TOP SHIPS INC.
Form 6-K
October 23, 2018

FORM 6-K

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Report of Foreign Private Issuer
Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934

For the month of October 2018

Commission File Number: 001-37889

TOP SHIPS INC.
(Translation of registrant's name into English)

1 VAS. SOFIAS & MEG.
ALEXANDROU STREET
151 24, MAROUSSI
ATHENS, GREECE
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.
Form 20-F [X] Form 40-F [ ]

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): _______.

Note: Regulation S-T Rule 101(b)(1) only permits the submission in paper of a Form 6-K if submitted solely to provide an attached annual report to security holders.

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): ________.

Note: Regulation S-T Rule 101(b)(7) only permits the submission in paper of a Form 6-K if submitted to furnish a report or other document that the registrant foreign private issuer must furnish and make public under the laws of the jurisdiction in which the registrant is incorporated, domiciled or legally organized (the registrant's "home country"), or under the rules of the home country exchange on which the registrant's securities are traded, as long as the report or other document is not a press release, is not required to be and has not been distributed to the registrant's security holders, and, if discussing a material event, has already been the subject of a Form 6-K submission or other Commission filing on EDGAR.

INFORMATION CONTAINED IN THIS FORM 6-K REPORT

Attached as Exhibit 1 to this Report on Form 6-K is Management's Discussion and Analysis of Financial Condition and Results of Operations and the unaudited interim condensed consolidated financial statements and related notes thereto forTOP Ships Inc. (the "Company"), as of and for the six months ended June 30, 2018.

The information contained in this report on Form 6-K is hereby incorporated by reference into the Company's registration statement on Form F-3 (File No. 333-215577) that was filed with the SEC and became effective on February 1, 2017.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Matters discussed in this report may constitute forward-looking statements. The Private Securities Litigation ReformAct of 1995 provides safe harbor protections for forward-looking statements in order to encourage companies to provide prospective information about their business. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts.

The Company desires to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and is including this cautionary statement in connection with this safe harbor legislation. This report and any other written or oral statements made by us or on our behalf may include forward-looking statements, which reflect our current views with respect to future events and financial performance. When used in this report, the words "anticipate," "believe," "expect,""intend," "estimate," "forecast," "project," "plan," "potential," "may," "should," and similar expressions identify forward-looking statements.

The forward-looking statements in this report are based upon various assumptions, many of which are based, in turn, upon further assumptions, including without limitation, management's examination of historical operating trends, data contained in our records and other data available from third parties. Although the Company believes that these assumptions were reasonable when made, because these assumptions are inherently subject to significant uncertainties and contingencies that are difficult or impossible to predict and are beyond our control, we cannot assure you that we will achieve or accomplish these expectations, beliefs or projections.

In addition to these assumptions and matters discussed elsewhere herein and in the documents incorporated by reference herein, important factors that, in our view, could cause actual results to differ materially from those discussed in the forward-looking statements include the following:

- our ability to maintain or develop new and existing customer relationships with major refined product importers and exporters, major crude oil companies and major commodity traders, including our ability to enter into long-term charters for our vessels;

- our future operating and financial results;

- oil and chemical tanker industry trends, including charter rates and vessel values and factors affecting vessel supply and demand;

- our ability to integrate into our fleet any newbuildings we may order in the future and the ability of shipyards to deliver vessels on a timely basis;

- the aging of our vessels and resultant increases in operation and drydocking costs;

- the ability of our vessels to pass classification inspections and vetting inspections by oil majors and big chemical corporations;

- significant changes in vessel performance, including increased vessel breakdowns;

- the creditworthiness of our charterers and the ability of our contract counterparties to fulfill their obligations to us;

- our ability to repay outstanding indebtedness, to obtain additional financing and to obtain replacement charters for our vessels, in each case, at commercially acceptable rates or at all;

- changes to governmental rules and regulations or actions taken by regulatory authorities and the expected costs thereof;

- potential liability from litigation and our vessel operations, including discharge of pollutants;
- changes in general economic and business conditions;
- general domestic and international political conditions, potential disruption of shipping routes due to accidents,political events or acts by terrorists;
- changes in production of or demand for oil and petroleum products and chemicals, either globally or in particular regions;
- the strength of world economies and currencies, including fluctuations in charterhire rates and vessel values; and other important factors described from time to time in the reports filed by us with the U.S. Securities and ExchangeCommission.

We undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict all of these factors. Further, we cannot assess the impact of each such factor on our business or the extent to which any factor, or combination of factors, may cause actual results to be materially different from those contained in any forward-looking statement.

SIGNATURES

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

TOP SHIPS INC.
(registrant)

Dated:	
October 23, 2018	By: /s/ Evangelos J. Pistiolis
	Name: Evangelos J. Pistiolis
	Title: Chief Executive Officer

MANAGEMENT'S DISCUSSION AND ANALYSIS OFFINANCIAL CONDITION AND RESULTS OF OPERATIONSFOR THE SIX MONTHS ENDED JUNE 30, 2017 AND 2018

The following management's discussion and analysis is intended to discuss our financial condition, changes in financial condition and results of operations for the six months ended June 30, 2017 and 2018, and should be read in conjunction with our historical unaudited interim condensed consolidated financial statements and related notes included in this filing. For additional background information please see our annual report on Form 20-F for the year ended December 31, 2017 filed with the Securities and ExchangeCommission, or the Commission, on March 29, 2018.
This discussion contains forward-looking statements that reflect our current views with respect to future events and financial performance. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, such as those set forth in the section "Risk Factors" included in the Company'sAnnual Report on Form 20-F filed with the Commission, on March 29, 2018.

Overview

We are an international owner and operator of modern, fuel efficient eco medium range, or MR, tanker vessels focusing on the transportation of crude oil, petroleum products (clean and dirty) and bulk liquid chemicals. As of June 30, 2018, our fleet consists of two bareboat chartered-in 50,000 dwt product/chemical tankers vessels, the M/T Stenaweco Energy and the M/T Stenaweco Evolution, two 39,000 dwt product/chemical tankers vessels, the M/T Eco Fleet and the M/T Eco Revolution, three 50,000 dwt product/chemical tankers, the M/T Stenaweco Excellence, the M/T Nord Valiant and the M/T Stenaweco Elegance.We also own 50% interests in two 50,000 dwt product/chemical tankers.
Finally we own five newbuilding vessels as per the below table:

Name	Deadweight	Delivery date	Shipyard
M/T Eco Palm Desert (Hull No 2648)	50,000	September 2018	Hyundai Mipo Vinashin
M/T Eco California (Hull No 8218)	50,000	January 2019	Hyundai Mipo S. Korea
M/T Eco Marina Del Ray (Hull No 8242)	50,000	March 2019	Hyundai Mipo S. Korea
M/T Eco Bel Air (Hull No 874)	159,000	April 2019	Hyundai Samho S. Korea
M/T Eco Beverly Hills (Hull No 875)	159,000	May 2019	Hyundai Samho S. Korea

We intend to continue to review the market in order to identify potential acquisition targets on accretive terms.
We believe we have established a reputation in the international ocean transport industry for operating and maintaining vessels with high standards of performance, reliability and safety. We have assembled a management team comprised of executives who have extensive experience operating large and diversified fleets of tankers and who have strong ties to a number of national, regional and international oil companies, charterers and traders.

Non-US GAAP Measures

This report describes adjusted Earnings Before Interest, Taxes, Depreciation and Amortization (Adjusted EBITDA), which is not a measure prepared in accordance with U.S. GAAP (i.e., a "Non-US GAAP" measure). We define Adjusted EBITDA as earnings before interest, taxes, depreciation and amortization, vessel bareboat charter hire expenses (including amortization of prepaid hire), vessel impairments, and gains/losses on derivative financial instruments.
Adjusted EBITDA is a non-U.S. GAAP financial measure that is used as a supplemental financial measure by management and external users of financial statements, such as investors, to assess our financial and operating performance. We believe that this non-U.S. GAAP financial measure assists our management and investors by increasing the comparability of our performance from period to period. This is achieved by excluding the potentially

disparate effects between periods of interest, gain/loss on financial instruments, taxes, depreciation and amortization, vessel bareboat charter hire expenses (including amortization of prepaid hire and vessel impairments,) and which items are affected by various and possibly changing financing methods, capital structure and historical cost basis and which items may significantly affect results of operations between periods.

This Non-U.S. GAAP measure should not be considered in isolation from, as a substitute for, or superior to financial measures prepared in accordance with U.S. GAAP. In evaluating Adjusted EBITDA, you should be aware that in the future we may incur expenses that are the same as or similar to some of the adjustments in this presentation. Our definition of Adjusted EBITDA may not be the same as reported by other companies in the shipping industry or other industries. Adjusted EBITDA does not represent and should not be considered as an alternative to operating income or cash flow from operations, as determined by U.S. GAAP.

Reconciliation of Net Income to Adjusted EBITDA

(Expressed in thousands of U.S. Dollars)	Six months ended June 30, 2017	2018
Net income/(loss) and comprehensive income/(loss)	(5,838)	(6,619)
Add: Bareboat charter hire expenses	3,115	3,115
Add: Amortization of prepaid bareboat charter hire	829	828
Add: Vessel depreciation	2,790	3,002
Add: Interest and finance costs	7,457	3,350
Add: Gain on financial instruments	(1,057)	(130)
Less: Interest income	-	(98)
Adjusted EBITDA	7,296	3,448

A. Operating Results

For additional information please see our annual report on Form 20-F for the year ended December 31, 2017 filed with the Securities and Exchange Commission, or the Commission, on March 29, 2018, "Item 5. Operating and Financial Review and Prospects".

RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDEDJUNE 30, 2017 AND 2018

The following table depicts changes in the results of operations for the six months ended June 30, 2018 compared to the six months ended June 30, 2017.

	Six Month Period Ended June 30, 2017	2018	Change June 30, 2017 vs June 30, 2018 $	%
	($ in thousands)			
Voyage Revenues	18,982	19,683	701	3.7 %
Voyage expenses	496	492	(4)	-0.8 %
Bareboat charterhire expenses	3,115	3,115	-	0.0 %
Amortization of prepaid bareboat charter hire	829	828	(1)	-0.1 %
Other vessel operating expenses	6,596	7,135	539	8.2 %
Vessel depreciation	2,790	3,002	212	7.6 %
Management fees-related parties	3,126	4,254	1,128	36.1 %
Other operating gain, net	(914)	-	914	-100.0%
General and administrative expenses	3,502	4,358	856	24.4 %
Expenses	19,540	23,184	3,644	18.6 %
Operating loss	(558)	(3,501)	(2,943)	527.4 %
Interest and finance costs	(7,457)	(3,350)	4,107	-55.1 %
Gain on financial instruments	1,057	130	(927)	-87.7 %
Debt forgiveness	1,118	-	(1,118)	-100.0%
Other, net	2	-	(2)	-100.0%
Interest Income	-	98	98	-
Total other expenses, net	(5,280)	(3,122)	2,158	-40.9 %
Net loss and comprehensive loss	(5,838)	(6,623)	(785)	13.4 %

Equity gains in unconsolidated joint ventures	-	4	4	-	
Net loss attributable to common shareholders	(5,838)	(6,619)	(781)	13.4	%

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Period inPeriod Comparison of Operating Results

1. Management fees—related parties

	Six months ended June 30,		Change June 30, 2017 vs June 30, 2018	
	2017	2018		
	($ in thousands)		$	%
Management fees—related parties	3,126	4,254	1,128	36.1%

During the six months ended June 30, 2018,management fees to related parties increased by $1.1 million, or 36%, compared to the six months ended June 30, 2017.This increase was mainly due to an increase of $1.0 million in the cash performance fee we granted to Central Shipping Monaco SAM ("CSM"), a related party affiliated with the family of Mr. Evangelos J. Pistiolis, our President, Chief Executive Officer and Director and a $0.1 million increase in accounting and reporting fees charged by CSM.

2. General and administrative expenses

General and administrative expenses include executive compensation paid to Central Mare for the provision of our executive officers and a number of administrative staff, office rent, legal and auditing costs, regulatory compliance costs, other miscellaneous office expenses, non-cash stock compensation, and corporate overhead. Central Mare provides the services of the individuals who serve as our Chief Executive Officer, Chief Financial Officer, Executive Vice President and Chief Technical Officer, and other administrative employees. For further information, please see our Annual Report on Form 20-F for the year ended December 31, 2017, "Item 7. Major Shareholders and Related Party Transactions - B. Related Party Transactions - Central Mare Letter Agreement, Management Agreements, and Other Agreements".

	Six months ended June 30,		Change June 30, 2017 vs June 30, 2018	
	2017	2018		
	($ in thousands)		$	%
General and administrative expenses	3,502	4,358	856	24.4%

During the six months ended June 30, 2018,our general and administrative expenses increased by $0.9 million, or 24%, compared to the six months ended June 30, 2017. This increase is mainly attributed to an increase in bonuses of $0.7 million and an increase of$0.3 million in legal and consulting fees and expenses. These increases were offset by a decrease of $0.1 million in other general and administrative expenses.

3. Interest and finance Costs

Six months ended June 30,		Change June 30, 2017 vs June 30, 2018	
2017	2018		
($ in thousands)		$	%

Interest and finance costs	(7,457)	(3,350)	4,107	-55.1%

During the six months ended June 30, 2018,interest and finance costs decreased by $4.1 million, or 55%, compared to the six months ended June 30, 2017.This decrease is mainly attributed to:

a) A decrease of $3.6 million in amortization of debt discount as in the six months ended June 30, 2017 we amortized $3.7 million of debt discount relating to the convertibility features of the Series C convertible preferred shares, absent in the same period of 2018, in which we only amortized $0.1 million of debt discount relating to the convertibility features of the Family Trading facility(please see the Unaudited Interim Condensed Consolidated Financial Statements for the six months ended June 30, 2018 – "Note 7 -Debt" included elsewhere in this document).

b) A decrease of $0.2 million in loan interest expense, mainly due to capitalization of imputed interest of our current vessels under construction.

c) A decrease of $0.2 million in amortization of finance fees mainly due to the fact that in the six months ended June 30, 2017 we accelerated the amortization of arrangement fees of two of our short term notes due to their prepayment ($0.4 million) absent in the same period of 2018, offset by an increase of $0.2 million in amortization of finance fees of the Amsterdam Trade Bank pre-delivery facility in the six months ended June 30, 2018, absent in the same period of 2017.

d) A decrease of $0.1million in other financial costs.

4. (Loss)/Gain on derivative financial instruments

	Six months ended June 30,		Change June 30, 2017 vs June 30, 2018	
	2017	2018		
	($ in thousands)		$	%
Gain on derivative financial instruments	1,057	130	(927)	-87.7%

During the six months ended June 30, 2018,fair value gain on derivative financial instruments decreased by $0.9 million, or 88%, compared to the six months ended June 30, 2017,mainly due to the losses we recognized from the valuation of our outstanding warrants issued in connection with our follow-on offering that closed on June 11, 2014, when compared to the gains of the same that we recognized in the six months ended June 30, 2017 (the difference being $2.8 million). These losses were offset by a $1.7 million increase in the gains from the valuation of our interest rate swaps and a $0.2million decrease in realized losses on our interest rate swaps.

Recent Developments

On July 11, 2018, we entered into a credit facility with Alpha Bank for $10.1 million for the pre-delivery financing of M/T Eco Marina Del Ray. This facility can be drawn down in five tranches to finance in full the last five pre-delivery instalments of M/T Eco Marina Del Ray due for payment between July 2018 and February 2019 and is payable at the delivery of the vessel in March 2019.The facility contains restrictions on the subsidiary that owns the newbuilding contract from incurring further indebtedness or guarantees and from paying any dividends if the latter would result in an event of default.The facility bears interest at LIBOR plus a margin of 4.25% and a commitment fee of 1% per annum is payable quarterly in arrears over the committed and undrawn portion of the facility, starting from the date of signing the commitment letter. We drew down $1.7 million under the facility in July 2018, to finance one shipyard installment of M/T Eco Marina Del Ray.

On July 23, 2018, we terminated the Equity distribution agreement we entered into on May 25, 2018.

On September 7, 2018 we took delivery of M/T Eco Palm Desert, a 50,000 dwt newbuilding product/chemical tanker constructed at the Hyundai Mipo Vinashin shipyard.

On September 11, 2018 we obtained non-binding credit committee approval from a major Chinese leasing company for up to $92.5 million via sale and leaseback agreements (the "Financing Agreements") for our Suezmax newbuilding vessels with hull numbers 874 and 875, currently under construction at Hyundai Samho Heavy Industries Co., Ltd. in South Korea. We are currently negotiating the final terms of the Financing Agreements. Under the proposed terms of the Financing Agreements, the vessels will be sold when they are delivered from the shipyard, which is currently planned for April and May of 2019, respectively. The proposed Financing Agreements include pre and post-delivery financing and have a term of seven years. We have continuous options to buy back the vessels after the three year anniversary of each vessel's delivery up until the expiry of the Financing Agreements.

On September 26, 2018 and on October 5, 2018 we received two additional subpoenas from the U.S. Securities and Exchange Commission ("SEC") requesting certain documents and information in connection with the previous subpoena we received on August 1, 2017. We are providing the requested information to the SEC in response to that subpoena. The SEC investigation is ongoing and we continue to cooperate with the SEC in its investigation.

On September 27, 2018, we and Family Trading adopted an amended and restated version of the Amended Family Trading Credit Facility (the "Amended and Restated Family Trading Credit Facility") in order to, among other things, set the repayment date of the facility to December 31, 2019, increase the maximum borrowing capacity of the facility to $20 million, increase the interest rate to 12%, reduce the commitment fee to 2% and increase the arrangement fee to 5%.

