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Steven J. Gomo – Chief Financial Officer & Executive Vice President
Nicholas Noviello – Senior Vice President-Finance & Controller
Thomas Georgens – President, Chief Executive Officer & Director

Other Participants

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Mark A. Moskowitz – Analyst, JPMorgan Securities LLC
Aaron C. Rakers – Analyst, Stifel, Nicolaus & Co., Inc.
Jayson Noland – Analyst, Robert W. Baird & Co. Equity Capital Markets
Bill C. Shope – Analyst, Goldman Sachs & Co.
Brian Marshall – Analyst, International Strategy & Investment Group, Inc.
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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the NetApp Second Quarter Fiscal Year 2012 Conference Call. My name is John, and I'll be your operator for today's call. [Operator Instructions] Please note that this conference is being recorded.

I will now turn the call over to Ms. Tara Dhillon. Ms. Dhillon, you may begin.

Tara Dhillon, Vice President, Investor Relations

Good afternoon, everyone. Thank you for joining us. With me on today's call are our CEO, Tom Georgens; our CFO, Steve Gomo; and our SVP and Global Controller, Nick Noviello. This call is being webcast live and will be available for replay on our website, at netapp.com, along with the earnings release, the supplemental commentary, our financial tables, and the non-GAAP to GAAP reconciliation.

As a reminder, during today's call, we will make forward-looking statements and projections, including our financial outlook for Q3 and future operating metrics, the benefits to us and our customers of new product introductions, the adequacy of our future inventory supply, our expectations regarding our future competitive position, and the benefits we expect from our partnerships and strategic alliances, all of which involve risk and uncertainty.

Actual results may differ materially from our statements and projections. Factors that could cause actual results to differ include, among others, general macroeconomic and market conditions,

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particularly the continuing fiscal challenges in the U.S. and Europe; the effects of the flooding in Thailand; customer demand for our products and services, including our recently announced new product introductions; and other equally important factors which are detailed in our accompanying press release, which we have filed on an 8-K with the SEC, as well our 10-K and 10-Q reports, also on file with the SEC and available on our website, all of which are incorporated by reference into today's discussion.

All numbers discussed today are GAAP unless stated otherwise. To see the reconciling items between non-GAAP and GAAP, you may refer to the table in our press release, our supplemental commentary, or on our website.

In a moment, Steve will provide you with some additional color on our financial results, Nick will walk you through our guidance for Q3 of FY '12, and then Tom will walk you through his perspective on the business this quarter.

I'll now turn the call over to Steve for his thoughts. Steve?

Steven J. Gomo, Chief Financial Officer & Executive Vice President

Thank you, Tara, and good afternoon, everyone. This quarter's financial performance can be characterized by its contrasts. In terms of business demand, we continue to see strength across most of our business, with some normal puts and takes. For instance, our European enterprise and our Asia-Pac geographies were robust, and our E-Series OEM had another stellar quarter. Similarly, our volume channel businesses were very strong, and our largest channel partners demonstrated solid growth. Where we saw under-performance to our revenue forecast was in our major account program.

Our Q2 guidance included an analysis of the business dynamics associated with these large accounts, their seasonality, as well relatively modest expectations for sequential revenue growth from them. Of the 46 accounts in the program, just nine of the U.S. accounts produced the entire shortfall from the midpoint of our revenue guidance. Nevertheless, despite lower than expected revenue, both our non-GAAP operating margin and non-GAAP earnings per share were quite strong, with non-GAAP EPS above our targeted range and at record levels.

Our total OEM revenues were strong this quarter, at $230 million, growing 8% sequentially from Q1. NetApp branded revenues grew 3% sequentially, impacted primarily by softness in those nine major accounts I just mentioned. Software entitlements and maintenance revenue and services revenue showed a sequential decline this quarter. In the case of SEM, the revenue decline was a function of a minor perturbation in our deferred revenue schedule. For the services revenue, the sequential decline was due to a Q2 drop in professional services revenue, which tends to be lumpy.

