payments. We defer 100% of the recourse lease obligation and recognize revenue over the term of the lease as the lease payments become due. As of October 31, 2003 the maximum recourse exposure totaled approximately $5,600. Under the terms of the non-recourse leases we do not have any continuing obligations or liabilities. To date, we have not experienced significant losses under this lease financing program.

We do not maintain a general warranty reserve for estimated costs of product warranties at the time revenue is recognized due to our extensive product quality program and processes and because our customer service inventories utilized to correct product failures are carried at zero cost.

We defend and indemnify certain subcontractors and customers 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 non-infringing 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 identified any losses that are probable under these provisions and, accordingly, we have not recorded a liability related to these indemnification provisions. However, there can be no assurances that we will not have any future financial exposure under these indemnification obligations.

15. Subsequent Events

On November 4, 2003, Network Appliance signed an agreement to purchase Spinnaker Networks, Inc., a privately held company based in Pittsburgh, Pennsylvania, for approximately $300,000 in an all-stock transaction. The number of common shares to be issued will be determined using our average stock price based on a period immediately preceding the close date which is expected to be in January 2004.

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. Forward-looking statements usually contain the words "estimate," "intend," "plan," "predict," "seek," "may," "will," "should," "would," "anticipate," "expect," "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, (1) our intent to regularly introduce new products and product enhancements and our intent to support current and new products and product enhancements and incur prototype expenses and non-recurring engineering charges associated with the development of new products and technologies; (2) our expectation that our expenditures on expanding our current product offerings and introducing new products will increase in absolute dollars; (3) our intention to continue to establish and maintain business relationships with technology companies; (4) our expectation that we will increase sales and marketing expenses and add additional sales capacity commensurate with future revenue growth; (5) our belief that our general and administrative expenses will increase in absolute terms in the remainder of fiscal 2004; (6) our belief that our existing liquidity and capital resources are sufficient to fund our operations for at least the next twelve months; (7) our belief that our forward currency contracts will not subject us to undue risk; (8) our intention to continuously broaden our existing product offerings and introduce new products that expand our solutions portfolio; (9) our belief that our research and development expenses will increase in absolute dollars for the remainder of fiscal 2004 as compared to the comparable period in the prior year; (10) our belief that our products currently compete favorably with our competitors; (11) the possibility that we may engage in future acquisitions; (12) our expectation that the value of our investments will not decline significantly because of changes in market interest rates; (13) our expectation that amortization expense for existing technology will be $0.2 million in the remainder of fiscal 2004; (14) our expectation that amortization expense for capitalized patents for fiscal 2004 will be $0.9 million, and $1.8 million for each of the fiscal years 2005, 2006, 2007 and 2008 and $0.3 million thereafter; (15) our expectation that deferred stock compensation amortization for fiscal 2004, 2005 and 2006 will be $0.6 million, $0.7 million and $0.6 million, respectively; (16) our belief that if we are not able to sublease our currently vacated facilities, our aggregate liability for these additional lease payments will be approximately $2.8 million; (17) our belief that our future contractual obligations as of October 31, 2003 will be no more than $11.5 million in fiscal 2004, $25.1 million in fiscal 2005, $21.6 million in fiscal 2006, $15.5 million in fiscal 2007, $4.5 million in fiscal 2008 and $12.5 million thereafter, (18) our expectation that interest income will increase for the remainder of fiscal 2004; (19) our belief that our acquisition of Spinnaker Networks, Inc. will further accelerate the shift to networked storage, speed our ability to deliver new Storage Grids and provide our customers with many benefits; and (20) our belief that our competitive advantage is a result of lower total costs of ownership for our products, 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: (1) the amount of orders received in future periods; (2) our ability to ship our products in a timely manner; (3) our ability to achieve anticipated pricing, cost and gross margin levels; (4) our ability to successfully introduce new products; (5) our ability to achieve and capitalize on changes in market demand; (6) acceptance of, and demand for, our products; (7) our ability to maintain our supplier and contract manufacturer relationships; (8) our ability to expand our storage business through our indirect channel; (9) the ability of our competitors to introduce new products that compete successfully with our products; (10) the general economic environment and the continued growth of the storage and content delivery markets; (11) our ability to sustain and/or improve our cash and overall financial position; (12) our ability to generate future income to utilize our deferred tax assets; and (13) 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.

Overview

Based in Sunnyvale, California, Network Appliance was incorporated in California in April 1992, and reincorporated in Delaware in November 2001. Network Appliance is a world leader in unified storage solutions for the data-intensive enterprise. Network Appliance network storage solutions and service offerings provide data-intensive enterprises with consolidated storage, improved data center operations, economical business continuance, and efficient remote data access across the distributed enterprise. Network Appliance's success to date has been in delivering highly cost-effective network storage solutions that reduce the complexity associated with conventional storage solutions. We believe our products have set the standard for simplicity and ease of operation, with what we believe to be one of the lowest total costs of ownership and highest returns on investment in the industry. Network Appliance solutions are the data management and storage foundation for leading enterprises, government agencies, and universities worldwide. Since our inception in 1992, Network Appliance has pioneered technology, product, and partner firsts that continue to drive the evolution of storage.

Code of Business Conduct and Ethics

We maintain a code of business conduct and ethics for directors, officers and employees, and will promptly disclose any waivers of the code for directors or executive officers. Our code of business practices addresses all major aspects of employee behavior including, conflicts of interest; confidentiality; compliance with laws, rules and regulations (including insider trading laws); and related matters. We require as part of our regular process that all employees sign a statement that they have all read and understood the code of business conduct and ethics.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Note 2 to the Consolidated Financial Statements in the Annual Report on Form 10-K for the fiscal year ended April 30, 2003 describes the significant accounting policies and methods used in the preparation of the Consolidated Financial Statements. The preparation of these Consolidated Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses, and related disclosure of contingent assets and liabilities. We evaluate, on an ongoing basis, our estimates and judgments, including those related to sales returns, bad debts, excess inventory and purchase commitments, investments, intangible assets, lease losses and restructuring accruals, income taxes, and loss contingencies. We base our estimates on historical experience and assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates.

We believe the accounting policies described below, among others, are the ones that most frequently require us to make estimates and judgments, and therefore are critical to the understanding of our results of operations:

• revenue recognition and allowances;

• inventory write-down;

• restructuring accruals;

• loss contingencies;

• impairment losses on investments;

• accounting for income taxes;

• accounting for stock-based compensation; and

• derivative instruments.

Revenue Recognition and Allowances

We apply the provisions of SOP 97-2, *"Software Revenue Recognition"* and related interpretations, to all transactions that generate revenue. We recognize revenue when:

- *Persuasive Evidence of an Arrangement Exists.* It is our customary practice to have a purchase order prior to recognizing revenue on an arrangement from our end user customers, value added resellers, or distributors.

- *Delivery has Occurred.* Our product is physically delivered to our customers, generally with standard transfer terms as FOB shipping point. We typically do not allow for re-stocking rights with any of our value added resellers or distributors. Products shipped with acceptance criteria or return rights are not recognized as revenue until all criteria are achieved. If undelivered products or services exist that are essential to the functionality of the delivered product in an arrangement, delivery is not considered to have occurred.

- *The Fee is Fixed or Determinable.* Arrangements with payment terms extending beyond our standard terms and condition practices are not considered to be fixed or determinable. Revenue from such arrangements is recognized as the fees become due and payable. We typically do not allow for price-protection rights with any of our value added resellers or distributors.

- *Collection is Probable.* Probability of collection is assessed on a customer-by-customer basis. Customers are subject to a credit review process that evaluates the customers' financial position and ultimately their ability to pay. If it is determined from the outset of an arrangement that collection is not probable based upon our review process, revenue is recognized upon cash receipt.

For arrangements with multiple elements, we allocate revenue to each element using the residual method based on vendor specific objective evidence of the undelivered items. We defer the portion of the arrangement fee equal to the fair value of the undelivered elements until they are delivered. Vendor specific objective evidence is based on the price charged when the element is sold separately.

A typical arrangement includes product, software subscription, and maintenance. Some arrangements include training and consulting. Software subscriptions include unspecified product upgrades and enhancements on a when-and-if-available basis, bug fixes, and patch releases, and are included in product revenues. Service maintenance includes contracts for technical support and hardware maintenance. Revenue from software subscriptions and service is recognized ratably over the contractual term, generally one to three years. Revenue from training and consulting is recognized as the services are performed.

We record reductions to revenue for estimated sales returns at the time of shipment. These estimates are based on historical sales returns, changes in customer demand, and other factors. If actual future returns and allowances differ from past experience, additional allowances may be required.

Allowance for Doubtful Accounts

We also maintain a separate allowance for doubtful accounts for estimated losses based on our assessment of the collectibility of specific customer accounts and the aging of the accounts receivable. We analyze accounts receivable and historical bad debts, customer concentrations, customer solvency, current economic and geographic trends, and changes in customer payment terms and practices when evaluating the adequacy of the allowance for doubtful accounts. If the financial condition of our customers deteriorates, resulting in an impairment of their ability to make payments, additional allowances may be required.

Inventory Write-down

We write down inventory and record purchase commitment liabilities for estimated excess and obsolete inventory equal to the difference between the cost of inventory and the estimated fair value based upon assumptions about future demand and market conditions. Although we strive for accuracy in our forecasts of future product demand, any significant unanticipated changes in demand or technological developments could have a significant impact on the value of our inventory and commitments, and our reported results. If actual market conditions are less favorable than those projected, additional write-downs and other charges against earnings may be required. If actual market conditions are more favorable, we may realize higher gross margin in the period when the written-down inventory is sold.

We engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers. We also provide for the estimated cost of known product failures based on known quality issues when they arise. Should actual cost of product failure differ from our estimates, revisions to the estimated liability would be required.

Restructuring Accruals

In fiscal 2002, as a result of continuing unfavorable economic conditions and a reduction in IT spending rates, we implemented two restructuring plans, which included reductions in our workforce and a consolidation of our facilities. These restructuring accruals were accounted for in accordance with EITF Issue No. 94-3, *"Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)"*, and included various assumptions such as the time period over which the facilities will be vacant, expected sublease terms, and expected sublease rates. These estimates are reviewed and revised periodically and may result in a substantial change to restructuring expense should different conditions prevail than were anticipated in original management estimates. See Note 10 to the Condensed Consolidated Financial Statements for further discussion.

Loss Contingencies

We are subject to the possibility of various loss contingencies arising in the course of business. We consider the likelihood of the loss or impairment of an asset or the incurrence of a liability as well as our ability to reasonably estimate the amount of loss in determining loss contingencies. An estimated loss contingency is accrued when it is probable that a liability has been incurred or an asset has been impaired and the amount of loss can be reasonably estimated. We regularly evaluate current information available to us to determine whether such accruals should be adjusted.

Impairment Losses on Investments

We perform periodic reviews of our investments for impairment. Our investments in publicly held companies are generally considered impaired when a decline in the fair value of an investment as measured by quoted market prices is less than its carrying value, and such a decline is not considered temporary. Our investments in privately held companies are considered impaired when a review of the investees' operations and other indicators of impairment indicate that the carrying value of the investment is not likely to be recoverable. Such indicators include, but are not limited to, limited capital resources, limited prospects of receiving additional financing, and limited prospects for liquidity of the related securities. In the six-month period ended October 25, 2002, we recorded a non-cash write-down of $0.7 million related to impairments of our investment in a publicly traded company as its reduction in value was judged to be other than temporary. In the six-month period ended October 31, 2004, we recorded a gain of $0.1 million related to sales of previously impaired investments.

Accounting for Income Taxes

The determination of our tax provision is subject to judgments and estimates due to operations in several tax jurisdictions outside the U.S. Earnings derived from our international business are generally taxed at rates that are lower than U.S. rates, resulting in a reduction of our effective tax rate. The ability to maintain our current effective tax rate is contingent upon existing tax laws in both the U.S. and in the respective countries in which our international subsidiaries are located. Future changes in domestic or international tax laws could affect the continued realization of the tax benefits we are currently receiving and expect to receive from international business. In addition, a decrease in the percentage of our total earnings from our international business or in the mix of international business among particular tax jurisdictions could increase our overall effective tax rate. Also, our current effective tax rate assumes that U.S. income taxes are not provided for undistributed earnings of certain non-U.S. subsidiaries. These earnings could become subject to incremental foreign withholding or federal and state income taxes should they be either deemed or actually remitted to the U.S. For the three and six-month periods ended October 31, 2003, we recorded a non-recurring income tax benefit of $16.8 million associated with a favorable foreign tax ruling, which occurred during the second quarter of fiscal 2004. This favorable ruling from the Netherlands provides for retroactive benefits dating back to fiscal year 2001 as well as future tax rate benefits. We expect to receive a substantial tax refund that relates to prior years' tax payments.

The carrying value of our net deferred tax assets, which consists primarily of income tax deductions, credits, and net operating loss carryforwards resulting from stock option exercises, assumes that we will be able to generate sufficient future income to fully utilize these tax deductions and credits. If we do not generate sufficient future income, the realization of these deferred tax assets may be impaired resulting in additional income tax expense. We have provided a valuation allowance on certain of our deferred tax assets because of uncertainty regarding their realizability due to expectation of future employee stock option exercises.

Accounting for Stock-based Compensation

We account for stock-based compensation in accordance with the provisions of APB No. 25, *"Accounting for Stock Issued to Employees,"* and comply with the disclosure provisions of SFAS No. 123 *"Accounting for Stock-Based Compensation,"* as amended by SFAS No. 148, *"Accounting for Stock-Based Compensation — Transition and Disclosures."* Deferred compensation recognized under APB No. 25 is amortized to expense using the graded vesting method. We account for stock options issued to non-employees in accordance with the provisions of SFAS No. 123 and EITF No. 96-18 under the fair value based method.

Derivative Instruments

We adopted SFAS No. 133, *"Accounting for Derivative Instruments and Hedging Activities"* as amended by SFAS No. 149, *"Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities."* Derivatives that are not designated as hedges are adjusted to fair value through earnings. 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 asset or liability through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of the hedge is recognized in earnings immediately.

New Accounting Standards

In December 2002, the EITF reached a consensus on EITF 00-21, *"Revenue Arrangements with Multiple Deliverables."* This issue addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. In some arrangements, the different revenue-generating activities (deliverables) are sufficiently separable and there exists sufficient evidence of their fair values to separately account for some or all of the deliverables (that is, there are separate units of accounting). In other arrangements, some or all of the deliverables are not independently functional, or there is not sufficient evidence of their fair values to account for them separately. This issue addresses when and, if so, how an arrangement involving multiple deliverables should be divided into separate units of accounting. This issue does not change otherwise applicable revenue recognition criteria. The guidance in this issue is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The adoption of this accounting standard did not have a significant impact on our financial position and results of operations.

In January 2003, the FASB issued FIN 46, *"Consolidation of Variable Interest Entities."* FIN 46 requires an investor with a majority of the variable interests in a variable interest entity to consolidate the entity and also requires majority and significant variable interest investors to provide certain disclosures. A variable interest entity is an entity in which the equity investors do not have a controlling interest or the equity investment at risk is insufficient to finance the entity's activities without receiving additional subordinated financial support from the other parties. As of October 31, 2003, we had no investments which would require consolidation under FIN 46.

In April 2003, the FASB issued SFAS No. 149, *"Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities."* SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. In particular, this Statement clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative. It also clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS No. 149 is generally effective for contracts entered into or modified after June 30, 2003. The adoption of this accounting standard did not have a significant impact on our financial position, results of operations and cash flow.

In May 2003, the FASB has issued SFAS No. 150, *"Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity."* The Statement improves the accounting for certain financial instruments that, under previous guidance, issuers could account for as equity. The new Statement requires that those instruments be classified as liabilities in statements of financial position. This statement is effective for interim periods beginning after June 15, 2003. As of October 31, 2003, we had no financial instruments within the scope of this pronouncement.

Results of Operations

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

	Three Months Ended		Six Months Ended	
	October 31, 2003	October 25, 2002	October 31, 2003	October 25, 2002
Revenues:	100.0%	100.0%	100.0%	100.0%
Product revenue	90.6	89.9	90.5	90.1
Service revenue	9.4	10.1	9.5	9.9
Cost of Revenues:				
Cost of product revenue	32.0	31.3	32.3	31.1
Cost of service revenue	8.1	6.9	7.8	7.2
Gross margin	59.9	61.8	59.9	61.7
Operating Expenses:				
Sales and marketing	29.8	35.4	30.1	35.1
Research and development	11.4	13.2	11.8	13.3
General and administrative	4.7	4.3	4.6	3.9
Stock compensation	0.3	0.4	0.3	0.4
Restructuring Charges	0.4	0	0.2	0
Total operating expenses	46.6	53.3	47.0	52.7
Income from Operations	13.3	8.5	12.9	9.0
Other Income (Expense), net:				
Interest income	1.0	1.4	1.1	1.4
Other expense, net	(0.4)	(0.1)	(0.2)	(0.3)
Net gain (loss) on investments	—	—	—	(0.2)
Gain on sale of intangible asset	—	—	—	0.2
Total other income, net	0.6	1.3	0.9	1.1
Income before Income Taxes	13.9	9.8	13.8	10.1
Provision for (Benefit from) Income Taxes	(3.7)	2.5	(0.3)	2.5
Net Income	17.6%	7.3%	14.1%	7.6%

In the second quarter of fiscal year 2004, we continued to enhance our enterprise solutions, broaden our customer portfolio, extend our partnerships with other technology leaders, and gain market acceptance for our iSCSI, unified storage, and NearStore® solutions. We reaffirmed our commitment to iSCSI technology by becoming the first to support Windows®, Novell®, NetWare®, and Linux® native iSCSI initiators on Intel® technology-based platforms, enabling customers to share and network more of their data currently in direct-attached configurations using their existing network infrastructures. In addition, Network Appliance announced its program to qualify iSCSI adapter vendors as NetApp® supported solutions in conjunction with NetApp iSCSI storage systems, allowing vendors to develop affordable, certified, and interoperable storage consolidation solutions.

We broadened our enterprise storage solutions portfolio with our new FAS200 series entry-level systems that are designed for NAS, iSCSI and/or Fibre Channel SAN (storage area network) environments. We announced that our SnapLock™ Compliance regulated data solution and SnapLock Enterprise software are now available on NetApp FAS servers in addition to the NearStore platform. These solutions enable customers to create a flexible storage infrastructure that addresses a variety of data and storage needs for information-intensive business. These new systems and software further extend the Network Appliance unified storage portfolio for application data in mission-and business-critical environments for archive and reference purposes, and for enterprise-wide or workgroup and departmental requirements.

