NetApp, Inc.
Form 10-Q
February 19, 2019
a

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended January 25, 2019

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 000-27130

NetApp, Inc.

(Exact name of registrant as specified in its charter)

Delaware	77-0307520
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1395 Crossman Avenue,

Sunnyvale, California 94089

(Address of principal executive offices, including zip code)

(408) 822-6000

(Registrant's telephone number, including area code)

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 has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

As of February 13, 2019, there were 246,974,767 shares of the registrant's common stock, $0.001 par value, outstanding.

TABLE OF CONTENTS

TRADEMARKS

PART I — FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

NETAPP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions, except par value)

(Unaudited)

	January 25, 2019	April 27, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,271	$ 2,941
Short-term investments	1,778	2,450
Accounts receivable	872	1,047
Inventories	100	122
Other current assets	340	392
Total current assets	5,361	6,952
Property and equipment, net	763	756
Goodwill	1,742	1,739
Other intangible assets, net	56	94
Other non-current assets	496	450
Total assets	$ 8,418	$ 9,991
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 497	$ 609
Accrued expenses	730	825
Commercial paper notes	163	385
Current portion of long-term debt	399	—
Short-term deferred revenue and financed unearned services revenue	1,641	1,712
Total current liabilities	3,430	3,531
Long-term debt	1,144	1,541
Other long-term liabilities	898	992
Long-term deferred revenue and financed unearned services revenue	1,716	1,651
Total liabilities	7,188	7,715
Commitments and contingencies (Note 15)		

Stockholders' equity:		
Common stock and additional paid-in capital, $0.001 par value; 247 and 263 shares issued and outstanding as of January 25, 2019 and April 27, 2018	1,298	2,355
Retained earnings (accumulated deficit)	—	(9)
Accumulated other comprehensive loss	(68)	(70)
Total stockholders' equity	1,230	2,276
Total liabilities and stockholders' equity	$8,418	$9,991

See accompanying notes to condensed consolidated financial statements.

NETAPP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except per share amounts)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	January 25, 2019	January 26, 2018	January 25, 2019	January 26, 2018
Revenues:				
Product	$967	$952	$2,755	$2,498
Software maintenance	239	221	704	668
Hardware maintenance and other services	357	366	1,095	1,109
Net revenues	1,563	1,539	4,554	4,275
Cost of revenues:				
Cost of product	469	469	1,295	1,242
Cost of software maintenance	10	6	25	19
Cost of hardware maintenance and other services	102	108	315	334
Total cost of revenues	581	583	1,635	1,595
Gross profit	982	956	2,919	2,680
Operating expenses:				
Sales and marketing	401	419	1,218	1,263
Research and development	203	193	622	580
General and administrative	67	72	209	209
Restructuring charges	—	—	19	—
Gain on sale of properties	—	(218)	—	(218)
Total operating expenses	671	466	2,068	1,834
Income from operations	311	490	851	846
Other income, net	8	14	33	25
Income before income taxes	319	504	884	871
Provision for income taxes	70	983	111	1,045
Net income (loss)	$249	$(479)	$773	$(174)
Net income (loss) per share:				
Basic	$1.00	$(1.79)	$3.01	$(0.65)
Diluted	$0.98	$(1.79)	$2.94	$(0.65)
Shares used in net income (loss) per share calculations:				
Basic	250	268	257	269
Diluted	255	268	263	269
Cash dividends declared per share	$0.40	$0.20	$1.20	$0.60

See accompanying notes to condensed consolidated financial statements.

4

NETAPP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In millions)

(Unaudited)

.	Three Months Ended		Nine Months Ended	
	January 25, 2019	January 26, 2018	January 25, 2019	January 26, 2018
Net income (loss)	$249	$ (479)	$773	$ (174)
Other comprehensive income (loss):				
Foreign currency translation adjustments	(1)	(5)	(4)	3
Defined benefit obligations:				
Reclassification adjustments related to defined benefit obligations	(1)	(1)	(2)	(2)
Income tax effect	1	—	1	1
Unrealized gains (losses) on available-for-sale securities:				
Unrealized holding gains (losses) arising during the period	8	(17)	7	(15)
Other comprehensive income (loss)	7	(23)	2	(13)
Comprehensive income (loss)	$256	$ (502)	$775	$ (187)

See accompanying notes to condensed consolidated financial statements.