The underlying revenue growth trends for both SEM and service maintenance contracts remain intact. Moreover, our deferred revenue balance increased by $56 million sequentially and grew 25% year-over-year. We expect that the absolute revenue level will increase for both of these revenue categories next quarter.

Our non-GAAP product gross margins declined 0.6 percentage points from Q1 levels, as the favorable effects of increased volume and configuration mix were more than offset by increased mix of E-Series OEM business, warranty costs, and some pricing discounts. Normalizing for mix, these product margins remained within the range of our expectations. Non-GAAP service gross margin declined 3.2 percentage points sequentially, primarily as a result of a loss on a single transaction. We expect the services margin to bounce back next quarter. The underlying service maintenance contract gross margin remains very healthy.

Our non-GAAP operating expenses increased less than 1% sequentially this quarter, as we maintained our discipline on expense management. Employment growth moderated during the quarter and was lower than every quarter in the past year. The Q2 non-GAAP tax rate was also lower than forecast, finishing the quarter at 16.4%, as we are now anticipating a larger mix of our FY '12 pre-tax earnings will come from international geographies. We expect our tax rate to return to about 17.5% next quarter and average 17.5% for FY '12.

Our balance sheet remains strong, with approximately $4.6 billion in cash and investments, down only slightly from Q1, despite the $400 million accelerated share repurchase we executed early in the quarter. Our accounts receivable days sales outstanding was relatively steady, as it increased to 38 days from the 37 days reported in Q1. Inventory turns decreased again this quarter, to 14.1 times.

There are several reasons for this, including a large proactive pre-buy of flash memory and a large disk drive pre-buy as the flooding in Thailand was unfolding. We believe we will have sufficient drive inventory through the end of December, but it's difficult for anyone to predict the business impact beyond that.

Cash from operations, at $370 million, increased 4% from the same period last year. Free cash flow finished the quarter at $277 million. Our diluted share count decreased by 29.5 million shares sequentially, to about 376 million shares, primarily due to a lower average quarterly share price and to our share repurchase. Our average quarterly closing price was down from last quarter, to $38.25 per share. The accounting for shares associated with our convertible notes and warrants had a large impact, removing about 17 million shares from the diluted share count on a sequential basis, leaving about 7 million shares to account for the convertible notes.

As you may recall, 80% of the convertible notes are hedged. If we were to adjust the share count to reflect the bond hedge, then the non-GAAP EPS would have been about $0.01 higher. You can find a table on our website which shows the impact on the diluted share count for a range of stock prices.

In a moment, I'll turn the call over to Nick to talk with you about our guidance, given that he'll have responsibility for it come January. As I said last quarter, it's been a goal of mine to retire by the time I'm 60, and that milestone is all too close. December 31 will be my last day at NetApp, and therefore this is my last earnings call. I have enjoyed working with all of you over the years, and I hope to have an opportunity to say good-bye over the next six weeks. In the meantime, my CFO responsibilities remain the same as Nick and I work together to facilitate a smooth leadership transition. You will be in great hands come the first of 2012.

So at this point, I'll turn the call over to Nick.

Nicholas Noviello, Senior Vice President-Finance & Controller

Thank you, Steve, and many thanks for your mentorship over the years. I'm sure I speak for everyone at NetApp when I say you will truly be missed.

Now, looking forward, our target revenue range for Q3 is $1.52 billion to $1.61 billion, which at the midpoint implies approximately 4% sequential growth and 21% year-over-year growth. Consolidated non-GAAP gross margins are expected to finish around [ph] 16% (9:05). We expect that non-GAAP operating margins will finish around 17%.

As Steve mentioned earlier, we expect our blended, consolidated non-GAAP effective tax rate to be approximately 17.5%, based upon a shift in distribution of our earnings to our international

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geographies, bringing our non-GAAP earnings per share estimate to approximately $0.56 to $0.60 per share.