We also expanded our data protection and regulatory compliance initiatives by extending the SnapLock solutions for regulated data and data permanence storage. The SnapLock Compliance solution enables the storage safeguards required by Rule 17a-3 and 17a-4 under the Securities and Exchange Act of 1934, as amended. The SnapLock Enterprise provides customers with the assurance that important data and business records remain accurate, safe, accessible, and unmodified. In addition, Network Appliance teamed up with Decru DataFort™ and MDY Advanced Technologies to achieve U.S. Department of Defense 5015.2-STD certification for electronic records management applications, enabling defense users to meet stringent data protection and shredding regulations regarding national security.

In November 2003, we announced the signing of a definitive agreement to acquire Spinnaker Networks, Inc., a privately held company based in Pittsburgh, Pennsylvania, for approximately $300.0 million in an all stock transaction. The combination of NetApp unified storage and software solutions with advanced distributed systems architectures from Spinnaker will further accelerate the shift to networked storage and speeds our ability to deliver new Storage Grids as the foundation for data infrastructures of the future. Data-intensive enterprises will benefit from higher performance, more flexibility and scalability, increased infrastructure reliability, and much tighter integration with database and layered applications. The NetApp Storage Grid architecture will offer these benefits leveraging commodity components costs which lower customers' acquisition, expansion and management costs, and new approaches for next-generation information lifecycle management (ILM).

Our revenue growth was primarily driven by new product innovation and strategic partnerships, as we continued to penetrate into a variety of industries worldwide to help customers store, manage, protect and consolidate their business- and mission-critical data. We believe our competitive advantage is a result of lower total cost of ownership from a combination of four factors: lower acquisition cost, reduced administrative overhead, minimized service cost, and reduced downtime of critical business applications.

Product Revenues — Product revenues increased by 29.1% to $249.5 million for the second quarter of fiscal 2004, from $193.4 million for the second quarter of fiscal 2003. Product revenues increased by 27.7% to $485.3 million for the six-month period ended October 31, 2003, from $380.1 million for the six-month period ended October 25, 2002. Product revenues growth was across all geographies. This increase in product revenues was specifically attributable to increased software licenses and software subscriptions and an increase in units shipped, as compared to the same periods in the prior year.

Product revenues were favorably impacted by the following factors:

- increased revenues from our new product introductions in the three and six-month periods ended October 31, 2003 such as: FAS960, FAS940, and FAS250 filer products; NearStore R150 nearline storage systems; NetCache® C2100 and C1200 appliances, as well as our gateway filers (gFiler™,) GF960, GF940 and GF825;

- increased revenues from data management software products that simplify storage administration and increase data availability in mission- and business-critical environments;

- higher sales of software subscription upgrades representing 9.8% and 9.5% of total revenues for the three and six-month periods ended October 31, 2003, respectively and 7.9% and 7.5% of total revenues for the three and six-month periods ended October 25, 2002, respectively.

- a higher average selling price for our newer products: FAS960 and FAS250 filers, C1200 NetCache products, NearStore R150 nearline storage systems and software features, as well as our gateway filers (gFiler,) GF960, GF940 and GF825;

- increased sales through indirect channels, including sales through our resellers, distributors and OEM partners, representing 47.0% and 49.3% of total revenues for the three and six-month periods ended October 31, 2003, respectively, and 44.8% and 43.5% for the three and six-month periods ended October 25, 2002, respectively, and

- incremental revenue due to an extra week of business in the six-month period ended October 31, 2003 compared to the same period in the prior year.

Product revenues were negatively impacted by the following factors:

- larger, lower cost per megabyte disks as a result of larger disk capacity; and

- declining average selling price and unit sales of our older filer and caching products.

We cannot assure you that we will be able to maintain or increase market demand for our products.

Service Revenues — Service revenues, which include hardware support, professional services, and educational services, increased by 19.3% to $26.0 million in the second quarter of fiscal 2004, from $21.8 million in the second quarter of fiscal 2003. Service revenues increased by 21.1% to $50.7 million for the six-month period ended October 31, 2003 from $41.9 for the six-month periods ended October 25, 2002. Service revenues are generally deferred and, in most cases, recognized ratably over the service period obligations, which are typically one to three years. Service revenues represented 9.4% and 9.5% of total revenues for the three and six-month periods ended October 31, 2003, respectively and 10.1% and 9.9% of total revenues for the three and six-month periods ended October 25, 2002, respectively. The increase in absolute dollars was due to an increasing number of enterprise customers, who typically purchase more complete service packages. Higher service revenues was also related to a growing installed base resulting in new customer support contracts in addition to support contract renewals by existing customers. While it is an element of our strategy to expand and offer a more comprehensive, global enterprise support and service solution, we cannot assure you that service revenue will grow at the current rate in the remainder of fiscal 2004.

International total revenues (including United States exports) increased by 41.5% and 40.7% for the three and six-month periods ended October 31, 2003 as compared to the same periods of fiscal 2003, respectively. International total revenues were $112.9 million, or 41.0% of total revenues, and $221.4 million, or 41.3% of total revenues, for the three and six-month periods ended October 31, 2003, respectively. The increase in international sales for the second quarter of fiscal 2004 was primarily a result of European and Asia Pacific net revenues growth, driven by larger storage implementations, new products and higher storage spending in certain geographic regions, as compared to the same periods in the prior year. The increase in international sales for the six-month period ended October 31, 2003 compared to October 25, 2002 was generally attributed to the same factors cited above for the second quarters of fiscal 2004 and 2003. In addition, international sales were positively impacted by foreign exchange effects from a weaker U.S. dollar for the six-month period ended October 31, 2003 compared to the same period a year ago. We cannot assure you that we will be able to maintain or increase international revenues in the remainder of fiscal 2004.

Product Gross Margin — Product gross margin decreased to 64.7% for the second quarter of fiscal 2004, from 65.2% for the second quarter of fiscal 2003. Product gross margin decreased to 64.3% for the six-month period ended October 31, 2003, from 65.5% for the six-month period ended October 25, 2002. Amortization of existing technology included in cost of product revenues was $1.4 million and $2.7 million for the three and six-month periods ended October 31, 2003, respectively, and $1.4 million and $2.8 million for the three and six-month periods ended October 25, 2002, respectively. Estimated future amortization for fiscal 2004 will be $0.2 million and none thereafter.

Product gross margin was negatively impacted by:

• increased sales through indirect channels, which have a lower gross margin than our direct sales;

• transitional costs associated with the implementation of a new Enterprise Resource Planning ("ERP") system;

• higher disk content with an expanded storage capacity for the higher-end filers and Nearstore systems;

• sales price reductions due to competitive pricing pressure and selective pricing discounts;

• lower average selling price of certain add-on software options.

Product gross margin was favorably impacted by:

• favorable product and add-on software mix;

• competitive pricing solutions with our core filer products bundled with software features;

• higher average selling prices for our new products; and

• growth in software subscription upgrades and software licenses due primarily to a larger installed base and an increasing number of new enterprise customers.

Service Gross Margin — Service gross margin decreased to 13.9% in the second quarter of fiscal 2004 as compared to 32.1% in the second quarter of fiscal 2003. Service gross margin decreased to 17.7% in the six-month period ended October 31, 2003 as compared to 27.8% in the six-month period ended October 25, 2002. Investments in customer service increased by 51.3% to $22.4 million in the second quarter of fiscal 2004, from $14.8 million in the second quarter of fiscal 2003. Investments in customer service increased by 37.9% to $41.7 million in the six-month period ended October 31, 2003, from $30.3 million in the six-month period ended October 25, 2002. The decrease in service gross margin was primarily due to the continued investment in our service infrastructure to support our increasing enterprise customer base. These investments included additional professional support engineers, increased support center activities, global service partnership programs and stocking of additional parts associated with new products and components and increased related logistics costs. Service gross margin will typically experience some variability over time due to the timing of technical support service initiations and renewals and additional investments in our customer support infrastructure.

Sales and Marketing — Sales and marketing expenses consist primarily of salaries, commissions, advertising and promotional expenses, and certain customer service and support costs. Sales and marketing expenses increased 7.8% to $82.2 million for the second quarter of fiscal 2004, from $76.2 million for the second quarter of fiscal 2003. These expenses were 29.8% and 35.4% of total revenues for the second quarters of fiscal 2004 and fiscal 2003, respectively. Sales and marketing expenses increased 9.1% to $161.5 million for the six-month period ended October 31, 2003, from $148.1 million for the six-month period ended October 25, 2002. These expenses were 30.1% and 35.1% of total revenues for the six-month periods ended October 31, 2003, and October 25, 2002, respectively. The increase in absolute dollars was attributed to an extra week of expenses in the six-month period ended October 31, 2003 compared to the same period in the prior year; sales kick off/club meetings, increased commission expenses and the continued worldwide investment in our sales and customer service organizations associated with selling complete solutions at the enterprise level, offset by cost control and reduction in discretionary spending efforts.

Sales and marketing headcount decreased to 1,203 at October 31, 2003 from 1,276 at October 25, 2002. We expect to continue to selectively add sales capacity in an effort to expand domestic and international markets, introduce new products, establish and expand new distribution channels, and increase product and company awareness. We expect to increase our sales and marketing expenses commensurate with future revenue growth.