B. Liquidity and Capital Resources

Since our formation, our principal source of funds have been equity provided by our shareholders through equity offerings or at the market sales, operating cash flow, long-term borrowing and, related party short-term borrowings. Our principal use of funds has been capital expenditures to establish and grow our fleet, maintain the quality of our vessels, comply with international shipping standards and environmental laws and regulations and fund working capital requirements.

Our business is capital intensive and its future success will depend on our ability to maintain a high-quality fleet through the acquisition of newer vessels and the selective sale of older vessels. Our practice has been to acquire vessels using a combination of funds received from equity investors and bank debt secured by mortgages on our vessels. Future acquisitions are subject to management's expectation of future market conditions, our ability to acquire vessels on favorable terms and our liquidity and capital resources.

As of June 30, 2018, we had a total indebtedness of $105.9million, which after excluding unamortized financing fees and debt discounts amounts to $112.6million.

As of June 30, 2018, our cash and cash equivalent balances amounted to $7.3 million, held in U.S. Dollar accounts, $6.7 million of which are classified as restricted cash.

Working Capital Requirements and Sources of Capital

As of June 30, 2018, we had a working capital deficit (current assets less current liabilities) of $30.2 million, commitments for operating leases of $6.3 million and commitments for capital expenditures amounting to $46.3 million payable in 2018 and $143.1 million payable by June 30, 2019.

Our operating cash flow for the remainder of 2018 is expected to increase compared to the same period in 2017, as we expect to generate more revenue from employing M/T Eco Palm Desert, due to be delivered from the shipyard in September 2018.

We expect to finance our capital requirements, commitments under operating leases and working capital deficit through the following:

As of June 30, 2018, we had available committed financing of $61.9 million, which increased to $72.1 million in July 2018 when we entered into a senior facility with Alpha Bank for $10.1 million and further increased to $80.5 million in September 2018 when we entered into an amendment of the Amended Family Trading Credit Facility. Out of these $80.5 million, $18.6 million refer to pre-delivery facilities and have to be repaid in the first quarter of 2019. We expect to finance our unfinanced capital commitments with cash on hand, operational cash flow, debt or equity issuances, or a combination thereof and other sources such as funds from the our controlling shareholder and CEO, Mr. Pistiolis, if required. If we are unable to arrange debt or equity financing for our newbuilding vessels, we will sell one or more of our vessels or newbuilding contracts.

Cash Flow Information

Unrestricted cash and cash equivalents were $1.6 million and $0.6 million as of June 30, 2017 and 2018 respectively.

Net Cash from Operating Activities.

Net cash provided by operating activities increased by $1.8 million, during the six months ended June 30, 2018 to a net inflow of $0.6 million, compared to a net outflow of $1.2 million for the six months ended June 30, 2017.

Net Cash from Investing Activities.

Net cash used in investing activities in the six months ended June 30, 2018 was $25.6 million, consisting of $20.6 million cash paid for advances for vessels under construction, $1.2 million for the purchase of 10% of M/T Stenaweco Elegance and$3.8 million cash paid for investments in unconsolidated joint ventures.

Net Cash from Financing Activities.

Net cash provided from financing activities in the six months ended June 30, 2018 was $1.7 million, consisting of $11.8 million of proceeds from short term notes, $9.2 million from the pre-delivery facilities we entered into with Amsterdam Trade Bank,$5.3 million of proceeds from related party debt (Family Trading Facility) and $2.5 million of proceeds from equity offerings.

These inflows were partially offset by $21.4million consideration paid in excess of purchase price over book value of vessels acquired, $5.0 million of scheduled debt repayments,$0.6million payments of financing costs and $0.1 million of equity offering related costs.

TOP SHIPS INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

TOP SHIPS INC.

UNAUDITED INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2017 AND JUNE 30, 2018
(Expressed in thousands of U.S. Dollars - except share and per share data)

	December 31, 2017	June 30, 2018
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	24,081	584
Trade accounts receivable	621	638
Prepayments and other	428	602
Inventories	645	570
Prepaid bareboat charter hire	1,656	1,656
Deferred charges	341	-
Restricted cash	1,283	1,326
Total current assets	29,055	5,376
FIXED ASSETS:		
Advances for vessels under construction (Note 4(a))	6,757	27,763
Vessels, net (Note 4(b))	154,935	151,933
Other fixed assets, net	1,042	982
Total fixed assets	162,734	180,678
OTHER NON CURRENT ASSETS:		
Prepaid bareboat charter hire	5,278	4,450
Restricted cash	5,249	5,407
Investments in unconsolidated joint ventures (Note 12)	17,738	21,617
Derivative financial instruments (Note 11)	394	1,760
Total non-current assets	28,659	33,234
Total assets	220,448	219,288
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt (Note 7)	9,508	9,126
Short-term debt (Note 7)	10,183	16,294
Due to related parties (Note 5)	120	3,850
Accounts payable	2,799	3,423
Accrued liabilities	1,985	2,386
Unearned revenue	986	521

Total current liabilities	25,581	35,600
NON-CURRENT LIABILITIES:		
Derivative financial instruments (Note 11)	3,335	4,491
Debt from related parties (Note 7)	-	920
Non-current portion of long term debt (Note 7)	84,258	79,606
Total non-current liabilities	87,593	85,017
COMMITMENTS AND CONTINGENCIES (Note 8)		
Total liabilities	113,174	120,617
STOCKHOLDERS' EQUITY:		
Preferred stock, $0.01 par value; 20,000,000 shares authorized; of which 100,000 Series D shares were outstanding at December 31, 2017 and June 30, 2018	1	1
Common stock, $0.01 par value; 1,000,000,000 shares authorized; 8,923,617 and 19,227,962 shares issued and outstanding at December 31, 2017 and June 30, 2018 (Note 9)	89	192
Additional paid-in capital	402,644	401,747
Accumulated deficit	(296,645)	(303,269)
Total stockholders' equity	106,089	98,671
Non-controlling Interests	1,185	-
Total equity	107,274	98,671
Total liabilities and stockholders' equity	220,448	219,288

TOP SHIPS INC.

UNAUDITED INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVELOSSFOR THE SIX MONTHS ENDED JUNE 30, 2017 AND 2018
(Expressed in thousands of U.S. Dollars - except share and per share data)

	Six Months Ended June 30, 2017	June 30, 2018
REVENUES:		
Revenues	$ 18,982	$ 19,683
EXPENSES:		
Voyage expenses	496	492
Bareboat charter hire expenses	3,115	3,115
Amortization of prepaid bareboat charter hire	829	828
Other vessel operating expenses	6,596	7,135
Vessel depreciation (Note 4(b))	2,790	3,002
Management fees-related parties (Note 5)	3,126	4,254
Other operating gain, net	(914)	-
General and administrative expenses	3,502	4,358
Operating loss	(558)	(3,501)
OTHER INCOME (EXPENSES):		
Interest and finance costs (including $143 and $361, respectively to related party)	(7,457)	(3,350)
Gain on financial instruments, net (Note 11)	1,057	130
Debt forgiveness	1,118	-
Interest income	-	98
Other, net	2	-
Total other loss, net	(5,280)	(3,122)
Net loss and comprehensive loss	(5,838)	(6,623)
Equity gains in unconsolidated joint ventures	-	4
Net loss attributable to common shareholders	(5,838)	(6,619)
Attributable to:		
Common stock holders	(5,847)	(6,624)
Non-controlling interests	9	5
Loss per common share, basic and diluted (Note 10)	(10,422.45)	(0.42)

Weighted average common shares outstanding, basic and diluted	561	15,620,543

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TOP SHIPS INC.

UNAUDITED INTERIM CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2017 AND 2018

(Expressed in thousands of U.S. Dollars – except number of shares and per share data)

	Preferred Stock		Common Stock					
	# of Shares	Par Value	# of Shares*	Par Value*	Additional Paid-in Capital*	Accumulated Deficit attributable to common stockholders	Non-controlling interest	Total
BALANCE, December 31, 2016	-	-	31	-	328,762	(283,241)	-	45,521
Net (loss)/income				-	-	(5,847)	9	(5,838)
Issuance of common stock pursuant to convertible related party loans			4	-	2,040	-	-	2,040
Issuance of common stock pursuant to the Common Stock Purchase Agreement			3,485	-	28,623	-	-	28,623
Issuance of common stock pursuant to Series C convertible preferred shares conversions			10,839	-	3,153	-	-	3,153
Series C convertible preferred stock'sbeneficial conversion feature			-	-	7,500			7,500
Issuance of common stock due to exercise of warrants			2	-	487	-	-	487
Stock-based compensation			-	-	(8)			(8)
Excess of consideration over acquired assets			-	-	(9,309)	-	-	(9,309)
Issuance of common stock pursuant to Series B convertible preferred stock conversions reflected in Mezzanine equity			39	-	1,372	-	-	1,372
Issuance of Series D convertible preferred stock	100,000	-	-	-	1	-	-	1
Additional paid-in capital attributed to non-controlling interests			-	-	(1,124)	-	- 1,124	-
BALANCE, June 30, 2017	100,000	-	14,400	-	361,497	(289,088)	1,133	73,542

	Preferred Stock	Common Stock	Total

	# of Shares	Par Value	# of Shares*	Par Value*	Additional Paid –in Capital*	Accumulated Deficit attributable to common stockholders	Non-controlling interest	
BALANCE, December 31, 2017	100,000	1	8,923,617	89	402,644	(296,645)	1,185	107,274
Net (loss)/income						(6,624)	5	(6,619)
Issuance of common stock pursuant to the Common Stock Purchase Agreement (Note 9)			8,050,000	81	14,709			14,790
Issuance of common stock pursuant to the Equity Distribution Agreement (Note 9)			2,254,348	23	2,341			2,364
Stock-based compensation					(17)			(17)
Family Trading facility beneficial conversion feature (Note 7)					4,330			4,330
Excess of consideration over acquired assets (Note 1)					(22,260)			(22,260)
Purchase of 10% of M/T Stenaweco Elegance (Note 1)							(1,190)	(1,190)
Cancellation of fractional shares due to reverse stock splits			(3)	(1)				(1)
BALANCE, June 30, 2018	100,000	1	19,227,962	192	401,747	(303,269)	-	98,671

*Adjusted to reflect the reverse stock splits effected in March 2018 (see Note 9)

TOP SHIPS INC.
UNAUDITED INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2017 AND 2018
(Expressed in thousands of U.S. Dollars)

	Six months ended June 30, 2017	2018
Cash Flows from Operating Activities:		
Net Cash (used in)/ provided by Operating Activities	(1,206)	597
Cash Flows from Investing Activities:		
Advances for vessels under construction	-	(20,591)
Vessel acquisitions(Note 4)	(43,755)	-
Purchase of 10% of M/T Stenaweco Elegance (Note 1)	-	(1,190)
Investments in unconsolidated joint ventures (Note 12)	(11,200)	(3,820)
Net Cash used in Investing Activities	(54,955)	(25,601)
Cash Flows from Financing Activities:		
Proceeds from debt (Note 7)	23,350	9,184
Proceeds from short-term Notes(Note 7)	34,200	11,769
Proceeds from related party debt (Note 7)	2,958	5,280
Principal payments of debt(Note 7)	(4,560)	(5,010)
Prepayment of related party debt	(4,085)	-
Consideration paid in excess of purchase price over book value of vessels (Note 1)	-	(21,397)
Proceeds from issuance of Series C convertible preferred stock	7,500	-
Proceeds from warrant exercises	513	-
Proceeds from equity offerings	-	2,531
Equity offerings costs	(409)	(71)
Payment of financing costs	(949)	(578)
Net Cash provided by Financing Activities	58,518	1,708
Net increase/(decrease) in cash and cash equivalents and restricted cash	2,357	(23,296)
Cash and cash equivalents and restricted cash at beginning of year	5,594	30,613
Cash and cash equivalents and restricted cash at end of the period	7,951	7,317
Cash breakdown		
Cash and cash equivalents	1,589	584
Restricted cash, current	1,270	1,326
Restricted cash, non-current	5,092	5,407
SUPPLEMENTAL CASH FLOW INFORMATION		
Capital expenditures included in Accounts payable/Accrued liabilities	367	448
Consideration for purchase of net assets included in Due to related parties	-	863
Interest paid net of capitalized interest	2,303	2,557

Finance fees included in Accounts payable/Accrued liabilities	3	55
Offering expenses included in liabilities	719	152
Shares issued in exchange for converting debt, interest & finance fees	4,238	-
Settlement of Notes with common stock issued	29,306	14,810

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States Dollars – except share and per share data, unless otherwise stated)

1. Basis of Presentation and General Information:

The accompanying unaudited interim condensed consolidated financial statements include the accounts of Top Ships Inc. and its wholly owned subsidiaries (collectively the "Company"). Ocean Holdings Inc. was formed on January 10, 2000, under the laws of Marshall Islands and was renamed to Top Tankers Inc. and Top Ships Inc. in May 2004 and December 2007, respectively.The Company is an international provider of worldwide oil, petroleum products and bulk liquid chemicals transportation services.

As of June 30, 2018, the Company was the sole owner of all outstanding shares of the following subsidiary companies. The following list is not exhaustive as the Company has other subsidiaries relating to vessels that have been sold and that remain dormant for the periods presented in these consolidated financial statements as well as intermediary companies that are 100% subsidiaries of the Company that own shipowning companies.

Companies	Date of Incorporation	Country of Incorporation	Activity
Top Tanker Management Inc.	May 2004	Marshall Islands	Management company

	Wholly owned Shipowning Companies with vessels in operation during six months ended June 30, 2018	Date of Incorporation	Country of Incorporation	Vessel
1	Monte Carlo 71 Shipping Company Limited	June 2014	Marshall Islands	M/T Stenaweco Energy (acquired June 2014), sold January 2015
2	Monte Carlo One Shipping Company Ltd	June 2012	Marshall Islands	M/T Stenaweco Evolution (acquired March 2014), sold March 2015
3	Monte Carlo Seven Shipping Company Limited	April 2013	Marshall Islands	M/T Stenaweco Excellence (acquired March 2014)
4	Monte Carlo Lax Shipping Company Limited	May 2013	Marshall Islands	M/T Nord Valiant (acquired March 2014)
5	Monte Carlo 37 Shipping Company Limited	September 2013	Marshall Islands	M/T Eco Fleet (acquired March 2014)
6	Monte Carlo 39 Shipping Company Limited	December 2013	Marshall Islands	M/T Eco Revolution (acquired March 2014)
7	Eco Seven Inc.	February 2017	Marshall Islands	M/T Stenaweco Elegance (acquired February, 2017)

	Wholly owned Shipowning Companies with vessels under construction during six months ended June 30, 2018	Date of Incorporation	Country of Incorporation	Vessel
8	Astarte International Inc.	April 2017	Marshall Islands	M/T Eco Palm Desert (contract acquired April 2017)
9	PCH77 Shipping Company Limited	September 2017	Marshall Islands	M/T Eco California (contract acquired November 2017)
10	PCH Dreaming Inc.	January 2018	Marshall Islands	M/T Eco Marina Del Ray (contract acquired January

				2018)
11	South California Inc.	January 2018	Marshall Islands	M/T Eco Bel Air (contract acquired January 2018)
12	Malibu Warrior Inc.	January 2018	Marshall Islands	M/T Eco Beverly Hills (contract acquired January 2018)

As of June 30, 2018, the Company was the owner of 50% of outstanding shares of the following companies.

	Shipowning Companies	Date of Incorporation	Country of Incorporation	Vessel
1	City of Athens Inc.	November 2016	Marshall Islands	M/T Eco Holmby Hills (acquired June, 2017)
2	Eco Nine Inc.	March 2015	Marshall Islands	M/T Eco Palm Springs (acquired June, 2017)

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States Dollars – except share and per share data, unless otherwise stated)

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information. Accordingly, they do not include all the information and notes required by U.S. GAAP for complete financial statements. These statements and the accompanying notes should be read in conjunction with the Company's Annual Report on Form 20-F for the fiscal year ended December 31, 2017, filed with the U.S. Securities and Exchange Commission (the "SEC") on March29, 2018.
These unaudited condensed consolidated financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments considered necessary for a fair presentation of the Company's financial position, results of operations and cash flows for the periods presented. Operating results for the six month period ended June 30, 2018 are not necessarily indicative of the results that might be expected for the fiscal year ending December 31, 2018.