Diluted share count is forecast to increase to about 380 million shares in Q3, based on our average stock price of $41.84 for the first ten days of the quarter. This will include about 9 million shares from the convertible notes and 0.5 million shares from the warrants. Recall that the favorable impact of the note hedges is not included as an offset. If we were to adjust the share count for the convertible note hedge, that would add about $0.01 to the EPS guidance.

To summarize, our business model continued to show its underlying resiliency in the second quarter, as we exceeded our operating margin and EPS targets despite some revenue softness. In fact, for the first half, we generated 23% year-over-year revenue growth, at a non-GAAP operating margin of 18.5%. However, the original financial targets we laid out at our analyst day did not foresee the two substantial macroeconomic factors we find ourselves managing through today, those being the increasing economic turmoil in Europe and flooding in Thailand.

These conditions make forecasting both revenue and cost of sales going forward far less predictable. Therefore, we cannot confidently forecast a specific range for Q4 revenue and earnings per share at this time. We will provide you with an update on our Q3 earnings call.

At this point, I'll turn the call over to Tom for his thoughts. Tom?

Thomas Georgens, President, Chief Executive Officer & Director

Thanks, Nick, and good afternoon, everyone. As Steve indicated, the sequential decline in our major account program in a quarter where we expected seasonal growth was the biggest deviation from our forecast. While we were not anticipating sequential growth comparable to last year, we needed better performance from this group to meet our objectives.

Fortunately, most of the unexpected shortfall was confined to a small number of accounts where the customer-specific dynamics can be understood. Unlike last quarter, the companies were not concentrated in any specific industry. Beyond this concentrated shortfall, the rest of the business was generally positive.

The strength in the other areas of our business is evident when looking at it from a geographical perspective. Our U.S. commercial business grew 24% year-over-year. Our Asia-Pacific business grew 55% year-over-year, and our EMEA business grew 12% year-over-year in a challenging environment. Our E-Series OEM business remains well ahead of plan, with 11% sequential growth. We even saw some rebound in spending from the financial services sector. We also saw some budget flush in the U.S. public sector, which while up only 9% year-over-year, it was over a [ph] monster (12:16) compare, and it grew 56% sequentially.

Outside of those nine major accounts, our enterprise business was generally strong. Our number of transactions over $1 million dollars was the second highest ever, increasing 17% sequentially and over 30% year-over-year, while the total net new customer account acquisition is at a 2.5-year high. The volume segments of the business around mid-size enterprise and state, local, and higher education were very robust and were the highest growth areas of the portfolio.

Our emphasis on pathway diversification continues to pay off, as we saw record sales from our indirect channels representing the highest-ever percentage of our revenue. Our largest distribution partners, Arrow and Avnet, grew to 31% of total revenue and grew 18% year-over-year. CBW, our largest reseller in fiscal year '12, grew over 75% year-over-year.

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Our Alliance program continues to generate leverage, as we broaden our portfolio of tightly integrated solution offerings in partnership with other best-of-breed vendors. We are in the process of conducting our Global Insight events, where we train thousands of technical resources, both internally and from our resellers and partners. At the event, we further enhance our solution offerings by introducing four new verified architectures: Microsoft private cloud, Oracle database, media content management, and FlexPod data center solutions.

FlexPod is our modular data center solution, developed in conjunction with Cisco, to provide partners and customers with an integrated, standardized, and scalable infrastructure to support a variety of workloads. Together, we offer validated designs for VMware, SharePoint, SAP, Citrix, and Red Hat Linux. FlexPod had another strong quarter, and our relationship with Cisco continues to deepen as a result. We now have over 400 FlexPod customers and a robust pipeline for future FlexPod business.

On the products side, the newer 3000 and 6000 platforms both had solid quarters. Units shipped of the 3000 were up 34% year-over-year, and FAS6000 units more than doubled over last year's Q2 levels. The 2000 was down year-over-year and down slightly on a sequential basis. We saw decreased demand in both the channel and our large enterprises, as well as a shift in business to the newer 3000 family.