Research and Development — Research and development expenses consist primarily of salaries and benefits, prototype expenses, non-recurring engineering charges, fees paid to outside consultants and amortization of capitalized patents. Included in research and development expenses is capitalized patents amortization of $0.5 million and $0.6 million for the three and six-month periods ending October 31, 2003, respectively as compared to none for the same periods in the prior year. Estimated future capitalized patents amortization expenses for fiscal 2004 will be $0.9 million, $1.8 million for each of the fiscal years 2005, 2006, 2007 and 2008 and $0.3 million thereafter.

Research and development expenses increased 11.1% to $31.5 million for the second quarter of fiscal 2004 from $28.4 million for the second quarter of fiscal 2003. These expenses represented 11.4% and 13.2% of total revenues for the second quarters of fiscal 2004 and 2003, respectively. Research and development expenses increased 12.1% to $63.1 million for the six-month period ended October 31, 2003 from $56.2 million for the six-month period ended October 25, 2002. These expenses represented 11.8% and 13.3% of total revenues for the six-month periods ended October 31, 2003 and October 25, 2002, respectively. The increase in research and development expenses was primarily a result of an extra week of expenses in the six-month period ended October 31, 2003 compared to the same period in the prior year, increased headcount, offset by a partial holiday shutdown in July 2003, cost control and reduction in discretionary spending efforts. Research and development headcount increased to 567 as of October 31, 2003 compared to 529 as of October 25, 2002. For both the three and six-month periods ended October 31, 2003 and October 25, 2002, no software development costs were capitalized.

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 and enhancement efforts, and incur prototyping expenses and non-recurring engineering charges associated with the development of new products and technologies. We intend to continuously broaden our existing product offerings and introduce new products that expand our solutions portfolio.

We believe that our research and development expenses will increase in absolute dollars for the remainder of fiscal 2004 as compared to the comparable period in the prior year.

General and Administrative — General and administrative expenses increased 39.4% to $12.7 million for the second quarter of fiscal 2004, from $9.1 million for the second quarter of fiscal 2003. These expenses represented 4.7% and 4.3% of total revenues for the second quarters of fiscal 2004 and 2003, respectively. General and administrative expenses increased 50.8% to $25.0 million for the six-month period ended October 31, 2003, from $16.6 million for the six-month period ended October 25, 2002. These expenses represented 4.6% and 3.9% of total revenues for the six-month periods ended October 31, 2003 and October 25, 2002, respectively. This increase in absolute dollars was primarily due to the investment in our enterprise-wide ERP system, expenses associated with expanded regulatory requirements, an extra week of expenses in the six-month period ended October 31, 2003 compared to the same period in the prior year, a $1.5 million benefit from the collection of previously accrued customer-specific bad debt allowance in the six-month period ended in the prior year, offset by cost control, reduction in discretionary spending efforts and a partial holiday shutdown in July 2003. General and administrative headcount increased to 297 at October 31, 2003 from 264 at October 25, 2002. We believe that our general and administrative expenses will increase in absolute dollars for the remainder of fiscal 2004 due to the investment in our enterprise-wide ERP system and additional expenses related to expanded regulatory requirements as compared to the comparable period in the prior year.

Stock Compensation — We account for stock-based compensation in accordance with the provisions of APB No. 25 and comply with the disclosure provisions of SFAS No. 123, as amended by SFAS No. 148. Deferred compensation recognized under APB No. 25 is amortized to expense using the graded vesting method. We account for stock options issued to non-employees in accordance with the provisions of SFAS No. 123 and EITF No. 96-18 under the fair value based method.

Stock compensation expenses were $0.9 million in both the second quarters of fiscal 2004 and 2003. Stock compensation expenses were $1.5 million and $1.9 million in the six-month periods ended October 31, 2003 and October 25, 2002, respectively. This net decrease in the six-month periods in stock compensation expenses reflected primarily lower stock compensation attributed to forfeitures of unvested options assumed in the WebManage Technologies, Inc. acquisition in fiscal 2001; offset by an increase in stock compensation expenses relating to restricted stock awards. Estimated future deferred stock compensation amortization expenses are $0.6 million in the remainder of fiscal 2004, $0.7 million in fiscal 2005 and $0.6 million in fiscal 2006 and none thereafter.

Restructuring Charges — In fiscal 2002, as a result of continuing unfavorable economic conditions and a reduction in IT spending rates, we implemented two restructuring plans, which included reductions in our workforce and a consolidation of our facilities.

Fiscal 2002 Second Quarter Restructuring Plan

As a result of the restructuring in August 2001, we recorded a charge of $8.0 million. The restructuring charge included $4.8 million of severance-related amounts, $2.7 million of committed excess facilities and facility closure expenses, and $0.5 million in fixed assets write-offs. The reserve balance of $0.8 million at October 31, 2003 was included in other accrued liabilities.

During fiscal 2002, we purchased our Sunnyvale headquarters site and terminated the operating leases. As a result, an adjustment was made to reduce the previously recorded estimated facilities lease losses by $1.5 million. During fiscal 2002 and 2003, we recorded a net restructuring adjustment of $0.1 million, $0.3 million, respectively, due to changes in the estimated costs of certain actions and final resolution of certain restructuring activities. In the event that the foreign facilities are not subleased, we will be obligated for additional total lease payments of approximately $0.5 million to be payable through January 2006.

The following analysis sets forth the significant components of the second quarter fiscal 2002 restructuring at October 31, 2003 (in thousands):

	Severance-Related Amounts	Fixed Assets Write-off	Facility	Total
Restructuring charge	$ 4,796	$ 528	$ 2,656	$ 7,980
Cash payments and others	(4,444)	—	(885)	(5,329)
Non-cash portion	—	(528)	(46)	(574)
Adjustments	315	—	(1,585)	(1,270)
Reserve balance at April 30, 2003	667	—	140	807
Cash payments and others	11	—	(9)	2
Non-cash portion	—	—	(1)	(1)
Reserve balance at August 1, 2003	678	—	130	808
Cash payments and others	19	—	3	22
Non-cash portion	—	—	(1)	(1)
Reserve balance at October 31, 2003	$ 697	$ —	$ 132	$ 829

Fiscal 2002 Fourth Quarter Restructuring Plan

In April 2002, we completed a restructuring related to the closure of an engineering facility and consolidation of resources to the Sunnyvale headquarters. As a result of this restructuring, we recorded a charge of $5.9 million. The restructuring charge included $0.8 million of severance-related amounts, $4.6 million of committed excess facilities and facility closure expenses, and $0.5 million in fixed assets write-offs. Of the reserve balance at October 31, 2003, $0.8 million was included in other accrued liabilities and the remaining $4.5 million was classified as long-term obligations.

In January 2003 and October 2003, we updated our assumptions and estimates based on certain triggering events, which resulted in additional net charges of $0.9 million and $1.1 million, respectively, primarily relating to our engineering facility lease. Our estimates are reviewed and revised periodically and may result in a substantial charge to restructuring expense should different conditions prevail than were anticipated in original management estimates. Such estimates included various assumptions such as the time period over which the facilities will be vacant, expected sublease terms, and expected sublease rates. In the event that the engineering facility is not subleased, we will be obligated for an additional total lease payments of $2.3 million to be payable through November 2010.

The following analysis sets forth the significant components of the fourth quarter fiscal 2002 restructuring at October 31, 2003 (in thousands):

	Severance-Related Amounts	Fixed Assets Write-off	Facility	Total
Restructuring charge	$ 813	$ 473	$ 4,564	$ 5,850
Net cash payments	(706)	—	(1,023)	(1,729)
Non-cash portion	—	(473)	—	(473)
Adjustments	(107)	—	1,030	923
Reserve balance at April 30, 2003	—	—	4,571	4,571
Net cash payments	—	—	(205)	(205)
Reserve balance at August 1, 2003	—	—	4,366	4,366
Net cash payments	—	—	(203)	(203)
Adjustments	—	—	1,110	1,110
Reserve balance at October 31, 2003	$ —	$ —	$ 5,273	$ 5,273

Interest Income — Interest income was $2.8 million and $2.9 million for the second quarters of fiscal 2004 and 2003, respectively. For the six-month periods ended October 31, 2003 and October 25, 2002, interest income was $5.9 million and $6.0 million, respectively. The moderate decrease in interest income was primarily driven by lower average interest rates on our investment portfolio, partially offset by higher investment balances provided by operating activities. We expect interest income to increase for the remainder of fiscal 2004 as a result of higher invested balances in a higher interest-rate portfolio environment as we reinvest our securities in longer-term investments.

Other Expense, Net — The three and six-month periods ended October 31, 2003 included a net exchange loss from foreign currency transactions of $1.2 million and $1.3 million, respectively and for the three and six-month periods ended October 25, 2002, $0.1 million and $1.0 million, respectively. The increase in net exchange loss was attributed to the impact of currency balance sheet hedging activities resulting from forecast variances.

Net Gain/(Loss) on Investments — Our investments in publicly held companies are generally considered impaired when a decline in the fair value of an investment as measured by quoted market prices is less than its carrying value, and such a decline is not considered temporary. In the six-month ended October 25, 2002, we recorded a noncash write down of $0.7 million related to the impairment of our investment in a publicly traded company as its reduction in value was judged to be other than temporary. In the six-month ended October 31, 2003, we sold certain previously impaired investments and realized a net gain of $0.1 million.

Gain on Sale of Intangible Assets — We recorded a gain on sale of intangible assets of $0.6 million in the first quarter of fiscal 2003 related to the sale of our ContentReporter™ software. We intend to resell this software through a licensing arrangement.