On January 31, 2018 the Company acquired:

a. 100% of the issued and outstanding shares of PCH Dreaming Inc., a Marshall Islands company that has entered into a new building contract for a high specification 50,000 dwt Medium Range ("MR") product/chemical tanker (M/T Eco Marina Del Ray or Hull No 8242)under construction at Hyundai Mipo Dockyard Co., Ltd. in South Korea and scheduled for delivery during March 2019. The Company has acquired the shares from an entity affiliated with the Company's Chief Executive Officer, for an aggregate purchase price of $3,950. The transaction specified that following its delivery, the vessel was going to enter into a time charter with an entity affiliated with the seller for a firm duration of one year at a gross daily rate of $16, with a charterer's option to extend for two additional years at $17 and $18, respectively. In June 2018 the Company cancelled without penalty the abovementioned time charter and entered into a new 5 year time charter with Cargill International SA("Cargill") at a gross daily rate of $15.1.
b. 100% of the issued and outstanding shares of South California Inc., a Marshall Islands company that has entered into a new building contract for a high specification, scrubber-equipped, 157,000 dwt Suezmax Crude Oil Carrier (M/T Eco Bel Air or Hull No 874) under construction at Hyundai Samho Heavy Industries Co. Ltd. in South Korea and scheduled for delivery during April 2019. The Company has acquired the shares from an entity affiliated with the Company's Chief Executive Officer for an aggregate purchase price of $8,950. The transaction specified that following its delivery, the vessel was going to enter into a time charter with an entity affiliated with the Seller for a firm duration of one year at a gross daily rate of $25, with a charterer's option to extend for two additional years at $26 and $27, respectively. In June the company cancelled without penalty the abovementioned time charter and entered into a new 3 year time charter with BP Shipping Limited at a gross daily rate of $25, with a charterer's option to extend for two additional years at $28 and $29.5, respectively.
c. 100% of the issued outstanding shares of Malibu Warrior Inc., a Marshall Islands company that has entered into a new building contract for a high specification, scrubber-equipped, 157,000 dwt Suezmax Crude Oil Carrier (M/T Beverly Hills or Hull No 875) under construction at Hyundai Samho Heavy Industries Co. Ltd. in South Korea and scheduled for delivery during May 2019. The Company has acquired the shares from an entity affiliated with the Company's Chief Executive Officer for an aggregate purchase price of $8,950. The transaction specified that following its delivery, the vessel was going to enter into a time charter with an entity affiliated with the Seller for a firm duration of one year at a gross daily rate of $25, with a charterer's option to extend for two additional years at $26 and $27, respectively. In June 2018 the Company cancelled without penalty the abovementioned time charter and entered into a new 3 year time charter with BP Shipping Limited at a gross daily rate of $25, with a charterer's option to extend for two additional years at $28 and $29.5, respectively.
d. 10% of the issued and outstanding shares of Eco Seven Inc., a Marshall Islands company that owns M/T Stena Elegance, a high specification 50,000 dwt MR product/chemical tanker delivered in February 2017 at Hyundai Vinashin. The Company has acquired the shares from an entity affiliated with the Company's Chief Executive Officer for an aggregate purchase price of $1,600. As a result of the transaction the Company owns 100% of the issued and outstanding shares of Eco Seven Inc.

Each of the acquisitions was approved by a special committee of the Company's board of directors, (the "Transaction Committee"), of which all of the directors were independent.The Company accounted for the abovementioned acquisitions as a transfer of assets between entities under common control and has recognized the vessels at their historical carrying amounts at the date of transfer.

The amount of the consideration given in excess of the historical carrying value of the net assets acquired is recognized as a reduction to the Company's additional paid in capital and presented as Excess of consideration over the carrying value of acquired assets in the Company's consolidated statement of stockholders' equity for the six months ended June 30, 2018. An analysis of the consideration paid is presented in the table below:

Consideration in cash	23,450
Less: Carrying value of net assets of companies acquired	1,190
Excess of consideration over acquired assets	22,260

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States Dollars – except share and per share data, unless otherwise stated)

2. Significant Accounting Policies:

A discussion of the Company's significant accounting policies can be found in the Company's annual financial statements for the fiscal year ended December 31, 2017 which have been filed with the US Securities and Exchange Commission on Form 20-F on March29, 2018. There have been no changes to these policies in the six-month period ended June 30, 2018.
During the six-month period ended June 30, 2018, the Company adopted the following Accounting Standard Updates ("ASU"):

ASU 2014-09 Revenue from Contracts with Customers: On May 28, 2014, the FASB issued the ASU No 2014-09 Revenue from Contracts with Customers. ASU 2014-09, as amended, outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The Company elected to use the modified retrospective transition method for the implementation of this standard. The implementation of this standard did not have a material impact on the financial statements since the Company's revenues are generated from long term charters which are subject to ASU 2016-02.

ASU No. 2016-02, Leases: In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This ASU requires that lessees recognize assets and liabilities for leases with lease terms greater than twelve months in the statement of financial position and also requires improved disclosures to help users of financial statements better understand the amount, timing and uncertainty of cash flows arising from leases. The amendments are effective for fiscal years beginning after December 15, 2018. The Company has preliminarily evaluated the impact of the pending adoption of ASU 2016-02 on its consolidated financial statements on a modified retrospective basis, and currently expects that all of its operating lease commitments relating to bareboat chartered-in vessels will be subject to the new standard and will be recognized as operating lease liabilities and right-of-use assets upon its adoption, which will increase the Company's total assets and total liabilities that the Company reports relative to such amounts prior to adoption. As of June 30, 2018, the contractual obligations for the Company's bareboat chartered-in vessels were $23,064.

ASU 2016-15 Classification of certain cash payments and cash receipts: There was no impact from the adoption of this update as the classification of the related cash payments and cash receipts has always been reported as described in the ASU.

In June 2018, the FASB issued ASU 2018-07, "Compensation–Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting." This ASU expands the scope of Topic 718, which currently only includes share-based payments issued to employees, to also include share-based payments issued to nonemployees for goods and services. Currently, nonemployee awards are measured at the fair value of the consideration received or the fair value of the equity instruments issued, whichever can be more reliably measured. Under ASU 2018-07, equity-classified nonemployee awards within the scope of Topic 718 will be measured at grant-date fair value. The ASU simplified the accounting for share-based payments granted to nonemployees for goods and services, therefore guidance on such payments to nonemployees would be mostly aligned with the requirements for share-based payments granted to employees. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company doesn't believe this ASU will have a material impact on its financial statements.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the disclosure requirements for fair value measurement. The amendments in this Update modify the disclosure requirements on fair value measurements in Topic 820, Fair Value Measurement, based on the concepts in the Concepts Statement, including the consideration of costs and benefits. The amendments in this Update are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Early adoption is permitted upon issuance of this Update. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this Update and delay adoption of the additional disclosures until their effective date. The adoption of this ASU is not expected to have a material effect on the Company's condensed consolidated financial statements and accompanying notes.

3. Going Concern:

At June 30, 2018, the Company had a working capital deficit of $30,224 and cash and cash equivalents of $584. As of June 30, 2018, the Company has remaining contractual commitments for the acquisition of its fleet totaling $189,337. Of this amount, $46,269 is payable in 2018 and $143,068by June30, 2019. Of the amount payable in 2018, an amount of $34,025 has been settled as of the date of issuance of these financial statements. As of June 30, 2018 the Company also has commitments under operating leases for the following twelve months amounting to $6,308.

As of June 30, 2018, the Company had available committed financing of $61,929 (Note 6 and 7), which increased to $72,069 in July 2018 when the Company entered into a senior facility with Alpha Bank for $10,140 and further increased to $80,517 in September 2018 when the Company entered into an amendment of the Amended Family Trading Credit Facility (see Note 13). Out of the $80,517, $18,590 refers to pre-delivery facilities and have to be repaid in the first quarter of 2019. The Company expects to finance its unfinanced capital commitments with cash on hand, operational cash flow, debt or equity issuances, or a combination thereof and other sources such as funds from the Company's controlling shareholder and CEO, Mr. Pistiolis, if required. If the Company is unable to arrange debt or equity financing for its newbuilding vessels, it will sell one or more of its vessels or newbuilding contracts. Hence the Company believes that it has the ability to continue as a going concern and finance its obligations as they come due over the next twelve months following the date of the issuance of these financial statements. The accompanying unaudited interim condensed consolidated do not include any adjustments relating to the recoverability and classification of recorded assets and liabilities, or any other adjustments that might result in the event the Company is unable to continue as a going concern.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States Dollars – except share and per share data, unless otherwise stated)

4(a). Advances for Vessels under construction:

An analysis of Advances for vessels under construction included in the accompanying unaudited interim condensed consolidated balance sheets is as follows:

	Advances for vessels acquisitions / under construction
Balance, December 31, 2017	6,757
— Advances paid	19,930
—Capitalized expenses	1,076
Balance, June 30, 2018	27,763

4(b). Vessels, net:

The balances in the accompanying unaudited interim condensed consolidated balance sheets are analyzed as follows:

	Vessel Cost	Accumulated Depreciation	Net Book Value
Balance, December 31, 2017	164,694	(9,759)	154,935
— Depreciation	-	(3,002)	(3,002)
Balance, June 30, 2018	164,694	(12,761)	151,933

The Company's vessels have been mortgaged as security under its loan facilities (see Note 7).

5. Transactions with Related Parties:

(a) Central Mare– Executive Officers and Other Personnel Agreements: On September 1, 2010, the Company entered into separate agreements with Central Mare, a related party affiliated with the family of Evangelos J. Pistiolis, pursuant to which Central Mare provides the Company with its executive officers and other administrative employees (Chief Executive Officer, Chief Financial Officer, Chief Technical Officer and Executive Vice President).

The fees charged by Central Mare for the six month periods ended June 30,2017and 2018are as follows:

	Six MonthPeriod Ended June 30,		
	2017	2018	Presented in:
Executive officers and other personnel expenses	1,200	1,200	General and administrative expenses - Statement of comprehensive loss
Amortization of awarded shares	-	(17)	Management fees - related parties - Statement of comprehensive loss
Total	1,200	1,183	

On March 27, 2017 and January 2, 2018, the Company's board of directors granted to the Chief Executive Officer a bonus of $1,500 and $2,250 respectively, to be distributed at his own discretion to other executives.

(b) Central Shipping Monaco SAM ("CSM") – Letter Agreement and Management Agreements: On March 10, 2014, the Company entered into a new letter agreement, or the New Letter Agreement, with CSM, a related party affiliated with the family of Evangelos J. Pistiolis, which detailed the services and fees for the management of the Company's fleet.

The fees charged by and expenses relating to CSM for the periods ended June 30, 2017 and 2018 are as follows:

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States Dollars – except share and per share data, unless otherwise stated)

	Six Months Ended June 30, 2017	2018	Presented in:
	34	-	Capitalized in Vessels, net / Advances for vessels acquisitions / under construction –Balance sheet
Management fees	1,081	1,159	Management fees - related parties -Statement of comprehensive loss
Supervision services fees	8	27	Capitalized in Vessels, net / Advances for vessels acquisitions / under construction –Balance sheet
	43	43	Vessel operating expenses -Statement of comprehensive loss
Superintendent fees	15	15	Capitalized in Vessels, net / Advances for vessels acquisitions / under construction –Balance sheet
Accounting and reporting cost	88	113	Management fees - related parties -Statement of comprehensive loss
Financing fees	-	24	Short-term debt – Balance sheet
Commission for sale and purchase of vessels	707	1,749	Management fees - related parties -Statement of comprehensive loss
Commission on charter hire agreements	236	245	Voyage expenses - Statement of comprehensive loss
Performance incentive fee	1,250	1,250	Management fees - related parties -Statement of comprehensive loss
Total	3,462	4,625	

For periods ended June 30, 2017 and 2018, CSM charged the Company newbuilding supervision related pass-through costs amounting to $109 and $386 respectively, that are not included in the table above.
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NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States Dollars – except share and per share data, unless otherwise stated)

(c) Vessel Acquisitions from affiliated entities: On January 31, 2018 the Company entered into a series of transactions with a number of entities affiliated with Evangelos J. Pistiolis that led to the purchase of the construction contracts of Eco Marina Del Ray, Eco Bel Air, Eco Beverley Hills and10% interest in M/T Stenaweco Elegance(see Note 1 and Note 4).

6. Leases

A. Lease arrangements, under which the Company acts as the lessee

Future minimum lease payments:

The Company's future minimum lease payments required to be made after June 30, 2018, relating to the bareboat chartered-in vessels M/T Stenaweco Energy and M/T Stenaweco Evolution and are as follows:

Year ending December 31,	Bareboat Charter Lease Payments
2018 (remainder)	3,167
2019	6,282
2020	6,299
2021	6,282
2022	1,034
Total	23,064

B. Lease arrangements, under which the Company acts as the lessor

Charter agreements:

In the period ended June 30, 2018, the Company operated four vessels(M/T Stenaweco Energy, M/T Stenaweco Evolution, M/T Stenaweco Excellence and M/T Stenaweco Elegance) under time charters with Stena Bulk A/S,two vessels (M/T Eco Fleet and M/T Eco Revolution) under time charters with BP ShippingLimited ("BP") and one vessel (M/T Nord Valiant) under time charter with Dampskibsselskabet Norden A/S.

Furthermore the company has entered into time charter parties for its newbuilding vessels, namely with BP (M/T Eco Bel Air andM/T Eco Beverly Hills), Cargill (M/T Eco Marina Del Ray), Shell Tankers Singapore Private Limited (M/T Eco California)and Central Tanker Chartering Inc (M/T Eco Palm Desert).

Future minimum time-charter receipts, based on the vessels commitments to these non-cancellable time charter contracts, as of June 30, 2018, are as follows:

Year ending December 31,	Time Charter receipts
2018 (remainder)	21,350
2019	55,955
2020	62,857
2021	37,935
2022	11,612

2023	5,512
2024	1,329
Total	196,550

In arriving at the minimum future charter revenues, an estimated 20 days off-hire time to perform scheduled dry-docking on each vessel has been deducted, and it has been assumed that no additional off-hire time is incurred, although there is no assurance that such estimate will be reflective of the actual off-hire in the future
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NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States Dollars – except share and per share data, unless otherwise stated)

7. Debt:

Details of the Company's credit facilities are discussed in Note 9 of the Company's Consolidated Financial Statements for the year ended December 31, 2017.

a. Long-term debt

ABN Facility

As at June 30, 2018, the outstanding balance of the ABN facility is $50,350.The applicable three-month LIBOR as of June 30, 2018 was 2.36%.

NORD/LB Facility

As at June 30, 2018, the outstanding balance of the NORD/LB facility is $19,093.The applicable three-month LIBOR as of June 30, 2018 was 2.32%.

Alpha Bank Facility

As at June 30, 2018, the outstanding balance of the Alpha Bank facility is $21,350.The applicable three-month LIBOR as of June 30, 2018 was 2.33%.

AT Bank Senior Facility

The Company on June 1, 2018 signed a supplemental agreement with AT Bank that resulted in the decrease of the commitment fee from 2% to 1.3%, effective from March 6, 2018.

As of June 30, 2018, the Company has not drawn down any amounts under the AT Bank Senior Facility and therefore has an undrawn balance of $23,500 as at June 30, 2018, part of which will be used to settle the AT Bank Predelivery Facility (see below) .

b. Short-term debt

Unsecured Notes

On December 14, 2017, the Company entered into a note purchase agreement, or the Note Purchase Agreement, with Crede Capital Group, LLC (or Crede), an unaffiliated third party, pursuant to which the Company issued to Crede a $12,500 unsecured promissory note with revolving options for two additional $5,000 notes. On January 5, 2018, the Company amended the Note Purchase Agreement, pursuant to which the Company issued to Crede a second unsecured promissory note in the amount of $5,369 with a revolving option for an additional $4,631 note. The Company further amended the Note Purchase Agreement on February 8, 2018, pursuant to which the borrowing availability was increased under the agreement and a third unsecured promissory note was issued to Crede in the amount of $6,400. The Company refers to the three notes issued to Crede under the Note Purchase Agreement as the "Crede Notes."

The Crede Notes mature 24 months from the date of their issuance and bear interest at a rate of 2.0% per annum for the period of ninety days starting on the issuance date, (ii) 10.0% per annum for the period of ninety days starting on the date that is ninety days immediately following the issuance date and (iii) 15.0% per annum starting on the date that is one hundred eighty days immediately following the issuance date.The Notes also restrict the Company from redeeming, repurchasing or declaring any cash dividend or distribution on any of its capital stock (other than any obligations to do so outstanding as of the issuance dates of the Notes), as long as there are outstanding amounts under the Notes.

As of June 30, 2018, the first and second Crede Notes have been repaid in full and there remains $5,836 of outstanding indebtedness under the third Crede Note.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States Dollars – except share and per share data, unless otherwise stated)

AT Bank Predelivery Facility

The Company during the period ended June 30, 2018 drew down $7,494 under the AT Bank Predelivery Facility, to finance fourshipyard installments of M/T Eco Palm Desert.

The Company on June 1, 2018 signed a supplemental agreement with AT Bank that resulted in the decrease of the loan margin to 6.3% from 8.5% and in the decrease of the commitment fee from 4.25% to 0%, effective from March 6, 2018.

The applicable three-month LIBOR as of June 30, 2018 was 2.32%. As of June 30, 2018 the outstanding balance of the facility is $8,993 and has an undrawn balance of $0.

AT Bank Second Predelivery Facility

On June 1, 2018, the Company entered into a credit facility with AT Bank for $10,140 for the pre-delivery financing of M/T Eco California (the "AT Bank Second Predelivery Facility"). This facility can be drawn down in five tranches to finance in full the last five pre-delivery instalments of M/T Eco California due for payment between June and December 2018 and is repayable upon delivery of the vessel in January 2019.

The facility contains various covenants, including a ratio of total net debt to the aggregate market value of the Company's fleet, current or future, of no more than 75% and minimum free liquidity of $750 per collateralized vessel and $500 per bareboated chartered-in vessel. Additionally, the facility contains restrictions on the subsidiary that owns the newbuilding contract from incurring further indebtedness or guarantees and from paying any dividends.