However, last week, we introduced newly designed 2000-class models for this segment with our Smart Decisions are Built on NetApp campaign. With refresh technology, attractive price points, and our latest Data ONTAP 8.1 operating system, it represents a compelling solution for each of its target segments. Our product launch had a particular focus on the mid-size enterprise and our state, local, and higher education channels, where our momentum is strong and the partners are eager to introduce the new offerings to their customers.

In addition to being the standard operating system on our 2000 series, Data ONTAP 8.1 is now available on our 3000 and 6000 platforms. Our 8.1 operating system is the first product in the market to marry the industry's richest portfolio of data management and storage-efficiency technologies with clustering to enable unmatched scalability and non-stop operations.

Previous architectures, including both traditional approaches and newer niche implementations, have forced customers to make tradeoffs amongst these features. NetApp is the only vendor to have the functionality and configurability to produce optimized solutions for the widest range of applications, including virtualization, technical computing, content repositories, and traditional business applications, all from a single architecture.

Evidence of its scalability was demonstrated when we recently published compelling results from an independent APEC SFS benchmark test in which a 24-node cluster of NetApp FAS6000s running 8.1 produced 1.5 million ops per second. This is over 35% faster than the previous record, and we did it with 50% fewer disks and 80% fewer controller nodes, demonstrating a real-world configuration with far better results and far lower cost.

Our total E-Series product family continues to make a big impact as well. Our 14% sequential growth was driven by especially strong demand from Teradata and Dell, but our other two major OEMs, IBM and Oracle, were up sequentially as well. We have been sufficiently clear about our commitment to this business, initially in words, and now in behavior, that each of our major OEM partners have confirmed the expectation of an ongoing relationship, and a couple have already introduced new offerings based on the E-Series technology.

The E-Series products are also key to our big data strategy in the areas of analytics and big bandwidth. For analytics, E-Series has now been designed into three integrated analytic appliances. We also have integrated it into our initial Hadoop solutions and partner engagements.

For big bandwidth, we are continually broadening the solution offerings to our field, enabling some high-profile, full-motion video and high-performance computing wins.

All in all, our business operated largely within the bounds of our expectation this quarter, and were it not for the exception of an unexpectedly large slowdown in a handful of our biggest accounts, we would have at least been at the midpoint of our targeted revenue range. Given continued instability in Europe, the persistent economic concerns in the U.S., and the associated uncertainty around federal spending, all things considered, the rest of the business was essentially in line or slightly better than we anticipated 90 days ago.

Nonetheless, in response to the aggregate revenue performance, the organization once again demonstrated its ability to manage to the business model, enabling us to increase operating margins over last quarter and produce record earnings per share.

Looking ahead, the impact of the Thailand flooding could potentially be the biggest swing factor on both our top and bottom line in the second half. The large buy of drives we did as this was all unfolding should sustain us through a good part of Q3, but probably not all of it. Although enterprise-class drives are considered to be the least impacted, we still anticipate some amount of supply and pricing complexity.

We have all heard the predictions of the industry analysts and the drive vendors themselves. Some of the information is conflicting, and most of it is changing daily in regards to scope and ultimate impact. I expect NetApp to fare better than most in this process, but it is far too early to state the exact extent this will impact our business, either directly or through our OEM partners.

On the other hand, our FAS business will begin to get uplift from the just-refreshed 2000 Series, and our partners and technical teams are coming off an invigorating symposium where they were briefed on ONTAP 8.1 and competing using NetApp products. I believe NetApp continues to have the best product portfolio and the best partnerships in the industry, both of which will pay off in the long run.

Before I open up the call to Q&A, I'd like to again thank Steve for more than nine years of tremendous contributions to NetApp. I'd also like to congratulate the entire NetApp team for being ranked number three on the World's Best Multinational Workplaces list by the Great Place to Work Institute. The culture at NetApp is one of our keys to success, and this recognition is strong validation of our commitment to creating a model company. It is this commitment that will drive us to continue to gain market share in both good and challenging times.