Provision for (Benefit from) Income Taxes — Provision for (benefit from) income taxes for the second quarter of fiscal 2004 included a non-recurring income tax benefit of $16.8 million or approximately $0.05 per share associated with a favorable foreign tax ruling, which occurred during the second quarter of fiscal 2004. This favorable ruling from the Netherlands provides for retroactive benefits dating back to fiscal year 2001 as well as future tax rate benefits. For the six-month period ended October 31, 2003, we applied an annual tax rate of 20.4% to pretax income, which excluded the $16.8 million non-recurring benefit from the foreign tax ruling. Our estimate is based on existing tax laws and our current projections of income (loss) and distributions of income (loss) among different entities and tax jurisdictions, and is subject to change, based primarily on varying levels of profitability.

Liquidity and Capital Resources

As of October 31, 2003, as compared to the April 30, 2003 balances, our cash, cash equivalents, and short-term investments increased by $103.3 million to $722.1 million. We derive our liquidity and capital resources primarily from our cash flow from operations and from working capital. Working capital increased by $112.8 million to $701.3 million as of October 31, 2003, compared to $588.5 million as of April 30, 2003.

We generated cash from operating activities totaling $127.5 million and $64.5 million for the six-month periods ended October 31, 2003 and October 25, 2002, respectively. Net cash provided by operating activities in the six-month period ended October 31, 2003 was principally related to net income of $75.5 million, increases in accounts payable, accrued compensation and related benefits, accrued liabilities, deferred revenue, coupled with depreciation, net gain or loss on investments, amortization of intangibles and stock compensation, partially offset by decreased income taxes payable and increases in accounts receivable, inventories and prepaid expenses and other assets.

We used $22.0 million and $31.5 million of cash in the six-month periods ended October 31, 2003 and October 25, 2002, respectively, for capital expenditures. We used net proceeds of $74.1 million and $25.3 million in the six-month periods ended October 31, 2003 and October 25, 2002, respectively, for net purchases/redemptions of short-term investments. In June 2003, we acquired additional patents for a purchase price of approximately $9.0 million. Investing activities in the six-month periods October 31, 2003 and October 25, 2002 also included new investments in privately-held companies of $0.3 million and $0.5 million, respectively.

We received $8.4 million and $12.0 million in the six-month periods ended October 31, 2003 and October 25, 2002, which included both common stock repurchases and sales of common stock. We repurchased 2.7 million shares of common stock at a total of $44.9 million during the six-month period ended October 31, 2003. Other financing activities provided $53.2 million and $12.0 million in the six-month periods ended October 31, 2003, and October 25, 2002, respectively, which related to sales of common stock related to employee stock transactions. The change in cash flow from financing was primarily due to the effects of the common stock repurchases partially offset by higher proceeds from issuance of common stock under employee programs compared to the same period in the prior year.

Our capital and liquidity requirements depend on numerous factors, including risks relating to fluctuating operating results, continued growth in the network storage and content delivery markets, customer and market acceptance of our products, dependence on new products, rapid technological change, dependence on qualified technical and sales personnel, risk inherent in our international operations, competition, reliance on a limited number of suppliers and contract manufacturers, relationships with strategic partners and resellers, dependence on proprietary technology, intellectual property rights, the value of our investments in equity securities and real estate, and other factors. We believe that our existing liquidity and capital resources are sufficient to fund our operations for at least the next twelve months.

Contractual Obligations

The following summarizes our contractual obligations at October 31, 2003, and the effect such obligations are expected to have on our liquidity and cash flow in future periods, (in thousands):

	2004	2005	2006	2007	2008	Thereafter	Total
Operating lease payments	$ 5,625	$10,531	$ 8,074	$ 4,775	$3,877	$10,794	$43,676
Venture capital funding commitments	300	600	600	600	588	1,736	4,424
Purchase commitments	3,037	8,400	10,000	10,000	—	—	31,437
Maintenance services and other	2,538	5,568	2,968	79	—	—	11,153
	$11,500	$25,099	$21,642	$15,454	$4,465	$12,530	$90,690

Risk Factors

The following risk factors and other information included in this Form 10-Q should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we presently deem less significant may also impair our business operations. If any of the following risks actually occur, our business, operating results, and financial condition could be materially adversely affected.

Factors beyond our control could cause our quarterly results to fluctuate.

We believe that period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as indicators of future performance. Many of the factors that could cause our quarterly operating results to fluctuate significantly in the future are beyond our control and include, but are not limited to, the following:

• changes in general economic conditions and specific economic conditions in the computer, storage, and networking industries;

• general decrease in global corporate spending on information technology leading to a decline in demand for our products;

• the effects of terrorist activity and international conflicts, which could lead to business interruptions and difficulty in forecasting;

• the level of competition in our target product markets;

• the size, timing, and cancellation of significant orders;

• product configuration and mix;

• the extent to which our customers renew their service and maintenance contracts with us;

• market acceptance of new products and product enhancements;

• announcements, introductions, and transitions of new products by us or our competitors;

• deferrals of customer orders in anticipation of new products or product enhancements introduced by us or our competitors;

• changes in pricing by us in response to competitive pricing actions;

• our ability to develop, introduce, and market new products and enhancements in a timely manner;

• supply constraints;

• technological changes in our target product markets;

• the levels of expenditure on research and development and sales and marketing programs;

- our ability to achieve targeted cost reductions;
- excess facilities;
- future accounting pronouncements and changes in accounting policies; and
- seasonality.

In addition, sales for any future quarter may vary and accordingly be inconsistent with our plans. We manufacture products based on a combination of specific order requirements and forecasts of our customer demands. Products are typically shipped within one to four weeks following receipt of an order. In certain circumstances, customers may cancel or reschedule orders without penalty. Product sales are also difficult to forecast because the network storage market is rapidly evolving and our sales cycle varies substantially from customer to customer.

Due to all of the foregoing factors, it is possible that in one or more future quarters our results may fall below the expectations of public market analysts and investors. In such event, the trading price of our common stock would likely decrease.

Our gross margins may vary based on the configuration of our product and service solutions, and such variation may make it more difficult to forecast our earnings.

We derive a significant portion of our sales from the resale of disk drives as components of our filers, and the resale market for hard disk drives is highly competitive and subject to intense pricing pressures. Our sales of disk drives generate lower gross margin percentages than those of our filer products. As a result, as we sell more highly configured systems with greater disk drive content, overall gross margin percentages may be negatively affected.

Our gross margins have been and may continue to be affected by a variety of other factors, including:

- demand for storage and content delivery products;
- discount levels and price competition;
- direct versus indirect sales;
- product and add-on software mix;
- the mix of services as a percentage of revenue;
- the mix and average selling prices of products;
- the mix of disk content;
- new product introductions and enhancements;
- excess inventory purchase commitments as a result of changes in demand forecasts and possible product and software defects as we transition our products; and
- the cost of components, manufacturing labor, and quality.

Changes in service gross margin may result from various factors such as continued investments in our customer support infrastructure, changes in the mix between technical support services and professional services, as well as the timing of technical support service contract initiations and renewals.

A significant percentage of our expenses are fixed, which could materially and adversely affect our net income.

Our expense levels are based in part on our expectations as to future sales and a significant percentage of our expenses are fixed. As a result, if sales levels are below expectations or previously higher levels, net income will be disproportionately affected in a material and adverse manner.

Because cost and expense control is critical to maintaining our positive cash flow from operations and profitability, if we are unable to control costs and expenses relative to our revenue, our cash flow and net income will be adversely affected.

In fiscal 2002, we reduced fixed costs through workforce reductions and a consolidation of our facilities. We believe strict cost containment is essential to maintaining positive cash flow from operations and remaining profitable in future quarters, especially since the outlook for future quarters is uncertain. A number of factors could preclude us from successfully maintaining costs and expenses in line with our revenues, such as our inability to accurately forecast business activities and deterioration of our revenues. If we are not able to maintain control over our costs and keep our expense structure in line with our business activities and revenues, our cash flow and net income will be adversely affected.

Our future financial performance depends on growth in the network storage and content delivery markets. If these markets do not continue to grow at the rates at which we forecast growth, our operating results will be materially and adversely impacted.

All of our products address the storage and content delivery markets. Accordingly, our future financial performance will depend in large part on continued growth in the storage and content delivery markets and on our ability to adapt to emerging standards in these markets. We cannot assure you that the markets for storage and content delivery will continue to grow or that emerging standards in these markets will not adversely affect the growth of UNIX®, Windows®, and the World Wide Web server markets upon which we depend.

For example, we provide our open access data retention solutions to customers within the financial services, healthcare, pharmaceuticals and government market segments, industries that are subject to various evolving governmental regulations with respect to data access, reliability and permanence (such as Rule 17(a)(4) of the Securities and Exchange Act of 1934, as amended) in the United States and in the other countries in which we operate. If our products do not meet, and continue to comply with, these evolving governmental regulations in this regard, customers in these market and geographical segments will not purchase our products and, therefore, we will not be able to expand our product offerings in these market and geographical segments at the rates for which we have forecast.

In addition, our business also depends on general economic and business conditions. A reduction in demand for network storage and content delivery caused by weakening economic conditions and decreases in corporate spending have resulted in decreased revenues and lower revenue growth rates. The network storage and content delivery market growth declined significantly beginning in the third quarter of fiscal 2001, causing both our revenues and operating results to decline. If the network storage and content delivery markets grow more slowly than anticipated or if emerging standards other than those adopted by us become increasingly accepted by these markets, our operating results could be materially adversely affected.

The market price for our common stock has fluctuated significantly in the past and will likely continue to do so in the future.