The facility is secured as follows:

- Assignment to the bank of the newbuilding contract and of the respective refund guarantee of M/T Eco California;
- Corporate guarantee of Top Ships Inc.;
- Pledge of the shares of the subsidiary owning the newbuilding contract;

The AT Bank Second Predelivery Facility bears interest at LIBOR plus a margin of 6.3% (reduced to 6% from September 2018 onwards). The facility bears no commitment fee. The Company drew down $1,690 under the AT Bank Second Predelivery Facility in June 2018, to finance one shipyard installment of M/T Eco California and as of June 30, 2018 the outstanding balance of the facility is $1,690 and the facility has an undrawn balance of $8,450. The applicable three-month LIBOR as of June 30, 2018 was 2.30%.

c. Long-term debt from related parties

Amended Family Trading Credit Facility

As of June 30, 2018, the outstanding amount under the Amended Family Trading Credit Facility is $5,280, excluding deferred finance fees of $170, and is included in Debt from related parties. The Company during the period ended June 30, 2018 has drawn $5,280,which resulted in a recognition of a debt discount of $4,330 according to the beneficial conversion feature ("BCF")guidance ASC 470-20. The intrinsic value of the BCF was determined as the proceeds received times the positive difference between the fair value of the stock on the commitment date and the conversion price formula of the facility. Debt discount is shown net of debt in the accompanying unaudited interim condensed consolidated Balance sheets, of which $140was amortized in the period ended June 30, 2018 and is included in Interest and finance costs in the accompanying unaudited interim condensend gains from foreign currency transactions and related hedging activities.

Provision for Income Taxes

	Three Months Ended		
	July 31, 2009	July 25, 2008	% Change

	(In millions)		
Provision for income taxes	$ 7.5	$ 5.4	41%

Our effective tax rate for the three month period ended July 31, 2009 was 12.7%, compared with 13.4% for the three month period ended July 25, 2008. Our effective tax rate reflects the impact of a significant amount of our earnings being taxed in foreign jurisdictions at rates below the U.S. statutory tax rate. Our effective tax rate before discrete reporting items for the three month period ended July 31, 2009 decreased relative to the three month period ended July 25, 2008 primarily due to the geographic mix of domestic profits for fiscal 2010 that are subject to higher tax rates. The provision for income taxes for the three month period ended July 31, 2009 included a discrete charge of approximately $7.2 million primarily attributable to a $16.0 million charge for the tax impact of the net merger termination fees and a $3.6 million increase in our reserve for uncertain tax positions, offset by a $12.6 million benefit related to stock-based compensation.

On May 27, 2009, the United States Court of Appeals for the Ninth Circuit held in Xilinx Inc. v. Commissioner that stock-based compensation must be included in the research and development cost base of companies that have entered into a cost sharing agreement and must, therefore, be allocated among the participants based on anticipated benefits. The Court s reversal of the prior U.S. Tax Court decision impacts our estimate of tax benefits that are required to be recognized under Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109.* We have evaluated the impact of the Xilinx case on our provision for income taxes for the three month period ended July 31, 2009 and have established additional liabilities for uncertain tax positions of $32.6 million. This additional reserve for uncertain tax positions resulted in a reduction of our unrecognized tax attributes.

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

Liquidity and Capital Resources

The following sections discuss our principal liquidity requirements, as well as our sources and uses of cash flows on our liquidity and capital resources. The principal objectives of our investment policy are the preservation of principal and maintenance of liquidity. We attempt to mitigate default risk by investing in high-quality investment grade securities, limiting the time to maturity and by monitoring the counter-parties and underlying obligors closely. We believe our cash equivalents and short-term investments are liquid and accessible. We are not aware of any significant deterioration in the fair value of our cash equivalents or investments from the values reported as of July 31, 2009.

Liquidity Sources, Cash Requirements

Our principal sources of liquidity as of July 31, 2009 consisted of: (1) approximately $2.7 billion in cash, cash equivalents and short-term investments, (2) cash we expect to generate from operations, and (3) an unsecured revolving credit facility totaling $250.0 million. Our principal liquidity requirements are primarily to meet our working capital needs, support ongoing business activities, implement restructuring plans, research and development, capital expenditure needs, investment in critical or complementary technologies, and to service our debt and synthetic leases.

Key factors that could affect our cash flows include changes in our revenue mix and profitability as well as our ability to effectively manage our working capital, in particular, accounts receivable and inventories. Based on our current business outlook, we believe that our sources of cash will be sufficient to fund our operations and meet our cash requirements for at least the next 12 months. However, in the event our liquidity is insufficient, we may be required to further curtail spending and implement additional cost saving measures and restructuring actions. In light of the current economic and market conditions, we cannot be certain that we will continue to generate cash flows at or above current levels or that we will be able to obtain additional financing, if necessary, on satisfactory terms, if at all.

Our cash contractual obligations and commitments as of July 31, 2009 are summarized below in the Contractual Obligations and Commitments tables.

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Our investment portfolio, including auction rate securities and our investment in the Primary Fund (as described in Note 6 to our condensed consolidated financial statements) has been and will continue to be exposed to market risk due to uncertainties in the credit and capital markets. However, we are not dependent on liquidating these investments in the next twelve months in order to meet our liquidity needs. We continue to closely monitor current economic and market events to minimize our market risk on our investment portfolio. Based on our ability to access our cash and short-term investments, our expected operating cash flows, and our other potential sources of cash, we do not anticipate that the lack of liquidity of these investments will impact our ability to fund working capital needs, capital expenditures, acquisitions or other cash requirements. We intend to and believe that we have the ability to hold these investments until the market recovers. If current market conditions deteriorate further, or the anticipated recovery in market values does not occur, we may be required to record additional charges to earnings in future periods.

Capital Expenditure Requirements

We expect to fund our capital expenditures, including our commitments related to facilities and equipment operating leases, over the next few years through existing cash, cash equivalents, investments and cash generated from operations. The timing and amount of our capital requirements cannot be precisely determined at this time and will depend on a number of factors including future demand for products, product mix, changes in the network storage industry, economic conditions and market competition. We expect that our existing facilities in Sunnyvale, California; Research Triangle Park, North Carolina; and worldwide are adequate for our requirements over at least the next two years, and that additional space will be available as needed. However, if current economic conditions deteriorate further, we may be required to implement additional restructuring plans to eliminate or consolidate excess facilities, incur cancellation penalties and impair fixed assets.

Cash Flows

As of July 31, 2009, compared to April 24, 2009, our cash and cash equivalents and short-term investments increased by $58.6 million to $2.7 billion. The increase in cash and cash equivalents and short-term investments was primarily a result of cash provided by operating activities, issuance of common stock related to employee stock option exercises and employee stock purchase plan, partially offset by capital expenditures. We derive our liquidity and capital resources primarily from our cash flow from operations and from working capital. Days sales outstanding for the three month period ended July 31, 2009 decreased to 39 days, compared to 46 days in the three month period ended April 24, 2009, primarily due to collection efficiencies and improvement in the rate at which products are shipped during the period (which we refer to as shipment linearity).Working capital increased by $114.5 million to $1.9 billion as of July 31, 2009, compared to $1.8 billion as of April 24, 2009.

Cash Flows from Operating Activities

During the three month period ended July 31, 2009, we generated cash flows from operating activities of $38.2 million. We recorded net income of $51.7 million for the three month period ended July 31, 2009. Significant changes in noncash adjustments affecting net income included stock-based compensation expense of $52.2 million; depreciation and amortization expense of $43.0 million; non-cash interest expense from the accretion of debt discount and issuance costs of $13.1 million, and tax benefits from stock options of $19.0 million. Significant changes in assets and liabilities impacting operating cash flows included a decrease in accounts receivable of $117.3 million, a decrease in accrued compensation and related benefits of $73.0 million due to purchases related to the employee stock purchase plan, as well as the payout of commissions and annual performance-based bonuses, and a decrease in the accrual for the GSA settlement of $128.7 million due to payment.

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, shipment linearity, accounts receivable collections, inventory and supply chain management, tax benefits from stock-based compensation, and the timing and amount of compensation and other payments.

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Cash Flows from Investing Activities

Capital expenditures for the three month period ended July 31, 2009 were $24.7 million. We received $233.6 million for net purchases and redemptions of short-term investments and received $1.4 million from the sale of nonmarketable and marketable securities.

Cash Flows from Financing Activities

We received $33.3 million from financing activities. Proceeds from employee stock option exercises and employee stock purchase plan were $38.5 million. We withheld shares with an aggregate value of $5.2 million in connection with the vesting of certain employees restricted stock units for purposes of satisfying those employees federal, state, and local withholding tax obligations.

Net proceeds from the issuance of common stock related to employee participation in employee stock programs have historically been a significant component of our liquidity. The extent to which our employees participate in these programs generally increases or decreases based upon changes in the market price of our common stock. As a result, our cash flow resulting from the issuance of common stock in connection with employee participation in employee stock programs and related tax benefits will vary.

Stock Repurchase Program

At July 31, 2009, $1.1 billion remained available for future repurchases under plans approved as of that date. The stock repurchase program may be suspended or discontinued at any time.

Convertible Notes

As of July 31, 2009, we had $1.265 billion principal amount of 1.75% Convertible Senior Notes due 2013. (See Note 7 to our condensed consolidated financial statements.) The Notes will mature on June 1, 2013, unless earlier repurchased or converted. As of July 31, 2009, the Notes have not been repurchased or converted. We also have not received any shares under the related Note Hedges or delivered cash or shares under the related Warrants.

Credit Facilities

As of July 31, 2009, we have an unsecured revolving credit facility totaling $250.0 million, of which $0.6 million was allocated as of July 31, 2009 to support certain of our outstanding letters of credit.

This credit facility requires us to maintain specified financial covenants, with which we were in compliance as of July 31, 2009. Such specified financial covenants include a maximum ratio of Total Debt to Earnings before Interest, Taxes, Depreciation and Amortization and a minimum amount of Unencumbered Cash and Short-Term Investments. Our failure to comply with these financial covenants could result in a default under the credit facility, which would give the counterparties thereto the ability to exercise certain rights, including the right to accelerate the amounts outstanding thereunder and to terminate the facility.

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Contractual Obligations

The following summarizes our contractual obligations at July 31, 2009 and the effect such obligations are expected to have on our liquidity and cash flows in future periods (in millions):

	2010*	2011	2012	2013	2014	Thereafter	Total
Contractual Obligations:							
Office operating lease payments	$ 20.6	$ 23.2	$ 18.1	$ 15.1	$ 13.0	$ 30.5	$ 120.5
Real estate lease payments(1)	2.8	3.7	3.7	129.5			139.7
Equipment operating lease payments	21.9	18.8	7.3	1.0			49.0
Purchase commitments with contract manufacturers(2)	60.0						60.0
Other purchase orders and commitments	23.4	14.1	7.0	3.8	1.2	0.1	49.6
1.75% Convertible notes(3)	11.1	22.1	22.1	22.1	1,276.1		1,353.5
Uncertain tax positions(4)						94.0	94.0
Total Contractual Cash Obligations	$ 139.8	$ 81.9	$ 58.2	$ 171.5	$ 1,290.3	$ 124.6	$ 1,866.3
Other Commercial Commitments:							
Letters of credit	$ 4.3	$ 0.5	$ 0.3	$ 0.1	$	$ 0.6	$ 5.8

For purposes of the above table, contractual obligations for the purchase of goods and services are defined as agreements that are enforceable, are legally binding on us, and subject us to penalties if we cancel the agreement. Some of the figures we include in this table are based on management s estimates and assumptions about these obligations, including their duration, the possibility of renewal or termination, anticipated actions by management and third parties, and other factors. Because these estimates and assumptions are necessarily subjective, our actual future obligations may vary from those reflected in the table.

* Reflects the remaining nine months of fiscal 2010.

(1) Included in real estate lease payments pursuant to four financing arrangements with BNP Paribas LLC (BNPPLC) are (i) lease commitments of $2.8 million in the remainder of fiscal 2010; $3.7 million in each of the fiscal years 2011 and 2012; and $2.4 million in fiscal 2013, which are based on either the LIBOR rate at July 31, 2009 plus a spread or a fixed rate for terms of five years, and (ii) at the expiration or termination of the lease, a supplemental payment obligation equal to our minimum guarantee of $127.1 million in the event that we elect not to purchase or arrange for sale of the buildings. See Note 16 to our condensed consolidated financial statements.

(2) Contract manufacturer commitments consist of obligations for on hand inventories and non-cancelable purchase order with our contract manufacturer. We record a liability for firm, noncancelable, and nonreturnable purchase commitments for quantities in excess of our future demand forecasts, which is consistent with the valuation of

our excess and obsolete inventory. As of July 31, 2009, the liability for these purchase commitments in excess of future demand was approximately $1.8 million and is recorded in other accrued liabilities.

(3) Included in these amounts are obligations related to the $1.265 billion principal amount of 1.75% Notes due 2013 (see Note 7 to our condensed consolidated financial statements). Estimated interest payments for the Notes are $88.6 million for fiscal 2010 through fiscal 2014.

(4) As of July 31, 2009, our liability for uncertain tax positions was $94.0 million.

As of July 31, 2009, we have four leasing arrangements (Leasing Arrangements 1, 2, 3 and 4) with BNPPLC which requires us to lease our land to BNPPLC for a period of 99 years, and to lease approximately 564,274 square feet of office space for our headquarters in Sunnyvale costing up to $149.6 million. Under these leasing arrangements, we pay BNPPLC minimum lease payments, which vary based on LIBOR plus a spread or a fixed rate on the costs of the facilities on the respective lease commencement dates. We make payments for each of the

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leases for a term of five years. We have the option to renew each of the leases for two consecutive five-year periods upon approval by BNPPLC. Upon expiration (or upon any earlier termination) of the lease terms, we must elect one of the following options: (i) purchase the buildings from BNPPLC at cost; (ii) if certain conditions are met, arrange for the sale of the buildings by BNPPLC to a third party for an amount equal to at least 85% of the costs (residual guarantee), and be liable for any deficiency between the net proceeds received from the third party and such amounts; or (iii) pay BNPPLC supplemental payments for an amount equal to at least 85% of the costs (residual guarantee), in which event we may recoup some or all of such payments by arranging for a sale of each or all buildings by BNPPLC during the ensuing two-year period. The following table summarizes the costs, the residual guarantee, the applicable LIBOR plus spread or fixed rate at July 31, 2009, and the date we began to make payments for each of our leasing arrangements (in millions):

Leasing Arrangements	Cost	Residual Guarantee	LIBOR plus Spread or Fixed Rate	Lease Commencement Date	Term
1	$ 48.5	$ 41.2	3.99%	January 2008	5 years
2	$ 80.0	$ 68.0	1.16%	December 2007	5 years
3	$ 10.5	$ 8.9	3.97%	December 2007	5 years
4	$ 10.6	$ 9.0	3.99%	December 2007	5 years

All leases require us to maintain specified financial covenants with which we were in compliance as of July 31, 2009. Such financial covenants include a maximum ratio of Total Debt to Earnings before Interest, Taxes, Depreciation and Amortization and a minimum amount of Unencumbered Cash and Short-Term Investments. Our failure to comply with these financial covenants could result in a default under the leases which, subject to our right and ability to exercise our purchase option, would give BNPPLC the right to, among other things, (i) terminate our possession of the leased property and require us to pay lease termination damages and other amounts as set forth in the lease agreements, or (ii) exercise certain foreclosure remedies. If we were to exercise our purchase option, or be required to pay lease termination damages, these payments would significantly reduce our available liquidity, which could constrain our operating flexibility.

We may from time to time terminate one or more of our leasing arrangements and repay amounts outstanding in order to meet our operating or other objectives.

Legal Contingencies

On September 5, 2007, we filed a patent infringement lawsuit in the Eastern District of Texas seeking compensatory damages and a permanent injunction against Sun Microsystems. On October 25, 2007, Sun Microsystems filed a counter claim against us in the Eastern District of Texas seeking compensatory damages and a permanent injunction. On October 29, 2007, Sun filed a second lawsuit against us in the Northern District of California asserting additional patents against us. The Texas court granted a joint motion to transfer the Texas lawsuit to the Northern District of California on November 26, 2007. On March 26, 2008, Sun filed a third lawsuit in federal court that extends the patent infringement charges to storage management technology we acquired in January 2008. The three lawsuits are currently in the discovery phase and no trial date has been set, so we are unable at this time to determine the likely outcome of these various patent litigations. In addition, as we are unable to reasonably estimate the amount or range of the potential settlement, no accrual has been recorded as of July 31, 2009.

In April 2009, we entered into a settlement with the United States of America, acting through the United States Department of Justice (DOJ) and on behalf of the General Services Administration (the GSA), under which we paid the United States $128.0 million, plus interest of $0.7 million, related to a dispute regarding our discount practices and compliance with the price reduction clause provisions of GSA contracts between August and February 2005. We are currently in discussions with the U.S. government to demonstrate that we have implemented processes and procedures to ensure that we comply with federal contracting rules.

In addition, we are subject to various legal proceedings and claims which have arisen or may arise in the normal course of business. While the outcome of these legal matters is currently not determinable, we do not believe

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that any current litigation or claims will have a material adverse effect on our business, cash flow, operating results, or financial condition.

Off-Balance Sheet Arrangements

During the ordinary course of business, we provide standby letters of credit or other guarantee instruments to third parties as required for certain transactions initiated either by us or our subsidiaries. As of July 31, 2009, our financial guarantees of $5.8 million that were not recorded on our balance sheet consisted of standby letters of credit related to workers compensation, a customs guarantee, a corporate credit card program, foreign rent guarantees and surety bonds, which were primarily related to self-insurance.

We use derivative instruments to manage exposures to foreign currency risk. Our primary objective in holding derivatives is to reduce the volatility of earnings and cash flows associated with changes in foreign currency. The program is not designated for trading or speculative purposes. Currently, we do not enter into any foreign exchange forward contracts to hedge exposures related to firm commitments or nonmarketable investments. Our major foreign currency exchange exposures and related hedging programs are described below:

We utilize monthly foreign currency forward and options contracts to hedge exchange rate fluctuations related to certain foreign monetary assets and liabilities.