At this point, I'll open up the call for Q&A. As always, I'll ask that you be respectful of your peers on the call and limit yourself to one question so we can try to address everyone in our allotted time today. Thank you. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Katy Huberty from Morgan Stanley. Please go ahead.

<Q – Katy Huberty – Morgan Stanley & Co. LLC>: Yes, thank you. You obviously did a great job in the channel as well as with signing up new accounts this quarter, but just a question on pricing, because Dell last night talked about more price competition in the mid-range. I wonder if there was some variability in pricing in order for you to win those deals in the mid-range this quarter. Thanks.

<A – Thomas Georgens – NetApp, Inc.>: Katy, I'd say in the channel, probably not so much. Clearly, that's a competitive business, and certainly our largest competitor there is being aggressive in the channel and certainly is doing a number of incentives to gain market share – or gain mindshare. But I would say, frankly, the pricing dynamics are a lot more complicated at the large accounts because they see, obviously, lesser demand and the opportunity to take advantage of that. So I'd say the pricing environment is probably no different, which isn't to say that it's calm. It's just to say that it's no different. But to the extent that pricing is relevant, I'd say it's probably a little bit more on the major account side.

<Q – Katy Huberty – Morgan Stanley & Co. LLC>: Thank you.

Operator: Our next question comes from Mark Moskowitz from JPMorgan. Please go ahead.

<Q – Mark Moskowitz – JPMorgan Securities LLC>: Yes, thank you, and congratulations, Steve, and congratulations to Nick as well on the transition. I wanted to ask you a question, though, Tom, regarding the overall connotation here of unexpected in terms of the unexpected weakness at your largest accounts. Was this due to macro events, company-specific events, NetApp's inability to deliver? Is there a competitive dynamic? I guess if you could just kind of qualify or provide us some context, that would be greatly appreciated.

<A – Thomas Georgens – NetApp, Inc.>: Yeah, I think that there's two things at play here. One of them is the performance of the accounts, and the other one is what was our expectation of the performance. I think there's certainly some accounts that certainly have well-known headlines that we knew, going into the quarter, were going to have some issues associated with them. Certainly, there was concern about the DoD and federal spending, and obviously some individual accounts that we're probably well aware of that we knew were going to be problematic, and we factored that into the forecast.

I think that the other ones, we actually probably expected more of our normal Q1 to Q2 seasonality as we think about them, and that's really not what happened. And I'd also add that these were not necessarily problem accounts. These were accounts – many of them actually on the ascendancy that chose to slow down. So I didn't want to indicate that we actually have nine more problem accounts on our major account portfolio. I think some of those are clearly in the ascendancy with NetApp. It's just that we were expecting more for them this particular quarter.

I think from competitive pressures, I think certainly pricing, clearly, in a market where demand is limited and there's a lot of capacity chasing deals, our customers are using that to their advantage. But from a pure competitive perspective, in those nine accounts, there's probably only one that I would say that has a meaningful competitive component to it, and I think all the other ones are either macro-related or company-specific.

<A – Tara Dhillon – NetApp, Inc.>: Next question, please?

Operator: Our next question comes from Aaron Rakers from Stifel Nicolaus. Please go ahead.

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<Q – Aaron Rakers – Stifel, Nicolaus & Co., Inc.>: Yeah, thanks, guys. Appreciate the question. I want to ask on – first of all, clarification. I heard you say 11% sequential growth on the E-Series, and then I also heard you say 14% sequential, so clarifying that. And then if I look at that and I look at your organic revenue growth at roughly 6% by my math, I know you talk about gaining market share in down and up markets. How do we think about your organic growth profile, or how are you thinking about the organic growth profile here over the next couple of quarters in that mindset of what is the market going to grow here looking out into 2012? Thank you.