The market price for our common stock has experienced substantial volatility in the past, and several factors could cause the price to fluctuate substantially in the future. These factors include:

- fluctuations in our operating results;
- fluctuations in the valuation of companies perceived by investors to be comparable to us;
- economic developments in the network storage market as a whole;
- international conflicts and acts of terrorism;
- a shortfall in revenues or earnings compared to securities analysts’ expectations;
- changes in analysts’ recommendations or projections;
- announcements of new products, applications or product enhancements by us or our competitors;

- changes in our relationships with our suppliers, customers and strategic partners; and

- general market conditions.

In addition, the stock market has experienced volatility that has particularly affected the market prices of equity securities of many technology companies. Additionally, certain macroeconomic factors such as changes in interest rates, the market climate for the technology sector, and levels of corporate spending on information technology could also have an impact on the trading price of our stock. As a result, the market price of our common stock may fluctuate significantly in the future and any broad market decline, as well as our own operating results, may materially adversely affect the market price of our common stock.

If we are unable to develop and introduce new products and respond to technological change, if our new products do not achieve market acceptance, or if we fail to manage the transition between our new and old products, our operating results could be materially adversely affected.

Our future growth depends upon the successful development and introduction of new hardware and software products. Due to the complexity of storage subsystems and Internet caching devices, and the difficulty in gauging the engineering effort required to produce new products, such products are subject to significant technical risks. However, we cannot assure you that any of our new products will achieve market acceptance. Additional product introductions in future periods may also impact our sales of existing products. In addition, our new products must respond to technological changes and evolving industry standards. If we are unable, for technological or other reasons, to develop and introduce new products in a timely manner in response to changing market conditions or customer requirements, or if such products do not achieve market acceptance, our operating results could be materially adversely affected.

In particular, in conjunction with the introduction of our product offerings in the fabric-attached storage market, we introduced products with new features and functionality that address the storage area network market. During fiscal 2003, we introduced iSCSI-enabled unified storage solutions. We also introduced Direct Access File System (DAFS) protocol-capable products and NearStore backup and recovery products during fiscal 2002. We face risks relating to these product introductions, including risks relating to forecasting of demand for such products, as well as possible product and software defects and a potentially different sales and support environment associated with selling these new systems. If any of the foregoing occur, our operating results could be adversely affected.

As new or enhanced products are introduced, we must successfully manage the transition from older products in order to minimize disruption in customers' ordering patterns, avoid excessive levels of older product inventories, and ensure that enough supplies of new products can be delivered to meet customers' demands.

Our business could be materially adversely affected as a result of a natural disaster, terrorist acts, or other catastrophic events.

Our operations, including our suppliers' and contract manufacturers' operations, are susceptible to outages due to fire, floods, power loss, power shortages, telecommunications failures, break-ins, and similar events. In addition, our headquarters are located in Northern California, an area susceptible to earthquakes. If any significant disaster were to occur, our ability to operate our business could be impaired.

Weak economic conditions or terrorist actions could lead to significant business interruptions. If such disruptions result in cancellations of customer orders, a general decrease in corporate spending on information technology, or direct impacts on our marketing, manufacturing, financial functions, or our suppliers' logistics function, our results of operations and financial condition could be adversely affected.

We depend on attracting and retaining qualified technical and sales personnel. If we are unable to attract and retain such personnel, our operating results could be materially and adversely impacted.

Our continued success depends, in part, on our ability to identify, attract, motivate, and retain qualified technical and sales personnel. Because our future success is dependent on our ability to continue to enhance and introduce new products, we are particularly dependent on our ability to identify, attract, motivate, and retain qualified engineers with the requisite education, backgrounds, and industry experience. In spite of the economic downturn, competition for qualified engineers, particularly in Silicon Valley, can be intense. The loss of the services of a significant number of our engineers or sales people could be disruptive to our development efforts or business relationships and could materially adversely affect our operating results.

Risks inherent in our international operations could have a material adverse effect on our operating results.

We conduct business internationally. For the three and six-month ended October 31, 2003, approximately 41.0% and 41.3%, respectively, of our total revenues was from international customers (including U.S. exports). Accordingly, our future operating results could be materially adversely affected by a variety of factors, some of which are beyond our control, including regulatory, political, or economic conditions in a specific country or region, trade protection measures and other regulatory requirements, government spending patterns, and acts of terrorism and international conflicts.

Our international sales are denominated in U.S. dollars and in foreign currencies. An increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive and, therefore, potentially less competitive in foreign markets. For international sales and expenditures denominated in foreign currencies, we are subject to risks associated with currency fluctuations. We hedge risks associated with foreign currency transactions in order to minimize the impact of changes in foreign currency exchange rates on earnings. We utilize forward contracts to hedge our currency exposure associated with certain assets and liabilities as well as anticipated foreign currency cash flow. All balance sheet hedges are marked to market through earnings every period, while gains and losses on cash flow hedges are recorded in other comprehensive income. There can be no assurance that such hedging strategies will be successful and that currency exchange rate fluctuations will not have a material adverse effect on our operating results.

Additional risks inherent in our international business activities generally include, among others, longer accounts receivable payment cycles, difficulties in managing international operations, and potentially adverse tax consequences. Such factors could materially adversely affect our future international sales and, consequently, our operating results.

Although operating results have not been materially adversely affected by seasonality in the past, because of the significant seasonal effects experienced within the industry, particularly in Europe, our future operating results could be materially adversely affected by seasonality.

We cannot assure you that we will be able to maintain or increase international market demand for our products.

An increase in competition could materially adversely affect our operating results.

The storage and content delivery markets are intensely competitive and are characterized by rapidly changing technology.

In the storage market, our FAS appliances and data management software compete primarily against storage products and data management software from EMC Corporation, Hitachi Data Systems, Hewlett-Packard Company (including the integrated Compaq Computer Corporation), IBM Corporation, and Sun Microsystems, Inc. We have also historically encountered less-frequent competition from Dell, LSI Logic Corp., MTI Corp., Procom Technology and Silicon Graphics, Inc.

In the content delivery market, our NetCache appliances and content delivery software compete against caching appliance and content delivery software vendors, including Akamai Technologies, Inc., BlueCoat Systems (formerly Cacheflow, Inc.) and Cisco Systems, Inc.

Additionally a number of new, privately held companies are currently attempting to enter the storage and content delivery markets, some of which may become significant competitors in the future.

We believe that the principal competitive factors affecting the storage and content delivery markets include product benefits such as response time, reliability, data availability, scalability, ease of use, price, multiprotocol capabilities, and customer service and support. To date, we have been able to compete successfully with our principal competitors in large part based on the product benefits that we believe result from the superior technology of our products. We must continue to maintain and enhance this technological advantage over our competitors. Otherwise, if those competitors with greater financial, marketing, service, support, technical and other resources were able to offer products that matched or surpassed the technological capabilities of our products, these competitors would, by virtue of these greater resources, gain a competitive advantage over us that would lead to greater sales for these competitors at the expense of our own market share, which would have a material adverse affect on our business, financial condition and results of operations.

Increased competition could also result in price reductions, reduced gross margins, and loss of market share, any of which could materially adversely affect our operating results. Our competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements, or devote greater resources to the development, promotion, sale, and support of their products. In addition, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties. Accordingly, it is possible that new competitors or alliances among competitors may emerge and rapidly acquire significant market share. We cannot assure you that we will be able to compete successfully against current or future competitors. Competitive pressures we face could materially adversely affect our operating results.

We rely on a limited number of suppliers, and any disruption or termination of these supply arrangements could delay shipment of our products and could materially adversely affect our operating results.

We rely on a limited number of suppliers of several key components utilized in the assembly of our products. We purchase most of our disk drives through a single supplier. We purchase computer boards and microprocessors from a limited number of suppliers. Our reliance on a limited number of suppliers involves several risks, including:

• a potential inability to obtain an adequate supply of required components because we do not have long-term supply commitments;

• supplier capacity constraints;

• price increases;

• timely delivery; and

• component quality.

Component quality is particularly significant with respect to our suppliers of disk drives. In order to meet product performance requirements, we must obtain disk drives of extremely high quality and capacity. In addition, there are periodic supply-and-demand issues for disk drives, microprocessors, and for semiconductor memory components, which could result in component shortages, selective supply allocations, and increased prices of such components. We cannot assure you that we will be able to obtain our full requirements of such components in the future or that prices of such components will not increase. In addition, problems with respect to yield and quality of such components and timeliness of deliveries could occur. Disruption or termination of the supply of these components could delay shipments of our products and could materially adversely affect our operating results. Such delays could also damage relationships with current and prospective customers.

In addition, we license certain technology and software from third parties that is incorporated into our products. If we are unable to obtain or license the technology and software on a timely basis, we will not be able to deliver product to our customers in a timely manner.

The loss of any contract manufacturers or the failure to accurately forecast demand for our products or successfully manage our relationships with our contract manufacturers could negatively impact our ability to manufacture and sell our products.

We currently rely on several contract manufacturers to manufacture most of our products. Our reliance on our third-party contract manufacturers reduces our control over the manufacturing process, exposing us to risks, including reduced control over quality assurance, production costs, and product supply. If we should fail to effectively manage our relationship, with our contract manufacturers, or if our contract manufacturers experience delays, disruptions, capacity constraints, or quality control problems in their manufacturing operations, our ability to ship products to our customers could be impaired and our competitive position and reputation could be harmed. Qualifying a new contract manufacturer and commencing volume production are expensive and time-consuming. If we are required to change contract manufacturers or assume internal manufacturing operations, we may lose revenue and damage our customer relationships. If we inaccurately forecast demand for our products, we may have excess or inadequate inventory, or incur cancellation charges or penalties, which could adversely impact our operating results.