We use currency forward contracts to hedge exposures related to forecasted sales denominated in certain foreign currencies. These contracts are designated as cash flow hedges and in general closely match the underlying forecasted transactions in duration.

As of July 31, 2009, our notional fair value of foreign exchange forward and foreign currency option contracts totaled $348.8 million. We do not believe that these derivatives present significant credit risks, because the counterparties to the derivatives consist of major financial institutions, and we manage the notional amount of contracts entered into with any one counterparty. Other than the risk associated with the financial condition of the counterparties, our maximum exposure related to foreign currency forward and option contracts is limited to the premiums paid. See Note 10 to our condensed consolidated financial statements for more information related to our hedging activities.

We enter into indemnification agreements with third parties in the ordinary course of business. Generally, these indemnification agreements require us to reimburse losses suffered by the third party due to various events, such as lawsuits arising from patent or copyright infringement. These indemnification obligations are considered off-balance sheet arrangements in accordance with FASB Interpretation 45, of FIN No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.*

We have commitments related to four lease arrangements with BNPPLC for approximately 564,274 square feet of office space for our headquarters in Sunnyvale, California (as further described above under Contractual Obligations).

We have evaluated our accounting for these leases under the provisions of FIN No. 46R and have determined the following:

BNPPLC is a leasing company for BNP Paribas in the United States. BNPPLC is not a special purpose entity organized for the sole purpose of facilitating the leases to us. The obligation to absorb expected losses and receive expected residual returns rests with the parent, BNP Paribas. Therefore, we are not the primary beneficiary of BNPPLC as we do not absorb the majority of BNPPLC s expected losses or expected residual returns; and

BNPPLC has represented in the related closing agreements that the fair value of the property leased to us by BNPPLC is less than half of the total of the fair values of all assets of BNPPLC, excluding any assets of BNPPLC held within a silo. Further, the property leased to NetApp is not held within a silo. The definition of held within a silo means that BNPPLC has obtained funds equal to or in excess of 95% of the fair value of the leased asset to acquire or maintain its investment in such asset through nonrecourse financing or other contractual arrangements, the effect of which is to leave such asset (or proceeds thereof) as the only significant asset of BNPPLC at risk for the repayment of such funds.

Accordingly, under FIN No. 46R, we are not required to consolidate either the leasing entity or the specific assets that we lease under the BNPPLC lease. Our future minimum lease payments and residual guarantees under these real estate leases will amount to a total of $139.7 million as discussed in above in Contractual Obligations .

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 Risk and Market Interest Risk

Investment and Interest Income As of July 31, 2009, we had available-for-sale investments of $999.0 million. Our investment portfolio primarily consists of investments with original maturities at the date of purchase of greater than three months, which are classified as available-for-sale. These investments, consisting primarily of corporate bonds, corporate securities, U.S. government agency bonds, U.S. Treasuries, and certificates of deposit, 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 July 31, 2009 would cause the fair value of these available-for-sale investments to decline by approximately $2.2 million. Volatility in market interest rates over time will, however, cause variability in our interest income. We do not use derivative financial instruments in our investment portfolio.

Our investment policy is to limit credit exposure through diversification and investment in highly rated securities. We further mitigate concentrations of credit risk in our investments by limiting our investments in the debt securities of a single issuer and by diversifying risk across geographies and type of issuer. We actively review, along with our investment advisors, current investment ratings, company specific events, and general economic conditions in managing our investments and in determining whether there is a significant decline in fair value that is other-than-temporary. We will continue to monitor and evaluate the accounting for our investment portfolio on a quarterly basis for additional other-than-temporary impairment charges. We could realize additional losses in our holdings of the Primary Fund and may not receive all or a portion of our remaining balance in the Primary Fund as a result of market conditions and ongoing litigation against the fund.

We are also exposed to market risk relating to our auction rate securities due to uncertainties in the credit and capital markets. As of July 31, 2009, we recorded temporary impairment charges of $4.1 million, offset by an immaterial amount of unrealized gains. The fair value of our auction rate securities may change significantly due to events and conditions in the credit and capital markets. These securities/issuers could be subject to review for possible downgrade. Any downgrade in these credit ratings may result in an additional decline in the estimated fair value of our auction rate securities. Changes in the various assumptions used to value these securities and any increase in the markets perceived risk associated with such investments may also result in a decline in estimated fair value.

If current market conditions deteriorate further, or the anticipated recovery in market values does not occur, we may be required to record additional unrealized losses in other comprehensive income (loss) or other-than-temporary impairment charges to earnings in future quarters. We intend and have the ability to hold these investments until the market recovers. We do not believe that the lack of liquidity relating to our portfolio investments will impact our ability to fund working capital needs, capital expenditures or other operating requirements. See Note 9 to our condensed consolidated financial statements in Part I, Item 1; Management s Discussion and Analysis of Financial Condition and Results of Operations, Liquidity and Capital Resources, in Part I, Item 2; and Risk Factors in Part II, Item 1A of this Quarterly Report on Form 10-Q for a description of recent market events that may affect the value and liquidity of the investments in our portfolio that we held at July 31, 2009.

Lease Commitments As of July 31, 2009, one of our four lease arrangements with BNPPLC is based on a floating interest rate. The minimum lease payments will vary based on LIBOR plus a spread. All of our leases have an initial term of five years, and we have the option to renew these leases for two consecutive five-year periods upon approval by BNPPLC. A hypothetical 10 percent increase in market interest rate from the level at July 31, 2009 would increase our lease payments on this one floating lease arrangement under the initial five-year term by an immaterial amount. We do not currently hedge against market interest rate increases.

Convertible Notes In June 2008, we issued $1.265 billion principal amount of 1.75% Notes due 2013. Holders may convert the Notes prior to maturity upon the occurrence of certain circumstances. Upon conversion, we would pay the holder the cash value of the applicable number of shares of our common stock, up to the principal amount of the Note. Amounts in excess of the principal amount, if any, may be paid in cash or in stock at our option. Concurrent with the issuance of the Notes, we entered into convertible note hedge transactions and separately, warrant transactions, to reduce the potential dilution from the conversion of the Notes and to mitigate any negative effect such conversion may have on the price of our common stock.

Our Notes have fixed annual coupon interest rates at 1.75% and therefore, we do not have significant interest rate exposure on our Notes. However, we are exposed to market interest rate impact on the fair value of our Notes. Generally, the fair market value of our Notes will increase as interest rates fall and decrease as interest rates rise. In addition, the fair value of our Notes is affected by our stock price. The principal amount value of our Notes was $1.265 billion and the estimated fair value of the principal amount was $1.2 billion at July 31, 2009, based on the closing trading price of $97.125 per $100 of our 1.75% Notes as of that date.

Nonmarketable Securities We have from time to time made cash investments in companies with distinctive technologies that are potentially strategically important to us. Our investments in nonmarketable securities would be negatively affected by an adverse change in equity market prices, although the impact cannot be directly quantified. Such a change, or any negative change in the financial performance or prospects of the companies whose nonmarketable securities we own, would harm the ability of these companies to raise additional capital and the likelihood of our being able to realize any gains or return of our investments through liquidity events such as initial public offerings, acquisitions, and private sales. These types of investments involve a high degree of risk, and there can be no assurance that any company we invest in will grow or be successful. We do not currently engage in any hedging activities to reduce or eliminate equity price risk with respect to such nonmarketable investments. Accordingly, we could lose all or part of these investments if there is an adverse change in the market price of a company we invest in. Our investments in nonmarketable securities had a carrying amount of $2.3 million as of July 31, 2009. If we determine that an other-than-temporary decline in fair value exists for a nonmarketable equity security, we write down the investment to its fair value and record the related impairment as an investment loss in our condensed consolidated statements of operations.

Foreign Currency Exchange Rate Risk and Foreign Exchange Forward Contracts

We hedge risks associated with foreign currency transactions to minimize the impact of changes in foreign currency exchange rates on earnings. We utilize forward and option 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 forecasted sales transactions. These derivatives are designated as cash flow hedges under SFAS No. 133. For cash flow hedges outstanding at July 31, 2009, the time-value component is recorded in earnings while all other gains or losses were included in other comprehensive income.

We do not enter into foreign exchange contracts for speculative or trading purposes. In entering into forward and option 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 exchange contracts with creditworthy multinational commercial banks. All contracts have a maturity of less than one year.

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The following table provides information about our foreign exchange forward contracts outstanding (based on trade date) on July 31, 2009 (in millions):

Currency	Buy/Sell	Foreign Currency Amount	Notional Contract Value in USD	Notional Fair Value in USD
Forward Contracts:				
EUR	Sell	151.1	$ 214.8	$ 214.8
GBP	Sell	41.4	$ 69.1	$ 69.1
CAD	Sell	12.5	$ 11.6	$ 11.6
Other	Sell	N/A	$ 15.4	$ 15.4
AUD	Buy	35.5	$ 29.6	$ 29.6
Other	Buy	N/A	$ 8.3	$ 8.3

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

Disclosure controls are controls and procedures designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, as amended (the Exchange Act), such as this Quarterly Report on Form 10-Q, is recorded, processed, summarized, and reported within the time periods specified in the U.S. Securities and Exchange Commission s rules and forms. Disclosure controls and procedures are also designed to ensure that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of July 31, 2009, the end of the fiscal period covered by this Quarterly Report on Form 10-Q (the Evaluation Date). Based on this evaluation, our CEO and CFO concluded as of the Evaluation Date that our disclosure controls and procedures were effective such that the information relating to NetApp, including its consolidated subsidiaries, required to be disclosed in its Securities and Exchange Commission (SEC) reports (i) is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to NetApp management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

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.

PART II. OTHER INFORMATION

Item 1. ***Legal Proceedings***

On September 5, 2007, we filed a patent infringement lawsuit in the Eastern District of Texas seeking compensatory damages and a permanent injunction against Sun Microsystems. On October 25, 2007, Sun Microsystems filed a counter claim against us in the Eastern District of Texas seeking compensatory damages and a permanent injunction. On October 29, 2007, Sun filed a second lawsuit against us in the Northern District of California asserting additional patents against us. The Texas court granted a joint motion to transfer the Texas lawsuit to the Northern District of California on November 26, 2007. On March 26, 2008, Sun filed a third lawsuit in federal court that extends the patent infringement charges to storage management technology we acquired in January 2008. The three lawsuits are currently in the discovery phase and no trial date has been set, so we are unable at this time to determine the likely outcome of these various patent litigations. Since we are unable to reasonably estimate the amount or range of any potential settlement, no accrual has been recorded as of July 31, 2009.

In April 2009, we entered into a settlement agreement with the United States of America, acting through the United States Department of Justice (DOJ) and on behalf of the General Services Administration (the GSA), under which we paid the United States $128.0 million, plus interest of $0.7 million, related to a dispute regarding our discount practices and compliance with the price reduction clause provisions of GSA contracts between August

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1997 and February 2005 in consideration for the release of NetApp by the DOJ and GSA with respect to the claims alleged in the investigation as set forth in the settlement agreement. The agreement reflects neither an admission nor denial by us of any of the claims alleged by the DOJ and represents a compromise to avoid continued litigation and associated risks. We made the settlement payment on April 27, 2009. We are currently in discussions with the U.S. government to demonstrate that we have implemented processes and procedures to ensure that we comply with federal contracting rules.

On June 12, 2009, a purported class action lawsuit was filed on behalf of the shareholders of Data Domain, Inc. (Data Domain) in the Court of Chancery of the State of Delaware (the Delaware Suit). In addition, on June 19, 2009, a purported class action lawsuit was filed on behalf of Data Domain s shareholders in the Superior Court of the State of California, County of Santa Clara (the California Suit). These lawsuits named as defendants the Data Domain directors, and NetApp and its merger subs (with the California Suit also naming Data Domain itself), and alleged breach of fiduciary duty by the Data Domain board of directors and aiding and abetting such breach by NetApp. Both complaints initially sought injunctive relief and damages. On July 23, 2009, plaintiff in the California Suit purported to serve an amended complaint alleging a single claim for attorneys fees and expenses based on the benefit allegedly conferred by plaintiff s lawsuit upon Data Domain s shareholders. On August 26, 2009, plaintiff in the Delaware Suit moved to dismiss its action and requested attorneys fees and expenses based on the benefit allegedly conferred by plaintiff s lawsuit upon Data Domain s shareholders. We believe any claims against NetApp or its merger subs, and any request for attorneys fees or expenses from NetApp or its merger subs, are without merit.

Item 1A. *Risk Factors*

The following risk factors and other information included in this Quarterly Report on 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. Please see page 27 of this Quarterly Report on Form 10-Q for additional discussion of these forward-looking statements. If any of the events or circumstances described in the following risk factors actually occurs, our business, operating results, and financial condition could be materially adversely affected.

Our operating results may be adversely affected by unfavorable economic and market conditions, including the current economic downturn.

We are subject to the effects of general global economic and market conditions challenging economic conditions worldwide have from time to time contributed, and are currently contributing, to slowdowns in the computer, storage, and networking industries at large, as well as the information technology (IT) market, resulting in:

Reduced demand for our products as a result of continued constraints on IT related spending by our customers;

Increased price competition for our products from competitors;

Deferment of purchases and orders by customers due to budgetary constraints or changes in current or planned utilization of our systems;

Risk of excess and obsolete inventories;

Excess facilities costs;

Higher overhead costs as a percentage of revenue;

Increased risk of losses or impairment charges related to our investment portfolio;

Negative impacts from increased financial pressures on customers, distributors and resellers;

Negative impacts from increased financial pressures on key suppliers or contract manufacturers; and

Potential discontinuance of product lines or businesses and related asset impairments.

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The turmoil in the global credit markets, the recent instability in the geopolitical environment in many parts of the world and other disruptions may continue to put pressure on global economic conditions. The economic challenges we initially experienced in the United States have spread throughout the world. If global economic and market conditions, or economic conditions in the United States or other key markets, remain uncertain, persist, or deteriorate further, we may experience material adverse impacts on our business, operating results, and financial condition.

Our quarterly operating results may fluctuate, which could adversely impact our common stock price.

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. Our operating results have in the past, and will continue to be, subject to quarterly fluctuations as a result of numerous factors, some of which may contribute to more pronounced fluctuations in an uncertain global economic environment. These factors include, but are not limited to, the following:

Fluctuations in demand for our products and services, in part due to changes in general economic conditions and specific economic conditions in the computer, storage, and networking industries;

A shift in federal government spending patterns;

Changes in sales and implementation cycles for our products and reduced visibility into our customers spending plans and associated revenue;

The level of price and product competition in our target product markets;

The impact of the current adverse economic and credit environment on our customers, channel partners, and suppliers, including their ability to obtain financing or to fund capital expenditures;

The overall movement toward industry consolidation among both our competitors and our customers;

Our reliance on a limited number of suppliers due to industry consolidation, which could subject us to periodic supply-and-demand, price rigidity, and quality issues with our components;

The timing of bookings or the 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 and introductions of, and transitions to, 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;

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

Technological changes in our target product markets;

Our levels of expenditure on research and development and sales and marketing programs;

Our ability to achieve targeted cost reductions;

Adverse movements in foreign currency exchange rates as a result of our international operations;

Excess or inadequate facilities;

Actual events, circumstances, outcomes and amounts differing from judgments, assumptions, and estimates used in determining the values of certain assets (including the amounts of valuation allowances), liabilities, and other items reflected in our consolidated financial statements;

Disruptions resulting from new systems and processes as we continue to enhance and scale our system infrastructure;

Future accounting pronouncements and changes in accounting rules, such as the increased use of fair value measures, changes in accounting standards related to revenue recognition, and the potential requirement that U.S. registrants prepare financial statements in accordance with International Financial Reporting Standards (IFRS);

Seasonality, such as our historical seasonal decline in revenues in the first quarter of our fiscal year and seasonal increase in revenues in the second quarter of our fiscal year, with the latter due in part to the impact of the U.S. federal government s September 30 fiscal year end on the timing of its orders, and

Linearity, such as our historical intraquarter revenue pattern in which a disproportionate percentage of each quarter s total revenues occur in the last month of the quarter.

Due to such factors, operating results for a future period are difficult to predict, and, therefore, prior results are not necessarily indicative of results to be expected in future periods. Any of the foregoing factors, or any other factors discussed elsewhere herein, could have a material adverse effect on our business, results of operations, and financial condition. It is possible that in one or more quarters our results may fall below our forecasts and the expectations of public market analysts and investors. In such event, the trading price of our common stock would likely decrease.

Our revenue for a particular period is difficult to forecast, and a shortfall in revenue may harm our business and our operating results.

Our revenues for a particular period are difficult to forecast, especially in light of the current global economic downturn and related market uncertainty. Product sales are also difficult to forecast because the storage and data management market is rapidly evolving, and our sales cycle varies substantially from customer to customer. New or additional product introductions also increase the complexities of forecasting revenues.

Additionally, we derive a majority of our revenue in any given quarter from orders booked in the same quarter. Bookings typically follow intraquarter seasonality patterns weighted toward the back end of the quarter. If we do not achieve bookings in the latter part of a quarter consistent with our quarterly targets, our financial results will be adversely impacted.

We use a pipeline system, a common industry practice, to forecast bookings and trends in our business. Sales personnel monitor the status of potential business and estimate when a customer will make a purchase decision, the dollar amount of the sale and the products or services to be sold. These estimates are aggregated periodically to generate a bookings pipeline. Our pipeline estimates may prove to be unreliable either in a particular quarter or over a longer period of time, in part because the conversion rate of the pipeline into contracts varies from customer to customer, can be difficult to estimate, and requires management judgment. Small deviations from our forecasted conversion rate may result in inaccurate plans and budgets and could materially and adversely impact our business or our planned results of operations. In particular, the continued adverse events in the economic environment and financial markets have made it even more difficult for us to forecast our future results and may result in a reduction in our quarterly conversion rate as our customers purchasing decisions are delayed, reduced in amount, or cancelled.