<A – Thomas Georgens – NetApp, Inc.>: Yeah, I think, first of all, on the E-Series, probably the two different data points, one was E-Series OEM business and the other one was E-Series overall, so the E-Series OEM business had a more natural compare. The overall, since it was really just started with a branded business, that's why that number was a little bit higher, and of course those are a revenue number. I believe on the last call I talked about a large $14 million deal that would not come to revenue this quarter, and that's clearly still true, if you're wondering where the $14 million went.

I think on the broader question, the real question here, as we think about the market and we think about the macro, NetApp focuses almost exclusively on market share because that's really the true measure of our penetration. And the key component in market share, or the only thing that gets actually counted in the market share as reported by the industry analysts, is actually product revenue growth. So as we think about companies in this space with product transitions and acquisitions, and I think we're dealing with a different macro environment this year than we were last year, I think probably it might be the best way to think about that is actually thinking about sequential growth. So if I look at our sequential growth from last quarter, it was about 5.2% on the product side.

So if I compare that to, say, EMC's product growth in storage in the most recent quarter, I think that number is about 1.2%. So you could say, well, it's a NetApp Q1 to Q2 and for them it's a Q2 to Q3, but if you go back another quarter with EMC and look at the Q1 to Q2 transition for them, that's only about 2%. So in terms from a market share perspective, which is really a measure of product growth, NetApp actually had more sequential growth in the last three months than EMC has had in the last six months on a percentage basis. So to the extent that we're the number 1 and number 2 market share players in this market, I'd have to think that our market share gains are greater than theirs.

<A – Tara Dhillon – NetApp, Inc.>: Next question, please?

Operator: Our next question comes from Jayson Noland from Robert W. Baird. Please go ahead.

<Q – Jayson Noland – Robert W. Baird & Co. Equity Capital Markets>: Great, thank you. And, Steve, good luck with the next step. A question for you or Nick, just trying to get a sense for what's in the guidance, the expectations for the 2240. Are you assuming constraints in the HDD world? And then on the major accounts, is there any push out there into this upcoming quarter?

<A – Nicholas Noviello – NetApp, Inc.>: Sure, Jayson. It's Nick. Just to give you some perspective on the new products, certainly, there is pickup of new products that's built into the guidance. As we mentioned, on the drive side of the fence, we talked about availability through the end of the calendar year. Certainly it gets a little bit more complicated once you get into the new year. So what we've built in on the guidance side is many of the positives that we talked about for this quarter continuing, the new products coming in, but those overall constraints on drives from Thailand and macro being there that we have to consider when we built the guidance.

<A – Thomas Georgens – NetApp, Inc.>: The one other thing I'd say on the 2240 is we've seen a decline in low-end units over the past – really pretty much over the last nine months or so, and I would say it would be real easy for us to just say we should expect to get all those units back and it will all be incremental. But the other thing to notice about our business is that the segments in the market that are most dependent upon products of that class, which is our volume channel business, have been the strongest part of our business, so clearly they've moved some of the demand to the newer 3000. So I would expect some of that demand to actually come back from the 3000 into the 2000. So I wouldn't – it would be real easy for me to say that it will all be incremental, but I think that there will be some reverse cannibalization of the 3000 just like we saw when the 3000 came out.

As far as the enterprise and Department of Defense or just, say, U.S. public sector, those are big consumers of this class of product as well. And there are some attributes of this product in terms of size and compatibility with prior products which actually will enable a product transition in our favor here that was held up at the previous generation. So I do expect not only this to impact our channel business, but I do expect it to impact on enterprise and our U.S. public sector business as well.

<Q – Jayson Noland – Robert W. Baird & Co. Equity Capital Markets>: Thanks, Tom.

Operator: Our next question comes from Bill Shope from Goldman Sachs. Please go ahead.

<Q – Bill Shope – Goldman Sachs & Co.>: Okay, great. Thanks, guys. I'm a little confused on the weakness in the nine accounts. Can you help us understand – I understand you can't lump in the weakness into one specific reason for all of them, but how are you addressing the weakness? Is there some execution issues that you're looking at? And my memory may be foggy, but this sounds somewhat similar to the shortfall you guys had in mid-2007, where you had some issues with large accounts. And I know you were able to reconcile that with basically a different approach to a broader customer base. How should we compare it to that prior hiccup, understanding that there was a big recession a year later, and how should we think about how you're addressing this weakness, and preventing it from spreading, frankly?