We intend to regularly introduce new products and product enhancements, which will require us to rapidly achieve volume production by coordinating with our contract manufacturers and suppliers. We may need to increase our material purchases, contract manufacturing capacity, and internal test and quality functions to meet anticipated demand. The inability of our contract manufacturers to provide us with adequate supplies of high-quality products, or the inability to obtain raw materials, could cause a delay in our ability to fulfill orders.

If we are unable to maintain our existing relationships and develop new relationships with major strategic partners, our revenue may be impacted negatively.

An element of our strategy to enhance revenue is to strategically partner with major third-party software and hardware vendors who integrate our products into their products and also comarket our products. A number of these strategic partners are industry leaders that offer us expanded access to segments of the storage market. There is intense competition for attractive strategic partners, and even if we can establish strategic relationships with these partners, we cannot assure you that these partnerships will generate significant revenue or that the partnerships will continue to be in effect for any specific period of time.

We intend to continue to establish and maintain business relationships with technology companies to accelerate the development and marketing of our storage solutions. To the extent we are unsuccessful in developing new relationships and maintaining our existing relationships, our future revenue and operating results could be impacted negatively. In addition, the loss of a strategic partner could have a material adverse effect on the progress of new products under development with that partner.

We may incur problems with current or future equity investments and acquisitions, and these investments may not achieve our objectives.

From time to time, we make equity investments for the promotion of business and strategic objectives. We have already made strategic investments in a number of network storage-related technology companies. Equity investments may result in the loss of investment capital. The market price and valuation of our equity investments in these companies may fluctuate due to market conditions and other circumstances over which we have little or no control, and recent events have adversely affected the public equity market. To the extent that the fair value of these securities is less than our cost over an extended period of time, our results of operations and financial position could be negatively impacted. In the first quarter of fiscal 2003, we recorded a non-cash write-down of $0.7 million related to the impairment of our investment in a publicly traded company as its reduction in value was judged to be other than temporary. In the first quarter of fiscal 2004, we recorded a gain of $0.1 million related to sales of previously impaired investments.

As part of our strategy, we are continuously evaluating opportunities to buy other businesses or technologies that would complement our current products, expand the breadth of our markets, or enhance our technical capabilities. We have acquired two companies since the beginning of fiscal 2001. We may engage in future acquisitions that dilute our stockholders' investments and cause us to use cash, to incur debt, or to assume contingent liabilities, see Note 15 Subsequent Events.

Acquisitions of companies entail numerous risks, and we may not be able to successfully integrate acquired operations and products or to realize anticipated synergies, economies of scale, or other value. In addition, we may experience a diversion of management's attention, the loss of key employees of acquired operations, or the inability to recover strategic investments in development stage entities. Any such problems could have a material adverse effect on our business, financial condition, and results of operation.

In addition, we adopted SFAS No. 142 *"Goodwill and Other Intangible Assets,"* which changes the accounting for goodwill from an amortization method to an impairment-only approach. As of October 31, 2003, the fair value for each of our reporting units exceeded the reporting unit's carrying amount and no impairment was recognized. On an ongoing basis, goodwill is reviewed annually for impairment (or more frequently if indicators of impairment arise). There had been no impairment of goodwill and intangible assets as of the end of the second quarter of fiscal 2004. There can be no assurance that future impairment tests will not result in a charge to earnings.

We rely and will increasing rely on our indirect sales channel for a significant portion of our revenue. If we are unable to manage effectively this sales channel, we will not be able to maintain or increase our revenue as we have forecasted, which would have a materially adverse impact on our business, financial condition and results of operations.

We market and sell our storage solutions directly through our worldwide sales force and indirectly through channels such as value-added resellers ("VARs"), systems integrators, distributors and strategic business partners and derive a significant portion of our revenue from these indirect channel partners. However, in order for us to maintain our current revenue sources and grow our revenue as we have forecasted, we must effectively manage our relationships with these indirect channel partners. To do so, we must attract and retain a sufficient number of qualified channel partners to successfully market our products. However, because we also sell our products directly to customers through our sales force, on occasion we compete with our indirect channels for sales of our products to our end customers, competition that could result in conflicts with these indirect channel partners and make it harder for us to attract and retain these indirect channel partners. At the same time, our indirect channel partners may develop and offer products of their own that are competitive to ours. Or, because our reseller partners generally offer products from several different companies, including products of our competitors, these resellers may give higher priority to the marketing, sale and support of our competitors' products than ours. If we fail to manage effectively our relationships with these indirect channel partners to minimize channel conflict and continue to evaluate and meet our indirect sales partners' needs with respect to our products, we will not be able to maintain or increase our revenue as we have forecasted, which would have a materially adverse affect on our business, financial condition and results of operations.

Undetected software, hardware errors, or failures found in new products may result in loss of or delay in market acceptance of our products, which could increase our costs and reduce our revenues.

Our products may contain undetected software, hardware errors, or failures when first introduced or as new versions are released. Despite testing by us and by current and potential customers, errors may not be found in new products until after commencement of commercial shipments, resulting in loss of or delay in market acceptance, which could materially adversely affect our operating results.

If actual results or events differ materially from our estimates and assumptions, our reported financial condition and results of operation for future periods could be materially affected.

The preparation of the consolidated financial statements and related disclosure in conformity with accounting principles generally accepted in the United States of America requires management to establish policies that contain estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Note 4 of the Notes to Condensed Consolidated Financial Statements describes the significant accounting policies essential to preparing our consolidated financial statements. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures. We base our estimates on historical experience and assumptions that we believe to be reasonable under the circumstances. Actual future results may differ materially from these estimates. We evaluate, on an ongoing basis, our estimates and assumptions. In addition, see our Critical Accounting Policies under Item 2.

If we are unable to protect our intellectual property, we may be subject to increased competition that could materially adversely affect our operating results.

Our success depends significantly upon our proprietary technology. We rely on a combination of copyright and trademark laws, trade secrets, confidentiality procedures, contractual provisions, and patents to protect our proprietary rights. We seek to protect our software, documentation, and other written materials under trade secret, copyright, and patent laws, which afford only limited protection. Some U.S. trademarks and some U.S.-registered trademarks are registered internationally as well. We will continue to evaluate the registration of additional trademarks as appropriate. We generally enter into confidentiality agreements with our employees and with our resellers, strategic partners, and customers. We currently have multiple U.S. and international patent applications pending and multiple U.S. patents issued. The pending applications may not be approved and if patents are issued, such patents may be challenged. If such challenges are brought, the patents may be invalidated. We cannot assure you that we will develop proprietary products or technologies that are patentable, that any issued patent will provide us with any competitive advantages or will not be challenged by third parties, or that the patents of others will not materially adversely affect our ability to do business.

Litigation may be necessary to protect our proprietary technology. Any such litigation may be time-consuming and costly. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. In addition, the laws of some foreign countries do not protect proprietary rights to as great an extent as do the laws of the U.S. We cannot assure you that our means of protecting our proprietary rights will be adequate or that our competitors will not independently develop similar technology, duplicate our products, or design around patents issued to us or other intellectual property rights of ours.

We are subject to intellectual property infringement claims. We may, from time to time, receive claims that we are infringing third parties' intellectual property rights. Third parties may in the future claim infringement by us with respect to current or future products, patents, trademarks, or other proprietary rights. We expect that companies in the appliance market will increasingly be subject to infringement claims as the number of products and competitors in our industry segment grows and the functionality of products in different industry segments overlaps. Any such claims could be time-consuming, result in costly litigation, cause product shipment delays, require us to redesign our products or require us to enter into royalty or licensing agreements, any of which could materially adversely affect our operating results. Such royalty or licensing agreements, if required, may not be available on terms acceptable to us or at all.

Item 3. *Quantitative and Qualitative Disclosures About Market Risk*

We are exposed to market risk related to fluctuations in interest rates, market prices and foreign currency exchange rates. We use certain derivative financial instruments to manage these risks. We do not use derivative financial instruments for speculative or trading purposes. All financial instruments are used in accordance with management-approved policies.

Market Interest and Interest Income Risk

Interest and Investment Income — As of October 31, 2003, we had short-term investments of $407.0 million. Our investment portfolio primarily consists of highly liquid investments with original maturities at the date of purchase of greater than three months, which are classified as available-for-sale, and investment in marketable equity securities in primarily technology companies. These highly liquid investments, consisting primarily of government and corporate debt securities, are subject to interest rate and interest income risk and will decrease in value if market interest rates increase. A hypothetical 10 percent increase in market interest rates from levels at October 31, 2003 would cause the fair value of these short-term investments to decline by approximately $0.7 million. By policy, we limit our exposure to longer term investments, and a substantial majority of our investment portfolio has maturities of less than three years. Because we have the ability to hold these investments until maturity we would not expect any significant decline in value of our investments caused by market interest rate changes. Declines in interest rates over time will, however, reduce our interest income. We do not use derivative financial instruments in our investment portfolio.

Market Price Risk

Equity Securities — We are also exposed to market price risk on our equity securities included in our short-term investments, which are primarily in publicly traded companies in the volatile high-technology industry sector. In the first quarter of fiscal 2003, we recorded a non-cash write down of $0.7 million related to the impairment of our investment in a publicly traded company as its reduction in value was judged to be other than temporary.