Uncertainty about current and future global economic conditions has caused consumers, businesses and governments to defer purchases in response to tighter credit, decreased cash availability and declining customer confidence. Accordingly, future demand for our products could differ from our current expectations.

We have experienced periods of alternating growth and decline in revenues and operating expenses. If we are not able to successfully manage these fluctuations, our business, financial condition and results of operations could be

significantly impacted.

The ongoing global financial crisis has led to a worldwide economic downturn that has negatively affected our business. If the current economic downturn continues or worsens, demand for our products and services and our revenues may be further reduced. A prolonged downturn can adversely affect our revenues, gross margin and results of operations. During such economic downturns, it is critical to appropriately align our cost structure with prevailing market conditions and to minimize the effect of such downturns on our operations, while also maintaining our capabilities and strategic investments for future growth.

Our expense levels are based in part on our expectations as to future revenues, and a significant percentage of our expenses are fixed. We have a limited ability to quickly or significantly reduce our fixed costs, and if revenue levels are below our expectations, operating results will be adversely impacted. During uneven periods of growth, we may incur costs before we realize some of the anticipated benefits, which could harm our operating results. We have significant investments in engineering, sales, service support, marketing programs and other functions to support and grow our business. We are likely to recognize the costs associated with these investments earlier than some of the anticipated benefits, and the return on these investments may be lower, or may develop more slowly, than we expect, which could harm our business, operating results and financial condition.

Conversely, if we are unable to effectively manage our resources and capacity, during periods of increasing demand for our products, we could experience a material adverse effect on operations and financial results. If the network storage market fails to grow, or grows slower than we expect, our revenues will be adversely affected. Also, even if IT spending increases, our revenue may not grow at the same pace.

Our gross margins have varied over time and may continue to vary, and such variation may make it more difficult to forecast our earnings.

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

- Demand for storage and data management products;
- Pricing actions, rebates, initiatives, discount levels, and price competition;
- Direct versus indirect and OEM sales;
- Changes in customer, geographic, or product mix, including mix of configurations within each product group;
- 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;
- The timing of revenue recognition and revenue deferrals;
- 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, quality, warranty, and freight.

Changes in software entitlements and maintenance gross margins may result from various factors, such as:

The size of the installed base of products under support contracts;

The timing of technical support service contract renewals;

Demand for and the timing of delivery of upgrades;

The timing of our technical support service initiatives; and

The level of spending on our customer support infrastructure.

Changes in service gross margins may result from various factors, such as:

The mix of customers;

The size and timing of service contract renewals;

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The volume and use of outside partners to deliver support services on our behalf; and

Product quality and serviceability issues.

Due to such factors, gross margins are subject to variations from period to period and are difficult to predict.

Our cost-reduction initiatives and restructuring plans may not result in anticipated savings or more efficient operations. Our restructuring plan announced earlier in calendar year 2009 may disrupt our operations and adversely affect our operations and financial results.

On February 11, 2009, in response to the worsening global economic conditions and uncertainty about future IT spending, we announced a restructuring of our worldwide operations in an effort to strategically align our cost structure with expected revenues, as well as to reallocate resources into areas of our business with more growth potential.

Additionally, in December 2008, we decided to cease development and availability of our SnapMirror® for Open Systems (SMOS) product, and as a result recorded restructuring and other charges attributable primarily to severance and employee-related and facility closure costs, as well as the impairment of certain acquired intangible assets.

We may not be able to successfully complete and realize the expected benefits of these restructuring plans. Our restructuring plans may involve higher costs or a longer timetable, or they may fail to improve our gross margins, results of operations and cash flows as we anticipate. Our inability to realize these benefits may result in an ineffective business structure that could negatively impact our results of operations. In addition to costs related to severance and other employee-related costs, our restructuring plans may also subject us to litigation risks and expenses.

In addition, our restructuring plans may have other adverse consequences, such as attrition beyond our planned reduction in workforce, the loss of employees with valuable knowledge or expertise, a negative impact on employee morale, or a gain in competitive advantage by our competitors over us. The restructuring efforts could also be disruptive to our day-to-day operations and cause our remaining employees to be less productive, which in turn may affect our revenue and other operating results in the future. In the event that the economy recovers sooner than we expect and results in increased IT spending, we may not have sufficient capacity to capitalize on the related increase in demand for our products and services.

We may undertake future cost-reduction initiatives and restructuring plans that may adversely impact our operations; and we may not realize all of the anticipated benefits of our prior or any future restructurings.

Changes in market conditions have led, and in the future could lead, to charges related to the discontinuance of certain of our products and asset impairments.

In response to changes in economic conditions and market demands, we may be required to strategically realign our resources and consider cost containment measures including restructuring, disposing of, or otherwise discontinuing certain products. Any decision to limit investment in, dispose of, or otherwise exit products may result in the recording of charges to earnings, such as inventory and technology-related or other intangible asset write-offs, workforce reduction costs, charges relating to consolidation of excess facilities, cancellation penalties or claims from third parties who were resellers or users of discontinued products, which would harm our operating results. Our estimates with respect to the useful life or ultimate recoverability of our carrying basis of assets, including purchased intangible assets, could change as a result of such assessments and decisions. Additionally, we are required to perform goodwill impairment tests on an annual basis, and between annual tests in certain circumstances when impairment indicators exist or if certain events or changes in circumstances have occurred. Future goodwill impairment tests may result in charges to earnings, which could materially harm our operating results.

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Our OEM relationship with IBM may not continue to generate significant revenue.

In April 2005, we entered into an OEM agreement with IBM, which enables IBM to sell IBM branded solutions based on NetApp unified solutions, including NearStore® and V-Series systems, as well as associated software offerings. While this agreement is an element of our strategy to expand our reach into more customers and countries, we do not have an exclusive relationship with IBM, and there is no minimum commitment for any given period of time; therefore, this relationship may not continue to contribute revenue in future years. In addition, we have no control over the products that IBM selects to sell, or its release schedule and timing of those products; nor do we control its pricing. In the event that sales through IBM increase, we may experience distribution channel conflicts between our direct sales force and IBM or among our channel partners. If we fail to minimize channel conflicts, our operating results and financial condition could be harmed. We cannot assure you that this OEM relationship will continue to generate significant revenue while the agreement is in effect, or that the relationship will continue to be in effect for any specific period of time.

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 increase revenue is to strategically partner with major third-party software and hardware vendors that integrate our products into their products and also co-market our products with these vendors. We have significant partner relationships with database, business application, backup management and server virtualization companies, including Microsoft, Oracle, SAP, Symantec and VMware. 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 relationships with these or other partners, these partnerships may not generate significant revenue or may not continue to be in effect for any specific period of time. If these relationships fail to materialize as expected, we could suffer delays in product development or other operational difficulties.

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 that we are unsuccessful in developing new relationships or 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 our revenues and operating results.

Disruption of or changes in our distribution model could harm our sales.

If we fail to manage distribution of our products and services properly, or if our distributors financial condition or operations weaken, our revenue and gross margins could be adversely affected.

We market and sell our storage solutions directly through our worldwide sales force and indirectly through channel partners such as value-added resellers, systems integrators, distributors, OEMs and strategic business partners, and we derive a significant portion of our revenue from these channel partners. During the three month period ended July 31, 2009, revenues generated from sales through our channel partners accounted for 69% of our revenues. In order for us to maintain or increase our revenues, we must effectively manage our relationships with channel partners.

Several factors could result in disruption of or changes in our distribution model, which could materially harm our revenues and gross margins, including the following:

- We compete with some of our channel partners through our direct sales force, which may lead these partners to use other suppliers who do not directly sell their own products;

Our channel partners may demand that we absorb a greater share of the risks that their customers may ask them to bear;

Our channel partners may have insufficient financial resources and may not be able to withstand changes and challenges in business conditions; and

Revenue from indirect sales could suffer if our channel partners financial condition or operations weaken.

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In addition, we depend on our channel partners to comply with applicable regulatory requirements in the jurisdictions in which they operate. Their failure to do so could have a material adverse effect on our revenues and operating results.

The U.S. government has contributed to our revenue growth and has become an important customer for us. Future revenue from the U.S. government is subject to shifts in government spending patterns. A decrease in government demand for our products could materially affect our revenues. In addition, our business could be adversely affected as a result of future examinations by the U.S. government.

The U.S. government has become an important customer for the storage market and for us; however, government demand is unpredictable, and there can be no assurance that we will maintain or grow our revenue from the U.S. government. Government agencies are subject to budgetary processes and expenditure constraints that could lead to delays or decreased capital expenditures in IT spending. If the government or individual agencies within the government reduce or shift their capital spending patterns, our revenues and operating results may be harmed.

In addition, selling our products to the U.S. government also subjects us to certain regulatory requirements. The failure to comply with these requirements could subject us to fines and other penalties, which could have a material adverse effect on our revenues and operating results. For example, in April 2009, we entered into a settlement agreement with the United States of America, acting through the United States Department of Justice (DOJ) and on behalf of the General Services Administration (the GSA), under which we paid the United States $128.0 million, plus interest of $0.7 million, related to a dispute regarding our discount practices and compliance with the price reduction clause provisions of its GSA contracts between August 1997 and February 2005. We are currently in discussions with the U.S. government to demonstrate that we have implemented processes and procedures to ensure that we comply with federal contracting rules. If we are unable to demonstrate to the U.S. government that we have implemented such improved policies and procedures or if we are subject to an adverse outcome in any future examinations of our federal contracting practices, we could be suspended or debarred from contracting with the U.S. government generally, or with any specific agency, which could materially and adversely affect our revenue and operating results.

A portion of our revenue is generated by large, recurring purchases from various customers, resellers and distributors. A loss, cancellation or delay in purchases by these parties has and could continue to negatively affect our revenue.

During the three month period ended July 31, 2009, Arrow and Avnet, who are U.S. distributors, each accounted for approximately 11% of our revenues. The loss of continued orders from any of our more significant customers, strategic partners, distributors or resellers could cause our revenue and profitability to suffer. Our ability to attract new customers will depend on a variety of factors, including the cost-effectiveness, reliability, scalability, breadth and depth of our products.

We generally do not enter into binding purchase commitments with our customers for an extended period of time, and thus we may not be able to continue to receive large, recurring orders from these customers, resellers or distributors. For example, our reseller agreements generally do not require minimum purchases and our customers, resellers and distributors can stop purchasing and marketing our products at any time.

Recent turmoil in the credit markets may further negatively impact our operations by affecting the solvency of our customers, resellers and distributors, or the ability of our customers to obtain credit to finance purchases of our products. If the global economy and credit markets continue to deteriorate and our future sales decline, our financial condition and operating results could be adversely impacted.

Because our expenses are based on our revenue forecasts, a substantial reduction or delay in sales of our products to, or unexpected returns from, customers and resellers, or the loss of any significant customer or reseller, could harm our business. Although our largest customers may vary from period to period, we anticipate that our operating results for any given period will continue to depend on large orders from significant customers. In addition, a change in the mix of our customers could adversely affect our revenue and gross margins.

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We are exposed to the credit risk of some of our customers, resellers, and distributors, as well as credit exposures in weakened markets, which could result in material losses.

Most of our sales to customers are on an open credit basis, with typical payment terms of 30 days in the United States and, because of local customs or conditions, longer in some markets outside the United States. We monitor individual customer payment capability in granting such open credit arrangements, and seek to limit such open credit to amounts we believe the customers can pay. Beyond our open credit arrangements, we also have recourse or nonrecourse customer financing leasing arrangements with third party leasing companies through preexisting relationships with customers. Under the terms of recourse leases, which are treated as off-balance sheet arrangements, we remain liable for the aggregate unpaid remaining lease payments to the third party leasing company in the event that any customers default. We expect demand for customer financing to continue. During periods of economic downturn in the storage industry and the global economy, our exposure to credit risks from our customers increases. In addition, our exposure to credit risks of our customers may increase if our customers and their customers or their lease financing sources are adversely affected by the current global economic downturn, or if there is a continuation or worsening of the downturn. Although we have programs in place to monitor and mitigate the associated risks, such programs may not be effective in reducing our credit risks.

In the past, there have been bankruptcies by our customers both who have open credit and who have lease financing arrangements with us, causing us to incur bad debt charges, and, in the case of financing arrangements, a loss of revenues. There can be no assurance that additional losses will not occur in future periods. Any future losses could harm our business and have a material adverse effect on our operating results and financial condition. Additionally, to the extent that the recent turmoil in the credit markets makes it more difficult for customers to obtain open credit or lease financing, those customers ability to purchase our product could be adversely impacted, which in turn could have a material adverse impact on our financial condition and operating results.

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 but are not limited to:

Fluctuations in our operating results;

Variations between our operating results and either the guidance we have furnished to the public or the published expectations of securities analysts;

Economic developments in the storage and data management market as a whole;

Fluctuations in the valuation of companies perceived by investors to be comparable to us;

Changes in analysts recommendations or projections;

Inquiries by the SEC, NASDAQ, law enforcement, or other regulatory bodies;

International conflicts and acts of terrorism;

Announcements of new products, applications, or product enhancements by us or our competitors;

Changes in our relationships with our suppliers, customers, channel and strategic partners; and

General market conditions, including the recent financial and credit crisis and global economic downturn.

In addition, the stock market has experienced volatility that has particularly affected the market prices of the equity securities of many technology companies. Certain macroeconomic factors such as changes in interest rates, the market climate for the technology sector, and levels of corporate spending on IT, as well as variations in our expected operating performance, could continue to 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 may materially and adversely affect the market price of our common stock.

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If we are unable to develop and introduce new products and respond to technological change, if our new products do not achieve market acceptance, if we fail to manage the transition between our new and old products, or if we cannot provide the expected level of service and support for our new products, our operating results could be materially and 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 storage security appliances and the difficulty in gauging the engineering effort required to produce new products, such products are subject to significant technical risks. 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 and adversely affected. New or additional product introductions increase the complexities of forecasting revenues, and if not managed effectively, may adversely affect our sales of existing products.

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.

As we enter new or emerging markets, we will likely increase demands on our service and support operations and may be exposed to additional competition. We may not be able to provide products, service and support to effectively compete for these market opportunities.

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

The storage markets are intensely competitive and are characterized by rapidly changing technology. In the storage market, our primary and near-line storage system products and our associated software portfolio compete primarily with storage system products and data management software from EMC, Hitachi Data Systems, HP, IBM, and Sun Microsystems. In addition, Dell, Inc. is a competitor in the storage marketplace through its business arrangement with EMC, which allows Dell to resell EMC storage hardware and software products, as well as through Dell s acquisition of EqualLogic, through which Dell offers low-priced storage solutions. In the secondary storage market, which includes the disk-to-disk backup, compliance and business continuity segments, our solutions compete primarily against products from EMC and Sun Microsystems. Our VTL products also compete with traditional tape backup solutions in the broader data backup/recovery space. Additionally, a number of small, newer companies have recently entered the storage systems and data management software markets, the near-line and VTL storage markets and the high-performance clustered storage markets, some of which may become significant competitors in the future.

There has been a trend toward industry consolidation in our markets for several years. For example, in April 2009, Oracle Corporation, one of our strategic partners, announced its plan to acquire Sun Microsystems. We expect this trend to continue as companies attempt to strengthen or hold their market positions in an evolving industry and as companies are acquired or are unable to continue operations. We believe that industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers. 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 may not be able to compete successfully against current or future competitors. Competitive pressures we face could materially and adversely affect our business and operating results.

Our future financial performance depends on growth in the storage and data management markets. If these markets do not perform as we expect and upon which we calculate and forecast our revenues, our operating results will be materially and adversely impacted.

All of our products address the storage and data management markets. Accordingly, our future financial performance will depend in large part on continued growth in the storage and data management markets and on our

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ability to adapt to emerging standards in these markets. The markets for storage and data management have been adversely impacted by the current global economic downturn and may not grow as anticipated or may decline.

Additionally, emerging standards in these markets may adversely affect the 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, pharmaceutical 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 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 we will not be able to expand our product offerings in these market and geographical segments at the rates which we have forecasted.

Supply chain issues, including financial problems of contract manufacturers or component suppliers, or a shortage of adequate component supply or manufacturing capacity that increases our costs or causes a delay in our ability to fulfill orders, could have a material adverse impact on our business and operating results, and our failure to estimate customer demand properly may result in excess or obsolete component supply, which could adversely affect our gross margins.

The fact that we do not own or operate our manufacturing facilities and supply chain exposes us to risks, including reduced control over quality assurance, production costs and product supply, which could have a material adverse impact on the supply of our products and on our business and operating results.

Financial problems of either contract manufacturers or component suppliers could limit supply, increase costs, or result in accelerated payment terms. The loss of any contract manufacturer or key supplier could negatively impact our ability to manufacture and sell our products. Qualifying a new contract manufacturer and commencing volume production is expensive and time-consuming. If we are required to change contract manufacturers, we may lose revenue and damage our customer relationships. Disruption or termination of manufacturing capacity or component supply could delay shipments of our products and could materially and adversely affect our operating results. Such delays could also damage relationships with current and prospective customers and suppliers, and our competitive position and reputation could be harmed.

A return to growth in the economy is likely to put greater pressures on us, our contract manufacturers and our suppliers to accurately project demand and to establish optimal purchase commitment levels. Additionally, the reservation of manufacturing capacity at our contract manufacturers by other companies, inside or outside of our industry, or the inability by us to appropriately cancel, reschedule, or adjust our manufacturing or components requirements based upon business needs could result in either limitation of supply or increased costs from these suppliers.