NETAPP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

(Unaudited)

	Nine Months Ended January 25, 2019	January 26, 2018
Cash flows from operating activities:		
Net income (loss)	$ 773	$ (174)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	149	150
Stock-based compensation	121	125
Deferred income taxes	(21)	245
Gain on sale of properties	—	(218)
Other items, net	8	(8)
Changes in assets and liabilities, net of acquisitions of businesses:		
Accounts receivable	165	(10)
Inventories	22	68
Other operating assets	(42)	16
Accounts payable	(101)	115
Accrued expenses	(85)	58
Deferred revenue and financed unearned services revenue	17	(99)
Long-term taxes payable	(60)	723
Other operating liabilities	(4)	(7)
Net cash provided by operating activities	942	984

Cash flows from investing activities:		
Purchases of investments	(22)	(1,262)
Maturities, sales and collections of investments	683	1,084
Purchases of property and equipment	(138)	(97)
Proceeds from sale of properties	—	210
Acquisitions of businesses, net of cash acquired	(3)	(75)
Other investing activities, net	1	(1)
Net cash provided by (used in) investing activities	521	(141)
Cash flows from financing activities:		
Proceeds from issuance of common stock under employee stock award plans	118	157
Payments for taxes related to net share settlement of stock awards	(92)	(67)
Repurchase of common stock	(1,611)	(450)
Proceeds from (repayments of) commercial paper notes, net	(221)	132
Issuance of long-term debt, net	—	795
Repayment of long-term debt	—	(750)
Dividends paid	(306)	(161)
Other financing activities, net	(5)	(6)
Net cash used in financing activities	(2,117)	(350)
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(17)	37
	(671)	530

Net increase (decrease) in cash, cash equivalents and restricted cash				
Cash, cash equivalents and restricted cash:				
Beginning of period		2,947		2,450
End of period	$	2,276	$	2,980

See accompanying notes to condensed consolidated financial statements.

NETAPP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Description of Business and Significant Accounting Policies

NetApp, Inc. (we, us, or the Company) provides global organizations the ability to manage and share their data across on-premises, private and public clouds. Together with our partners, we provide a full range of enterprise-class software, systems and services solutions that customers use to modernize their infrastructures, build next generation data centers and harness the power of hybrid clouds.

Basis of Presentation and Preparation

Our fiscal year is reported on a 52- or 53-week year ending on the last Friday in April. An additional week is included in the first fiscal quarter approximately every six years to realign fiscal months with calendar months. Fiscal years 2019 and 2018, ending on April 26, 2019, and April 27, 2018, respectively, are each 52-week years, with 13 weeks in each of their quarters.

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company, and reflect all adjustments, consisting only of normal recurring adjustments, that are, in the opinion of management, necessary for the fair presentation of our financial position, results of operations, comprehensive income and cash flows for the interim periods presented. The statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information. Accordingly, these statements do not include all information and footnotes required by GAAP for annual consolidated financial statements, and should be read in conjunction with our audited consolidated financial statements as of and for the fiscal year ended April 27, 2018 contained in our Annual Report on Form 10-K. The results of operations for the three and nine months ended January 25, 2019 are not necessarily indicative of the operating results to be expected for the full fiscal year or future operating periods.

The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Such estimates include, but are not limited to, revenue recognition, reserves and allowances; inventory valuation and purchase order accruals; valuation of goodwill and intangibles; restructuring reserves; product warranties; employee compensation and benefit accruals; stock-based compensation; loss contingencies; valuation of investment securities; income taxes and fair value measurements. Actual results could differ materially from those estimates.

Accounting Changes

In May 2014, the Financial Accounting Standards Board (FASB) issued a new standard, Revenue from Contracts with Customers (ASC 606), which establishes a comprehensive new revenue recognition model designed to depict the transfer of goods or services to a customer in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services. In the first quarter of fiscal 2019, we adopted this new standard using the full retrospective method of adoption. Accordingly, our prior period condensed consolidated financial statements and information, as presented herein, have been restated to conform to the new rules. Refer to Note 5 – Revenue for a summary of the impacts of adopting this standard, and a discussion of our updated policies related to revenue recognition.

In October 2016, the FASB issued an accounting standards update (ASU) which eliminates the deferred tax effects of intra-entity asset transfers other than inventory. As a result, tax expense from the sale of an asset in the seller’s tax jurisdiction is recognized when the transfer occurs, even though the pre-tax effects of that transaction are eliminated in consolidation. In the first quarter of fiscal 2019, we adopted this ASU using a modified retrospective transition approach and recorded a cumulative-effect adjustment to decrease retained earnings by $51 million, with a corresponding reduction of prepaid taxes, which were classified as other non-current assets on our condensed consolidated balance sheets.

In November 2016, the FASB issued an ASU that requires a statement of cash flows to explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. In the first quarter of fiscal 2019, we adopted this ASU using a retrospective transition method. Accordingly, our condensed consolidated statement of cash flows for the nine months ended January 26, 2018, as presented herein, has been restated to comply with the new requirements. Refer to Note 4 – Supplemental Financial Information for a detail of the components of our cash, cash equivalents and restricted cash balances.