We do not attempt to reduce or eliminate our market exposure on these securities and, as a result, the amount of income and cash flow that we ultimately realize from our investment in future periods may vary materially from the current fair value. A 50% adverse change in the equity price would result in an immaterial decrease in the fair value of our equity security as of October 31, 2003.

The hypothetical changes and assumptions discussed above will be different from what actually occurs in the future. Furthermore, such computations do not anticipate actions that may be taken by management, should the hypothetical market changes actually occur over time. As a result, the effect on actual earnings in the future will differ from those described above.

Foreign Currency Exchange Rate Risk

We hedge risks associated with foreign currency transactions in order to minimize the impact of changes in foreign currency exchange rates on earnings. We utilize forward contracts to hedge against the short-term impact of foreign currency fluctuations on certain assets and liabilities denominated in foreign currencies. All balance sheet hedges are marked to market through earnings every period. We also use foreign exchange forward contracts to hedge foreign currency forecasted transactions related to certain sales and operating expenses. These derivatives are designated as cash flow hedges under SFAS No. 133. For cash flow hedges, the gains or losses were included in other comprehensive income and were not material at October 31, 2003.

We do not enter into foreign exchange contracts for speculative or trading purposes. In entering into forward foreign exchange contracts, we have assumed the risk that might arise from the possible inability of counterparties to meet the terms of their contracts. We attempt to limit our exposure to credit risk by executing foreign contracts with credit worthy multinational commercial banks. All contracts have a maturity of less than one year.

The following table provides information about our foreign exchange forward contracts outstanding on October 31, 2003, (in thousands):

Currency	Buy/Sell	Foreign Currency Amount	Contract Value USD	Fair Value in USD
AUD	Sell	5,038	$ 3,550	$ 3,549
CHF	Sell	6,271	$ 4,673	$ 4,674
GBP	Sell	18,344	$ 31,009	$30,993
EUR	Sell	72,522	$ 84,070	$83,879
CAD	Sell	7,870	$ 5,938	$ 5,937
ZAR	Sell	16,800	$ 2,416	$ 2,414
GBP	Buy	1,420	$ 2,407	$ 2,399
EUR	Buy	5,354	$ 6,245	$ 6,191

Item 4. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures. Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

Changes in Internal Control over Financial Reporting. There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. In May 2003, we implemented new enterprise-wide software, as well as new business processes and procedures to support the software. These changes are the result of our normal business process to evaluate and upgrade or replace our systems software and related business processes to support our evolving operational needs. The new software and processes have been used to record and report our fiscal 2004 financial results.

Item 5. ***Other Information***

In accordance with Section 10A(i)(2) of the Securities Exchange Act of 1934, as added by Section 202 of the Sarbanes-Oxley Act of 2002 (the “Act”), we are required to disclose the non-audit services approved by our Audit Committee to be performed by Deloitte & Touche LLP, our external auditor. Non-audit services are defined in the Act as services other than those provided in connection with an audit or a review of the financial statements of a company. The Audit Committee has approved the engagement of Deloitte & Touche LLP for services related to local statutory audits and certain taxation matters.

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 Security Holders*

On September 2, 2003, we held our 2003 Annual Meeting of Stockholders. Voting results are summarized below:

Proposal I — To elect the following individuals to serve as members of the Board of the Directors for the ensuing year or until their respective successors are duly elected and qualified:

Name	Votes For	Abstain
Daniel J. Warmenhoven	306,721,997	2,256,951
Donald T. Valentine	306,485,728	2,493,220
Sanjiv Ahuja	304,237,613	4,741,335
Carol A. Bartz	298,648,721	10,330,227
Michael R. Hallman	304,238,128	4,740,820
Nicholas G. Moore	304,244,184	4,734,764
Sachio Semmoto	306,812,535	2,166,413
Robert T. Wall	299,027,991	9,950,957

Proposal II — To approve an amendment to the Company's 1999 Stock Option Plan (the 1999 Plan) to create a stock issuance program.

Votes For	Against	Abstain
204,822,121	102,291,085	1,865,742

Proposal III — To approve an amendment to the Company's Employee Stock Purchase Plan (the Purchase Plan) which will increase the share reserve under the plan by an additional 1,000,000 shares of Common Stock.

Votes For	Against	Abstain
293,181,841	13,989,604	1,807,503

Proposal IV — To ratify the appointment of Deloitte & Touche LLP as independent auditors of the Company for the fiscal year ending April 31, 2004.

Votes For	Against	Abstain
299,766,542	7,539,088	1,673,318

Item 5. *Other Information*

None

Item 6. *Exhibits and Reports on Form 8-K*

(a) *Exhibits*

3.1(1)	Certificate of Incorporation of the Company
3.2(1)	Bylaws of the Company
4.1(1)	Reference is made to Exhibits 3.1 and 3.2
10.1(2)	Asset Purchase Agreement dated June 20, 2003, by and between Auspex System, Inc. and the Company.
21	Subsidiaries of the Company
31.1	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-15(e) and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated December 4, 2003.
31.2	Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-15(e)and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated December 4, 2003.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated December 4, 2003.

(1) Previously filed as an exhibit with the Company's Current Report on Form 8-K dated December 4, 2001.

(2) Previously filed as an exhibit with the Company's Quarterly Report on Form 10-Q dated September 3, 2003.

(b) *Reports on Form 8-K*

On August 19, 2003, we furnished (but did not file) a report on Form 8-K relating to financial information for Network Appliance for the quarter ended August 1, 2003 and forward-looking statements relating to fiscal year 2004, as presented in a press release of August 19, 2003.

SIGNATURE

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

NETWORK APPLIANCE INC.
(Registrant)

/s/ STEVEN J. GOMO

Steven J. Gomo
Senior Vice President of Finance
and Chief Financial Officer

Date: December 4, 2003

EXHIBIT INDEX

Exhibit No.	Description
3.1(1)	Certificate of Incorporation of the Company.
3.2(1)	Bylaws of the Company.
4.1(1)	Reference is made to Exhibits 3.1 and 3.2.
10.1(2)	Asset Purchase Agreement dated June 20, 2003, by and between Auspex Systems, Inc. and the Company.
21	Subsidiaries of the Company
31.1	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-15(e) and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated December 4, 2003.
31.2	Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-15(e)and 15d-15(e) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated December 4, 2003.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated December 4, 2003.

(1) Previously filed as an exhibit with the Company’s Current Report on Form 8-K dated December 4, 2001.

(2) Previously filed as an exhibit with the Company’s Quarterly Report on Form 10-Q dated September 3, 2003.

Exhibit 21

SUBSIDIARIES OF THE COMPANY

SUBSIDIARIES:
Network Appliance Ltd. (U.K.)
Network Appliance SARL (France)
Network Appliance Srl. (Italy)
Network Appliance GmbH (Germany)
Network Appliance FSC Incorporated (Barbados)
Network Appliance KK (Japan)
Network Appliance Ltd. (Ireland)
Network Appliance GmbH (Switzerland)
Network Appliance BV (Netherlands)
Network Appliance GesmbH (Austria)
Network Appliance SL (Spain)
Network Appliance Global Ltd. (Bermuda)
Network Appliance Denmark ApS
Network Appliance (Australia) Pty Ltd
Network Appliance Mexico S de RL de CV
Network Appliance Singapore Private Ltd.
Network Appliance (Malaysia) Sdn Bhd
Network Appliance Systems (India) Private Ltd.
Network Appliance Argentina
Network Appliance (Brasil) Ltda.
Network Appliance Canada Ltd.
Network Appliance (Belgium) BVBA
Network Appliance Israel Ltd.
Network Appliance Poland Sp. z.o.o.
Network Appliance Federal Systems, Inc. (California)
Network Appliance South Africa (Pty) Limited
Network Appliance Sweden AB.
Network Appliance Finland Oy
Network Appliance Financial Solutions, Inc. (Delaware)
Nagano Sub, Inc. (Delaware)

Exhibit 31.1

CERTIFICATION

I, Daniel J. Warmenhoven, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Network Appliance Inc. (the "registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ DANIEL J. WARMENHOVEN

Daniel J. Warmenhoven
Chief Executive Officer

Date: December 4, 2003

Exhibit 31.2

CERTIFICATION

I, Steven J. Gomo, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Network Appliance Inc. (the "registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ STEVEN J. GOMO

Steven J. Gomo
Senior Vice President of Finance
and Chief Financial Officer

Date: December 4, 2003

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Daniel J. Warmenhoven, Chief Executive Officer of Network Appliance, Inc. (the "Company"), pursuant to 18 U.S.C.Section 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify to my knowledge that:

(i) the Quarterly Report on Form 10-Q of the Company for the quarterly period ended October 31, 2003, as filed with the Securities and Exchange Commission (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: December 4, 2003

/s/ Daniel J. Warmenhoven

Daniel J. Warmenhoven
Chief Executive Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Steven J. Gomo, Senior Vice President of Finance and Chief Financial Officer of Network Appliance, Inc. (the "Company"), pursuant to 18 U.S.C.Section 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify to my knowledge that:

(i) the Quarterly Report on Form 10-Q of the Company for the quarterly period ended October 31, 2003, as filed with the Securities and Exchange Commission (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: December 4, 2003

/s/ Steven J. Gomo

Steven J. Gomo
Senior Vice President of Finance
and Chief Financial Officer