If we inaccurately forecast demand for our products or if there is lack of demand for our products, we may have excess or inadequate inventory or incur cancellation charges or penalties, which would increase our costs and have an adverse impact on our gross margins.

We rely on a limited number of suppliers for components such as disk drives, computer boards and microprocessors utilized in the assembly of our products. In recent years, rapid industry consolidation has led to fewer component suppliers, which has and could subject us to future periodic supply constraints and price rigidity.

Furthermore, as a result of binding price or purchase commitments with suppliers, we may be obligated to purchase components at prices that are higher than those available in the current market, or in amounts greater than our needs.

In the event that we become committed to purchase components at prices in excess of the current market price when the components are actually used, or are committed to buy components in amounts greater than our needs, our gross margins could decrease.

Component quality is a risk and 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.

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As suppliers upgrade their components, they regularly end of life older components. As we become aware of an end of life situation, we attempt to make purchases or purchase commitments to cover all future requirements or find a suitable substitute component. We may not be able to obtain a sufficient supply of components on a timely and cost effective basis. Our failure to do so may lead to an adverse impact on our business. On the other hand, if we fail to anticipate customer demand properly or if there is reduced demand or no demand for our products, an oversupply of end of life components could result in excess or obsolete components that could adversely affect our gross margins.

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 quality functions to meet anticipated demand. The inability of our contract manufacturers or our component suppliers to provide us with adequate supplies of high-quality products and materials suitable for our needs could cause a delay in our ability to fulfill orders.

We are exposed to fluctuations in the market values of our portfolio investments and in interest rates; impairment of our investments could harm our financial results.

At July 31, 2009, we had $2.7 billion in cash, cash equivalents, available-for-sale securities and restricted cash and investments. We invest our cash in a variety of financial instruments, consisting principally of investments in U.S. Treasury securities, U.S. government agency bonds, corporate bonds, corporate securities, auction rate securities, certificates of deposit, and money market funds, including the Primary Fund. These investments are subject to general credit, liquidity, market and interest rate risks, which have been exacerbated by unusual events such as the financial and credit crisis, and bankruptcy filings in the United States which have affected various sectors of the financial markets and led to global credit and liquidity issues. These securities are generally classified as available-for-sale and, consequently, are recorded on our consolidated balance sheets at fair value with unrealized gains or losses reported as a component of accumulated other comprehensive income (loss), net of tax.

Investments in both fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate debt securities may have their market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates. Currently, we do not use derivative financial instruments in our investment portfolio. We may suffer losses if forced to sell securities that have experienced a decline in market value because of changes in interest rates. Currently, we do not use financial derivatives to hedge our interest rate exposure.

The fair value of our investments may change significantly due to events and conditions in the credit and capital markets. These securities/issuers could be subject to review for possible downgrade. Any downgrade in these credit ratings may result in an additional decline in the estimated fair value of our investments. Changes in the various assumptions used to value these securities and any increase in the markets perceived risk associated with such investments may also result in a decline in estimated fair value. If such investments suffer market price declines, as we experienced with some of our investments during fiscal 2009, we may recognize in earnings the decline in the fair value of our investments below their cost basis when the decline is judged to be other-than-temporary.

As a result of the bankruptcy filing of Lehman Brothers, which occurred during fiscal 2009, we recorded an other-than-temporary impairment charge of $11.8 million on our corporate bonds related to investments in Lehman Brothers securities and approximately $9.3 million on our investments in the Primary Fund that held Lehman Brothers investments. As of July 31, 2009, we have an investment in the Primary Fund, an AAA-rated money market fund at the time of purchase, with a par value of $60.9 million and an estimated fair value of $51.6 million, which suspended redemptions in September 2008 and is in the process of liquidating its portfolio of investments. On December 3, 2008, it announced a plan for liquidation and distribution of assets that includes the establishment of a special reserve to be set aside out of its assets for pending or threatened claims, as well as anticipated costs and expenses, including related legal and accounting fees. On February 26, 2009, the Primary Fund announced a plan to set aside $3.5 billion of the fund s remaining assets as the special reserve which may be increased or decreased as further information becomes available. The Primary Fund has received an SEC order providing that the SEC will supervise the distribution of assets from the Primary Fund. Our pro rata share of the $3.5 billion special reserve is approximately $41.5 million. The Primary Fund plans to continue to make periodic distributions, up to the amount of the special reserve, on a pro-rata basis. We could realize additional losses in our holdings of the Primary Fund and may not receive all or a portion of our remaining balance in the Primary Fund as a result of market conditions and ongoing litigation against the fund.

If the conditions in the credit and capital markets continue to worsen, our investment portfolio may be impacted and we could determine that more of our investments have experienced an other-than-temporary decline in fair value, requiring further impairments, which could adversely impact our financial position and operating results.

Funds associated with certain of our auction rate securities may not be accessible for more than 12 months and our auction rate securities may experience further other-than-temporary declines in value, which would adversely affect our earnings.

Auction rate securities (ARSs) held by us are securities with long-term nominal maturities, which, in accordance with investment policy guidelines, had credit ratings of AAA and Aaa at time of purchase. Interest rates for ARS are reset through a Dutch auction each month, which prior to February 2008 had provided a liquid market for these securities.

Substantially all of our ARSs are backed by pools of student loans guaranteed by the U.S. Department of Education, and we believe the credit quality of these securities is high based on this guarantee. However liquidity issues in the global credit markets resulted in the failure of auctions for certain of our ARS investments, with a par value of $75.2 million at July 31, 2009. For each failed auction, the interest rate resets to a maximum rate defined for each security, and the ARS continue to pay interest in accordance with their terms, although the principal associated with the ARS will not be accessible until there is a successful auction or such time as other markets for ARS investments develop.

As of July 31, 2009, we determined there was a total decline in the fair value of our ARS investments of approximately $6.2 million, of which we recorded temporary impairment charges of $4.1 million, and $2.1 million was recognized as an other-than-temporary impairment charge. In addition, we have classified all of our auction rate securities as long-term assets in our consolidated balance sheets of July 31, 2009 as our ability to liquidate such securities in the next 12 months is uncertain. Although we currently have the ability and intent to hold these ARS investments until recovery in market value or until maturity, if the current market conditions deteriorate further, or the anticipated recovery in market liquidity does not occur, we may be required to record additional impairment charges in future quarters.

Our leverage and debt service obligations may adversely affect our financial condition and results of operations.

As a result of our sale of $1.265 billion of 1.75% convertible senior notes in June 2008 (the Notes), we have a greater amount of long-term debt than we have maintained in the past. We also have a credit facility and various synthetic lease arrangements. In addition, subject to the restrictions in our existing and any future financings agreements, we may incur additional debt. Our maintenance of higher levels of indebtedness could have adverse consequences including:

- Adversely affecting our ability to satisfy our obligations;

- Increasing the portion of our cash flows from operations may have to be dedicated to interest and principal payments and may not be available for operations, working capital, capital expenditures, expansion, acquisitions or general corporate or other purposes;

Impairing our ability to obtain additional financing in the future;

Limiting our flexibility in planning for, or reacting to, changes in our business and industry; and

Making us more vulnerable to downturns in our business, our industry or the economy in general.

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Our ability to meet our expenses and debt obligations will depend on our future performance, which will be affected by financial, business, economic, regulatory and other factors. We will not be able to control many of these factors, such as economic conditions and governmental regulations. Furthermore, our operations may not generate sufficient cash flows from operations to enable us to meet our expenses and service our debt. As a result, we may be required to repatriate funds from our foreign subsidiaries, which could result in a significant tax liability to us. If we are unable to generate sufficient cash flows from operations, or if we are unable to repatriate sufficient or any funds from our foreign subsidiaries, in order to meet our expenses and debt service obligations, we may need to utilize our existing line of credit to obtain the necessary funds, or we may be required to raise additional funds. If we determine it is necessary to seek additional funding for any reason, we may not be able to obtain such funding or, if funding is available, obtain it on acceptable terms. If we fail to make a payment on our debt, we could be in default on such debt, and this default could cause us to be in default on our other outstanding indebtedness.

We are subject to restrictive and financial covenants in our credit facility and synthetic lease arrangements. The restrictive covenants may restrict our ability to operate our business.

Our access to undrawn amounts under our credit facility and the ongoing extension of credit under our synthetic lease arrangements are subject to continued compliance with financial covenants, which could be more challenging in a difficult operating environment. If we do not comply with these restrictive and financial covenants or otherwise default under the facility or arrangements, we may be required to repay any outstanding amounts under this credit facility or repurchase the properties and facility which are subject to the synthetic lease arrangements. If we lose access to these credit facility and synthetic lease arrangements, we may not be able to obtain alternative financing on acceptable terms, which could limit our operating flexibility.

The agreements governing our credit facility and synthetic lease arrangements contain restrictive covenants that limit our ability to operate our business, including restrictions on our ability to:

- Incur indebtedness;
- Incur indebtedness at the subsidiary level;
- Grant liens;
- Sell all or substantially all our assets:
- Enter into certain mergers;
- Change our business;
- Enter into swap agreements;
- Enter into transactions with our affiliates; and
- Enter into certain restrictive agreements.

As a result of these restrictive covenants, our ability to respond to changes in business and economic conditions and to obtain additional financing, if needed, may be significantly restricted. We may also be prevented from engaging in transactions that might otherwise be beneficial to us, such as strategic acquisitions or joint ventures.

We are also required to comply with financial covenants under our credit facility and synthetic lease arrangements, and our ability to comply with these financial covenants is dependent on our future performance, which will be subject to many factors, some of which are beyond our control, including prevailing economic conditions.

Our failure to comply with the restrictive and financial covenants could result in a default under our credit facility and our synthetic lease arrangements, which would give the counterparties thereto the ability to exercise certain rights, including the right to accelerate the amounts owed thereunder and to terminate the arrangement, and could also result in a cross default with respect to our other indebtedness. In addition, our failure to comply with these covenants and the acceleration of amounts owed under our credit facility and synthetic lease arrangements could result in a default under the Notes, which could permit the holders to accelerate the Notes. If all of our debt is accelerated, we may not have sufficient funds available to repay such debt.

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Future issuances of common stock and hedging activities by holders of the Notes may depress the trading price of our common stock and the Notes.

Any new issuance of equity securities, including the issuance of shares upon conversion of the Notes, could dilute the interests of our existing stockholders, including holders who receive shares upon conversion of their Notes, and could substantially decrease the trading price of our common stock and the Notes. We may issue equity securities in the future for a number of reasons, including to finance our operations and business strategy (including in connection with acquisitions, strategic collaborations or other transactions), to increase our capital, to adjust our ratio of debt to equity, to satisfy our obligations upon the exercise of outstanding warrants or options, or for other reasons.

In addition, the price of our common stock could also be affected by possible sales of our common stock by investors who view the Notes as a more attractive means of equity participation in our company and by hedging or arbitrage trading activity that we expect to develop involving our common stock by holders of the Notes. The hedging or arbitrage could, in turn, affect the trading price of the Notes, or any common stock that holders receive upon conversion of the Notes.

Conversion of our Notes will dilute the ownership interest of existing stockholders.

The conversion of some or all of our outstanding Notes will dilute the ownership interest of existing stockholders to the extent we deliver common stock upon conversion of the Notes. Upon conversion of a Note, we will satisfy our conversion obligation by delivering cash for the principal amount of the Note and shares of common stock, if any, to the extent the conversion value exceeds the principal amount. There would be no adjustment to the numerator in the net income per common share computation for the cash settled portion of the Notes as that portion of the debt instrument will always be settled in cash. The number of shares delivered upon conversion, if any, will be included in the denominator for the computation of diluted net income per common share. Any sales in the public market of any common stock issuable upon such conversion could adversely affect prevailing market prices of our common stock. In addition, the existence of the Notes may encourage short selling by market participants because the conversion of the Notes could be used to satisfy short positions, or anticipated conversion of the Notes into shares of our common stock could depress the price of our common stock.

The note hedges and warrant transactions that we entered into in connection with the sale of the Notes may affect the trading price of our common stock.

In connection with the issuance of the Notes, we entered into privately negotiated convertible note hedge transactions with certain option counterparties (the Counterparties), which are expected to reduce the potential dilution to our common stock upon any conversion of the Notes. At the same time, we also entered into warrant transactions with the Counterparties pursuant to which we may issue shares of our common stock above a certain strike price. In connection with these hedging transactions, the Counterparties may have entered into various over-the-counter derivative transactions with respect to our common stock or purchased shares of our common stock in secondary market transactions at or following the pricing of the Notes. Such activities may have had the effect of increasing the price of our common stock. The Counterparties are likely to modify their hedge positions from time to time prior to conversion or maturity of the Notes by purchasing and selling shares of our common stock or entering into other derivative transactions. Additionally, these transactions may expose us to counterparty credit risk for nonperformance. We manage our exposure to counterparty credit risk through specific minimum credit standards and the diversification of counterparties. The effect, if any, of any of these transactions and activities on the market price of our common stock or the Notes will depend, in part, on market conditions and cannot be ascertained at this time, but any of these activities could adversely affect the value of our common stock. In addition, if our stock price exceeds the strike price for the warrants, there could be additional dilution to our shareholders, which could adversely affect the value of our common stock.

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

Our synthetic leases are off-balance sheet arrangements that could negatively affect our financial condition and results. We have invested substantial resources in new facilities and physical infrastructure, which will increase our fixed costs. Our operating results could be harmed if our business does not grow proportionately to our increase in fixed costs.

We have various synthetic lease arrangements with BNP Paribas Leasing Corporation as lessor (BBPPLC) for our headquarters office buildings and land in Sunnyvale, California. These synthetic leases qualify for operating lease accounting treatment under SFAS No. 13, *Accounting for Leases (as amended)*, and are not considered variable interest entities under FIN No. 46R *Consolidation of Variable Interest Entities (revised).* Therefore, we do not include the properties or the associated debt on our condensed consolidated balance sheet. However, if circumstances were to change regarding our or BNPPLC s ownership of the properties, or in BNPPLC s overall portfolio, we could be required to consolidate the entity, the leased facilities and the associated debt.

Our future minimum lease payments under these synthetic leases limit our flexibility in planning for, or reacting to, changes in our business by restricting the funds available for use in addressing such changes. If we are unable to grow our business and revenues proportionately to our increase in fixed costs, our operating results will be harmed. If we elect not to purchase the properties at the end of the lease term, we have guaranteed a minimum residual value to BNPPLC. Therefore, if the fair value of the properties declines below that guaranteed minimum residual value, our residual value guarantee would require us to pay the difference to BNPPLC, which could have a material adverse effect on our cash flows, financial condition and operating results.

Reductions in headcount growth have resulted in excess capacity and vacant facilities. In addition, we may experience changes in our operations in the future that could result in additional excess capacity and vacant facilities. We will continue to be responsible for all carrying costs of these facilities operating leases until such time as we can sublease these facilities or terminate the applicable leases based on the contractual terms of the operating lease agreements, and these costs may have an adverse effect on our business, operating results and financial condition.

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

We conduct a significant portion of our business outside the United States. A substantial portion of our revenues is derived from sales outside of the U.S. During the three month periods ended July 31, 2009 and July 25, 2008, our international revenues accounted for 44% and 46% of our total revenues, respectively. In addition, we have several research and development centers overseas, and a substantial portion of our products are manufactured outside of the U.S. Accordingly, our business and our future operating results could be materially and adversely affected by a variety of factors affecting our international operations, 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. In addition, we may not be able to maintain or increase international market demand for our products.

We face exposure to adverse movements in foreign currency exchange rates as a result of our international operations. These exposures may change over time as business practices evolve, and they could have a material adverse impact on our financial results and cash flows. 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. Conversely, lowering our price in local currency may result in lower U.S.-based revenue. A decrease in the value of the U.S. dollar relative to

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foreign currencies could increase the cost of local operating expenses. Additionally, we have exposures to emerging market currencies, which can have extreme currency volatility. We utilize forward and option contracts to hedge our foreign currency exposure associated with certain assets and liabilities as well as anticipated foreign currency cash flows. All balance sheet hedges are marked to market through earnings every quarter. The time-value component of our cash flow hedges is recorded in earnings while all other gains and losses are marked to market through other comprehensive income until forecasted transactions occur, at which time such realized gains and losses are recognized in earnings. These hedges attempt to reduce, but do not always entirely eliminate, the impact of currency exchange movements. Factors that could have an impact on the effectiveness of our hedging program include the accuracy of forecasts and the volatility of foreign currency markets as well as widening interest rate differentials and the volatility of the foreign exchange market. 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 and difficulties in managing international operations. Such factors could materially and adversely affect our future international sales and consequently our operating results. Our international operations are subject to other risks, including general import/export restrictions and the potential loss of proprietary information due to piracy, misappropriation or laws that may be less protective of our intellectual property rights than U.S. law.

Moreover, in many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by regulations applicable to us, such as the Foreign Corrupt Practices Act. Although we implement policies and procedures designed to ensure compliance with these laws, our employees, contractors and agents, as well as those companies to which we outsource certain of our business operations, may take actions in violation of our policies. Any such violation, even if prohibited by our policies, could subject us to fines and other penalties, which could have a material adverse effect on our business, financial condition or results of operations.

We have credit exposure to our hedging counterparties.

In order to minimize volatility in earnings associated with fluctuations in the value of foreign currency relative to the U.S. Dollar, we utilize forward and option contracts to hedge our exposure to foreign currencies. As a result of entering into these hedging contracts with major financial institutions, we may be subject to counterparty nonperformance risk. Should there be a counterparty default, we could be exposed to the net losses on the original hedge contracts or be unable to recover anticipated net gains from the transactions.