There have been no other significant changes in our significant accounting policies as of and for the nine months ended January 25, 2019, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended April 27, 2018.

2. Recent Accounting Standards Not Yet Effective

Leases

In February 2016, the FASB issued an accounting standards update on financial reporting for leasing arrangements, including requiring lessees to recognize an operating lease with a term greater than one year on their balance sheets as a right-of-use asset and corresponding lease liability, measured at the present value of the lease payments. This new standard will be effective for us in our first quarter of fiscal 2020, although early adoption is permitted. Upon adoption, the new standard, as amended, allows lessees to apply the transition requirements either (1) retrospectively to each prior reporting period presented in the financial statements with the cumulative effect of applying the new rules recognized at the beginning of the earliest comparative period presented, or (2) retrospectively at the beginning of the period of adoption with the cumulative effect of applying the new rules recognized then. We plan to apply the second adoption methodology and are currently evaluating the impact of this new standard on our consolidated financial statements and disclosures. We expect that most of our operating lease commitments will be subject to the new standard and recognized as lease liabilities and right-of-use assets upon adoption, which will increase the total assets and total liabilities we report.

Credit Losses on Financial Instruments

In June 2016, the FASB issued an accounting standards update on the measurement of credit losses on financial instruments. The standard introduces a new model for measuring and recognizing credit losses on financial instruments, requiring financial assets measured at amortized cost basis to be presented at the net amount expected to be collected. It also requires that credit losses be recorded through an allowance for credit losses. This new standard will be effective for us in our first quarter of fiscal 2021, although early adoption is permitted. Upon adoption, companies must apply a modified retrospective transition approach through a cumulative-effect adjustment to retained earnings, though a prospective transition approach is required for debt securities for which an other-than-temporary impairment had been recognized before the effective date. Based on the composition of our investment portfolio, current market conditions, and historical credit loss activity, the adoption of this standard is not expected to have a material impact on our consolidated financial statements.

3. Goodwill and Purchased Intangible Assets, Net

Goodwill activity is summarized as follows (in millions):

Balance as of April 27, 2018	$1,739
Additions	3
Balance as of January 25, 2019	$1,742

On September 17, 2018, we acquired all of the outstanding shares of a privately-held software company for $3 million in cash. Substantially all of the purchase price was recorded to goodwill.

Purchased intangible assets, net are summarized below (in millions):

	January 25, 2019	April 27, 2018

	Gross Assets	Accumulated Amortization	Net Assets	Gross Assets	Accumulated Amortization	Net Assets
Developed technology	$160	$ (104)	$ 56	$164	$ (80)	$ 84
Customer contracts/relationships	41	(41)	—	43	(33)	10
Other purchased intangibles	—	—	—	9	(9)	—
Total purchased intangible assets	$201	$ (145)	$ 56	$216	$ (122)	$ 94

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

	Three Months Ended January 25, 2019	Three Months Ended January 26, 2018	Nine Months Ended January 25, 2019	Nine Months Ended January 26, 2018	Statements of Operations Classification
Developed technology	$10	$ 10	$28	$ 27	Cost of revenues
Customer contracts/relationships	3	3	10	11	Operating expenses
Other purchased intangibles	—	1	—	3	Operating expenses
Total	$13	$ 14	$38	$ 41	

8

As of January 25, 2019, future amortization expense related to purchased intangible assets is as follows (in millions):

Fiscal Year	Amount
Remainder of 2019	$ 9
2020	31
2021	16
Total	$ 56

4. Supplemental Financial Information

Cash, cash equivalents and restricted cash (in millions):

The following table presents cash and cash equivalents as reported in our condensed consolidated balance sheets, as well as the sum of cash, cash equivalents and restricted cash as reported on our condensed consolidated statement of cash flows in accordance with our adoption of the ASU discussed in Note 1 – Description of Business and Significant Accounting Policies:

	January 25, 2019	April 27, 2018
Cash	$ 2,162	$ 2,727
Cash equivalents	109	214
Cash and cash equivalents	$ 2,271	$ 2,941
Short-term restricted cash	4	5
Long-term restricted cash	1	1
Restricted cash	$ 5	$ 6
Cash, cash equivalents and restricted cash	$ 2,276	$ 2,947

Inventories (in millions):

	January 25, 2019	April 27, 2018
Purchased components	$ 11	$ 12
Finished goods	89	110
Inventories	$ 100	$ 122

Property and equipment, net (in millions):

	January 25, 2019	April 27, 2018
Land	$106	$106
Buildings and improvements	605	594
Leasehold improvements	87	88
Computer, production, engineering and other equipment	806	733
Computer software	357	357
Furniture and fixtures	104	99
Construction-in-progress	6	27
	2,071	2,004
Accumulated depreciation and amortization	(1,308)	(1,248)
Property and equipment, net	$763	$756

In September 2017, we entered into an agreement to sell certain land and buildings located in Sunnyvale, California, through two separate and independent closings, the first of which was completed in the third quarter of fiscal 2018. The remaining properties, consisting of land with a net book value of $52 million, were classified as assets held for sale, and included as other current assets in our condensed consolidated balance sheets as of January 25, 2019 and April 27, 2018. We will consummate the sale of these properties, and receive cash proceeds of $96 million, upon the completion of the second closing, which is expected to occur within the next 12 months. That closing is subject to due diligence, certain termination rights and customary closing conditions, including local governmental approval of the subdivision of a land parcel.

Other non-current assets (in millions):

	January 25, 2019	April 27, 2018
Deferred tax assets	$ 219	$ 229
Other assets	277	221
Other non-current assets	$ 496	$ 450

Accrued expenses (in millions):

	January 25, 2019	April 27, 2018
Accrued compensation and benefits	$ 334	$ 441
Product warranty liabilities	25	25
Other current liabilities	371	359
Accrued expenses	$ 730	$ 825

Product warranty liabilities:

Equipment and software systems sales include a standard product warranty. The following tables summarize the activity related to product warranty liabilities and their balances as reported in our condensed consolidated balance sheets (in millions):

	Three Months Ended		Nine Months Ended	
	January 25, 2019	January 26, 2018	January 25, 2019	January 26, 2018
Balance at beginning of period	$ 39	$ 44	$ 40	$ 50
Expense accrued during the period	6	3	16	11
Warranty costs incurred	(6)	(6)	(17)	(20)
Balance at end of period	$ 39	$ 41	$ 39	$ 41

	January 25,	April 27,

	2019	2018
Accrued expenses	$ 25	$ 25
Other long-term liabilities	14	15
Total warranty liabilities	$ 39	$ 40

Warranty expense accrued during the period includes amounts accrued for systems at the time of shipment, adjustments for changes in estimated costs for warranties on systems shipped in the period and changes in estimated costs for warranties on systems shipped in prior periods.

Other long-term liabilities (in millions):

	January 25, 2019	April 27, 2018
Liability for uncertain tax positions	$ 326	$ 314
Income taxes payable	476	549
Product warranty liabilities	14	15
Other liabilities	82	114
Other long-term liabilities	$ 898	$ 992

Statements of cash flows additional information (in millions):

Non-cash investing and financing activities and supplemental cash flow information are as follows:

	Nine Months Ended January 25, 2019	January 26, 2018
Non-cash Investing and Financing Activities:		
Capital expenditures incurred but not paid	$6	$ 19
Non-cash extinguishment of sale-leaseback financing obligations	$—	$ 130
Supplemental Cash Flow Information:		
Income taxes paid, net of refunds	$150	$ 51
Interest paid	$41	$ 45

5. Revenue

Effective our first quarter of fiscal 2019, we adopted ASC 606 using the full retrospective method and have restated each prior reporting period presented to conform to the new rules. The most significant impact of the new standard relates to our accounting for arrangements containing software. For our enterprise software license agreements (ELAs), we now recognize the license fee component of such arrangements up front. Under the prior rules, the software license fee was recognized over the term of the enterprise license based on our inability to establish vendor specific objective evidence of fair value for the undelivered software support element of these arrangements. In addition, for other software arrangements, revenue deferred for the undelivered elements that was previously allocated based on the residual method is now allocated based on relative fair value, which generally results in more software arrangement revenue being recognized earlier. The new standard also impacts our estimation of variable consideration for certain arrangements with contract terms such as rights of return, potential penalties and acceptance clauses.

The following table presents the impacts of adoption of ASC 606 to select line items of our condensed consolidated balance sheet as of the end of fiscal 2018:

	As of April 27, 2018 As Previously Reported	Impact of ASC 606 Adoption		As Adjusted
ASSETS				
Accounts receivable	$1,009	$38	(1)	$ 1,047
Inventories	$126	$(4)		$ 122
Other current assets	$330	$62	(2)	$ 392
Other non-current assets	$420	$30	(2)	$ 450
LIABILITIES AND STOCKHOLDERS' EQUITY				
Short-term deferred revenue and financed unearned services revenue	$1,804	$(92)	(3)	$ 1,712
Other long-term liabilities	$961	$31	(4)	$ 992
Long-term deferred revenue and financed unearned services revenue				