A significant portion of our cash and cash equivalents balances is held overseas. If we are not able to generate sufficient cash domestically in order to fund our U.S. operations and strategic opportunities and service our debt, we may incur a significant tax liability in order to repatriate the overseas cash balances, or we may need to raise additional capital in the future.

A portion of our earnings which is generated from our international operations is held and invested by certain of our foreign subsidiaries. These amounts are not freely available for dividend repatriation to the United States without triggering significant adverse tax consequences, which could adversely affect our financial results. As a result, unless the cash generated by our domestic operations is sufficient to fund our domestic operations, our broader corporate initiatives such as stock repurchases, acquisitions, and other strategic opportunities, and to service our outstanding indebtedness, we may need to raise additional funds through public or private debt or equity financings, or we may need to expand our existing credit facility to the extent we choose not to repatriate our overseas cash. Such additional financing may not be available on terms favorable to us, or at all, and any new equity financings or offerings would dilute our current stockholders ownership. Furthermore, lenders, particularly in light of the current challenges in the credit markets, may not agree to extend us new, additional or continuing credit. If adequate funds are not available, or are not available on acceptable terms, we may be forced to repatriate our foreign cash and incur a significant tax expense or we may not be able to take advantage of strategic opportunities, develop new products, respond to competitive pressures or repay our outstanding indebtedness. In any such case, our business, operating results or financial condition could be materially adversely affected.

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Changes in our effective tax rate or adverse outcomes resulting from examination of our income tax returns could adversely affect our results.

Our effective tax rate could be adversely affected by several factors, many of which are outside of our control, including:

Earnings being lower than anticipated in countries where we are taxed at lower rates as compared to the U.S. statutory tax rate;

Material differences between forecasted and actual tax rates as a result of a shift in the mix of pretax profits and losses by tax jurisdiction, our ability to use tax credits, or effective tax rates by tax jurisdiction that differ from our estimates;

Changing tax laws or related interpretations, accounting standards, regulations, and interpretations in multiple tax jurisdictions in which we operate, as well as the requirements of certain tax rulings;

An increase in expenses not deductible for tax purposes, including certain stock-based compensation expense, write-offs of acquired in-process research and development, and impairment of goodwill;

The tax effects of purchase accounting for acquisitions and restructuring charges that may cause fluctuations between reporting periods;

Changes related to our ability to ultimately realize future benefits attributed to our deferred tax assets, including those related to other-than-temporary impairments;

Tax assessments resulting from income tax audits or any related tax interest or penalties could significantly affect our income tax expense for the period in which the settlements take place; and

A change in our decision to indefinitely reinvest foreign earnings.

We receive significant tax benefits from sales to our non-U.S. customers. These benefits are contingent upon existing tax regulations in the United States and in the countries in which our international operations are located. Future changes in domestic or international tax regulations could adversely affect our ability to continue to realize these tax benefits. We have not provided for United States federal and state income taxes or foreign withholding taxes that may result on future remittances of undistributed earnings of foreign subsidiaries. The Obama administration recently announced several proposals to reform United States tax rules, including proposals that may result in a reduction or elimination of the deferral of United States income tax on our future unrepatriated earnings. Absent a restructuring of some legal entities and their functionality, some of the future unrepatriated earnings would be taxed at the United States federal income tax rate.

Additionally, the United States Court of Appeals for the Ninth Circuit on May 27, 2009 held in Xilinx Inc. v. Commissioner that stock-based compensation must be included in the research and development cost base of companies that have entered into a cost sharing arrangement and must, therefore, be allocated among the participants based on anticipated benefits. The Court s reversal of the prior U.S. Tax Court decision impacts our estimate of tax benefits that are required to be recognized under Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109 . We have evaluated the impact of the Xilinx case on our provision for income taxes for the first quarter of fiscal 2010 and have established additional liabilities for uncertain tax positions of $32.6 million. This additional liability for uncertain tax positions results in a reduction of our unrecognized tax attributes.

Our international operations currently benefit from a tax ruling concluded in the Netherlands, which expires in 2010. If we are unable to negotiate a similar tax ruling upon expiration of the current ruling, our effective tax rate could increase and our operating results could be adversely affected. Our effective tax rate could also be adversely affected by different and evolving interpretations of existing law or regulations, which in turn would negatively impact our operating and financial results as a whole. Our effective tax rate could also be adversely affected if there is a change in international operations and how the operations are managed and structured. The price of our common stock could decline to the extent that our financial results are materially affected by an adverse change in our effective tax rate.

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We are currently undergoing federal income tax audits in the United States and several foreign tax jurisdictions. The rights to some of our intellectual property (IP) are owned by certain of our foreign subsidiaries, and payments are made between U.S. and foreign tax jurisdictions relating to the use of this IP in a qualified cost sharing arrangement. In recent years, several other U.S. companies have had their foreign IP arrangements challenged as part of IRS examinations, which has resulted in material proposed assessments and/or pending litigation with respect to those companies. During fiscal 2009, we received Notices of Proposed Adjustments from the IRS in connection with federal income tax audits conducted with respect to our fiscal 2003 and 2004 tax years. If the ultimate determination of income taxes assessed under the current IRS audit or under audits being conducted in any of the other tax jurisdictions in which we operate results in an amount in excess of the tax provision we have recorded or reserved for, our operating results, cash flows and financial condition could be adversely affected.

Our acquisitions may not provide the anticipated benefits and may disrupt our existing business.

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. The success our acquisitions is impacted by a number of factors, and may be subject to the following risks:

The inability to successfully integrate the operations, technologies, products and personnel of the acquired companies;

The diversion of management s attention from normal daily operations of the business;

The loss of key employees;

Substantial transaction costs and accounting charges; and

Exposure to litigation related to acquisitions.

Any future acquisitions may also result in risks to our existing business, including:

Dilution of our current stockholders percentage ownership to the extent we issue new equity;

Assumption of additional liabilities;

Incurrence of additional debt or a decline in available cash;

Adverse effects to our financial statements, such as the need to make large and immediate write-offs or the incurrence of restructuring and other related expenses;

Liability for intellectual property infringement and other litigation claims, which we may or may not be aware of at the time of acquisition; and

Creation of goodwill or other intangible assets that could result in significant future amortization expense or impairment charges.

The failure to achieve the anticipated benefits of an acquisition may also result in impairment charges for goodwill or acquired intangibles. For example, in fiscal 2009 we announced our decision to cease the development and availability of our SMOS product, which was originally acquired through our acquisition of Topio, Inc. in fiscal 2007, resulting in the impairment of acquired intangibles related to such acquisition. Additional or realized risks of this nature could have a material adverse effect on our business, financial condition and results of operations.

The occurrence of any of the above risks could seriously harm our business.

We may face increased risks and uncertainties related to our current or future investments in nonmarketable securities of private companies, and these investments may not achieve our objectives.

On occasion, we make strategic investments in nonmarketable securities of development stage entities. As of July 31, 2009, the carrying value of our investments in nonmarketable securities totaled $2.3 million. Investments in nonmarketable securities are inherently risky, and some of these companies are likely to fail. Their success (or lack thereof) is dependent on product development, market acceptance, operational efficiency and other key business success factors. In addition, depending on these companies future prospects, they may not be able to raise additional funds when needed, or they may receive lower valuations, with less favorable investment terms than in previous financings, and our investments in them would likely become impaired. We could lose our entire investment in these companies. For example, during fiscal 2009 we determined that our investments in nonmarketable securities of two companies had been impaired, and we recorded impairment charges of $6.3 million.

If we are unable to establish fair value for any undelivered element of a sales arrangement, all or a portion of the revenue relating to the arrangement could be deferred to future periods.

In the course of our sales efforts, we often enter into multiple element arrangements that include our systems and one or more of the following undelivered software-related elements: software entitlements and maintenance, premium hardware maintenance, and storage review services. If we are required to change the pricing of our software related elements through discounting, or otherwise introduce variability in the pricing of such elements, we may be unable to maintain Vendor Specific Objective Evidence of fair value of the undelivered elements of the arrangement, and would therefore be required to delay the recognition of all or a portion of the related arrangement. A delay in the recognition of revenue may cause fluctuations in our financial results and may adversely affect our operating margins.

We are continually seeking ways to make our cost structure more efficient, including moving activities from higher- to lower-cost owned locations, as well as outsourcing certain business process functions. Problems with the execution of these changes could have an adverse effect on our business or results of operations.

We continuously seek to make our cost structure more efficient. We are focused on increasing workforce flexibility and scalability, and improving overall competitiveness by leveraging our global capabilities, as well as external talent and skills worldwide. For example, certain engineering activities and projects that were formerly performed in the U.S. have been moved to lower cost international locations. The challenges involved with these initiatives include executing business functions in accordance with local laws and other obligations while maintaining adequate standards, controls and procedures.

In addition, we will rely on partners or third party service providers for the provision of certain business process functions and activities in IT, human resources and accounting, and as a result, we may incur increased business continuity risks as we increase our reliance on such parties. For example, we may no longer be able to exercise control over some aspects of the future development, support or maintenance of outsourced operations and processes, including the management and internal controls associated with those outsourced business operations and processes, which could adversely affect our business. If we are unable to effectively utilize or integrate and interoperate with external resources or if our partners or third party service providers experience business difficulties or are unable to provide business services as anticipated, we may need to seek alternative service providers or resume providing these business processes internally, which could be costly and time consuming and have a material adverse effect on our operating results.

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

We depend on the ability of our personnel, raw materials, equipment and products to move reasonably unimpeded around the world. Any political, military, terrorism, global trade, world health or other issue that hinders this movement or restricts the import or export of materials could lead to significant business disruptions. Furthermore, any strike, economic failure or other material disruption caused by fire, floods, hurricanes, power loss, power shortages, telecommunications failures, break-ins and similar events could also adversely affect our ability to conduct business. If such disruptions result in cancellations of customer orders or contribute to a general decrease in economic activity or corporate spending on information technology, or directly impact our marketing, manufacturing, financial and logistics functions, our results of operations and financial condition could be materially adversely affected. 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.

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, background and industry experience. Competition for qualified engineers, particularly in Silicon Valley, can be intense. The loss of the services of a significant number of our engineers or salespeople could be disruptive to our development efforts or business relationships and could materially and adversely affect our operating results.

Undetected software errors, 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. Product quality problems could lead to reduced revenue, gross margins and operating results.

Our products may contain undetected software errors, 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 and adversely affect our operating results.

If we fail to remedy a product defect, we may experience a failure of a product line, temporary or permanent withdrawal from a product or market, damage to our reputation, inventory costs or product reengineering expenses, any of which could have a material impact on our revenue, gross margins and operating results.

In addition, we may be subject to losses that may result from or are alleged to result from defects in our products, which could subject us to claims for damages, including consequential damages. Based on our historical experience, we believe that the risk of exposure to product liability claims is low. However, should we experience increased exposure to product liability claims, our business could be adversely impacted.

We are exposed to various risks related to legal proceedings or claims and protection of intellectual property rights, which could adversely affect our operating results.

We are a party to lawsuits in the normal course of our business, including our ongoing litigation with Sun Microsystems. Litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a particular lawsuit could have a material adverse effect on our business, operating results, or financial condition.

If we are unable to protect our intellectual property, we may be subject to increased competition that could materially and 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 of our U.S. 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 our existing and future patents may be challenged. If such challenges are brought, the patents may be invalidated. We may not be able to develop proprietary products or technologies that are patentable, or where any issued patent will provide us with any competitive advantages or will not be challenged by third parties. Further, the patents of others may materially and adversely affect our ability to do business. In addition, a failure to obtain and defend our trademark registrations may impede our marketing and branding efforts and competitive position.

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 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 United States. Our means of protecting our proprietary rights may not be adequate or our competitors may 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 network storage 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 enter into royalty or licensing agreements, any of which could materially and adversely affect our operating results. Such royalty or licensing agreements, if required, may not be available on terms acceptable to us or at all.

Our business could be materially adversely affected by changes in regulations or standards regarding energy efficiency of our products.

We continually seek ways to increase the energy efficiency of our products. Recent analyses have estimated the amount of global carbon emissions that are due to information technology products. As a result, governmental and non-governmental organizations have turned their attention to development of regulations and standards to drive technological improvements and reduce such amount of carbon emissions. There is a risk that the development of these standards will not fully address the complexity of the technology developed by the IT industry or will favor certain technological approaches. Depending on the regulations or standards that are ultimately adopted, compliance could adversely affect our business, financial condition or operating results.

Our business is subject to increasingly complex corporate governance, public disclosure, accounting and tax requirements that have increased both our costs and the risk of noncompliance.

Because our common stock is publicly traded, we are subject to certain rules and regulations of federal, state and financial market exchange entities charged with the protection of investors and the oversight of companies whose securities are publicly traded. These entities, including the Public Company Accounting Oversight Board, the SEC, and NASDAQ, have implemented requirements and regulations and continue developing additional regulations and requirements in response to corporate scandals and laws enacted by Congress, most notably the Sarbanes-Oxley Act of 2002. Our efforts to comply with these regulations have resulted in, and are likely to continue resulting in, increased general and administrative expenses and diversion of management time and attention from revenue-generating activities to compliance activities.

We completed our evaluation of our internal controls over financial reporting for the fiscal year ended April 24, 2009 as required by Section 404 of the Sarbanes-Oxley Act of 2002. Although our assessment, testing and evaluation resulted in our conclusion that as of April 24, 2009, our internal controls over financial reporting were effective, we cannot predict the outcome of our testing in future periods. If our internal controls are ineffective in future periods, our business and reputation could be harmed. We may incur additional expenses and commitment of management s time in connection with further evaluations, either of which could materially increase our operating expenses and accordingly reduce our operating results.

Because new and modified laws, regulations, and standards are subject to varying interpretations in many cases due to their lack of specificity, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This evolution may result in continuing uncertainty regarding compliance matters and additional costs necessitated by ongoing revisions to our disclosure and governance practices.

Changes in financial accounting standards may cause adverse unexpected fluctuations and affect our reported results of operations.

A change in accounting standards or practices and varying interpretations of existing accounting pronouncements, such as the increased use of fair value measures, changes to standards related to revenue recognition, and the potential requirement that U.S. registrants prepare financial statements in accordance with International Financial

Reporting Standards (IFRS), could have a significant effect on our reported financial results or the way we conduct our business.

Item 2. ***Unregistered Sales of Equity Securities and Use of Proceeds***

The following table provides information as of July 31, 2009 with respect to the shares of common stock repurchased by NetApp during the three month period ended July 31, 2009:

Period	Total Number of Shares Purchased(1) (Shares in thousands)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program(2) (Shares in thousands)	Approximate Dollar Value of Shares that may yet be Purchased Under the Repurchase Program(2) (Dollars in millions)
April 25, 2009 May 22, 2009	240	$ 18.27		$ 1,096
May 23, 2009 June 26, 2009	27	$ 19.42		$ 1,096
June 27, 2009 July 31, 2009	7	$ 20.83		$ 1,096
Total	274	$ 18.45		$ 1,096

(1) Consists of shares repurchased to satisfy tax withholding obligations that arose on the vesting of shares of restricted stock units.

(2) On May 13, 2003, we announced that our Board of Directors had authorized a stock repurchase program. As of July 31, 2009, our Board of Directors had authorized the repurchase of up to $4,023,638,730 of common stock under this program. We did not repurchase any common stock during the three month period ended July 31, 2009. As of July 31, 2009, we had repurchased 104,325,286 shares of our common stock at a weighted-average price of $28.06 per share for an aggregate purchase price of $2,927,376,373 since inception of the stock repurchase program, and the remaining authorized amount for stock repurchases under this program was $1,096,262,357 with no termination date.

Item 3. ***Defaults upon Senior Securities***

None

Item 4. ***Submission of Matters to a Vote of Security Holders***

None

Item 5. ***Other Information***

None.

Item 6. ***Exhibits***

See the Exhibit Index immediately following the signature page of this Quarterly Report on Form 10-Q.

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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.

NETAPP, INC.
(Registrant)

/s/ STEVEN J. GOMO

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

Date: September 4, 2009

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EXHIBIT INDEX

Exhibit No	Description
3.1(1)	Certificate of Incorporation of the Company, as amended.
3.2	Bylaws of the Company, as amended.
10.1(2)	Agreement and Plan of Merger, dated as of May 20, 2009, by and among NetApp, Inc., Data Domain, Inc., Kentucky Merger Sub One Corporation, a direct, wholly-owned subsidiary of NetApp, Inc., and Derby Merger Sub Two LLC, a direct, wholly-owned subsidiary of NetApp, Inc.
10.2(2)	Amendment No. 1 to Agreement and Plan of Merger, dated June 3, 2009, by and among NetApp, Inc., Data Domain, Inc., Kentucky Merger Sub One Corporation, a direct, wholly-owned subsidiary of NetApp, Inc., and Derby Merger Sub Two LLC, a direct, wholly-owned subsidiary of NetApp, Inc.
10.3	Termination Notice under Agreement and Plan of Merger, dated July 8, 2009, by and among NetApp, Inc., Data Domain, Inc., Kentucky Merger Sub One Corporation, a direct, wholly-owned subsidiary of NetApp, Inc., and Derby Merger Sub Two LLC, a direct, wholly-owned subsidiary of NetApp, Inc.
31.1	Certification of the Chief Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

(1) Previously filed as an exhibit to the Company s Annual Report on Form 10-K dated June 24, 2008.

(2) Previously filed as an exhibit to Registration Statement on Form S-4, as filed with the SEC on July 2, 2009.