<A – Thomas Georgens – NetApp, Inc.>: Yeah, I think if we think about it from last quarter, clearly, the federal side was a concern for us. We were wrapping up the quarter in the face of the debt ceiling crisis, and I don't really know whether that impacted us or not, but we also – on the last call we talked about the U.S. public sector and we talked about financial services. So you can actually argue that it's actually even more concentrated than it was last quarter, so instead of spreading, it might actually be contracting. And as far as the accounts, we need to look at every single one of them. One of them clearly is really competitive – or largely competitive, and I think we need to take that on clearly, and I don't think that's lost on anybody.

But I think most of the other ones, I think most of those are accounts that are actually doing quite well from a NetApp perspective, and they took a pause, and some of them, obviously, we did some insight to see when we expect them to come back. Some of them will. Some of them will pause a little bit longer based on their own company dynamics. So I think that the advantage of it having been a definable set of named accounts is that we can build an action plan around every single one of them, as opposed to if we saw broad weakness in the channel, that would be a 1,000-account problem.

So I think that there are things that we're going to jump onto. I'd say that most of those accounts are still relatively favorable at NetApp, and we're not losing any share in them. We may or may not, depending on each individual situation, actually see a rebound in them next quarter, and that's what's factored into our guidance.

<Q – Bill Shope – Goldman Sachs & Co.>: And the comparison to 2007, is that relevant?

<A – Thomas Georgens – NetApp, Inc.>: I'd say 2007 had a much, much greater concentration of financial services. In fact, I would argue that last quarter's dynamic looked more like 2007 than this one. And I also want to be really clear: It's not like financial services came back in a big way.

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Certainly, they didn't have a 50-something-percent sequential increase like our federal business did. But some of them did come back, and some of them came back in a meaningful way. And we anticipated some of that in our guidance, as well, so it's not universal. I think last quarter we had six major accounts in financial services, and they were all down. It was a bit more balanced this time.

<Q – Bill Shope – Goldman Sachs & Co.>: Okay. Great. Thank you.

Operator: Our next question comes from Brian Marshall from ISI Group. Please go ahead.

<Q – Brian Marshall – International Strategy & Investment Group, Inc.>: Great, thanks. Steve, we'll be looking for you on the Seniors Tour here pretty soon.

<A – Steven Gomo – NetApp, Inc.>: You'll have to look in the crowd.

<Q – Brian Marshall – International Strategy & Investment Group, Inc.>: No, no. I guess a little bit of confusion with respect to your nine large customers and the top 46. If that was really the shortfall, and $50 million, so call it roughly $5 million per account, are we talking mostly on the 6000 series here? Because that business was up 100% year-over-year, so I'm just trying to tie those two together, what these guys were actually buying and what went down.

<A – Thomas Georgens – NetApp, Inc.>: I wouldn't necessarily tie it to the 6000, and simply put is there's two things to factor in. One of them is the amount of money that they were down, and the other one is the amount of seasonality uplift that we were expecting from Q1, so I think there's both of those that come into play. But suffice to say that if they came in as expected, we would have sold even more 3000s and 6000s and probably some 2000s as well. So I think that the strength of those business – I think we're heartened by the fact that the significant movements in certainly the high-end, and clearly that has some indication about the customers and the types of applications we're deployed in – but the 3000 was quite strong. I wouldn't rule out that we'll see some reverse cannibalization of the 3000 going into next quarter, moving back to the 2000, but the 6000 remains robust, and it could have been even more so, certainly, had some of these accounts come through.

<Q – Brian Marshall – International Strategy & Investment Group, Inc.>: Thanks.

Operator: Our next question comes from Glenn Hanus from Needham & Company. Please go ahead.

<Q – Glenn Hanus – Needham & Co. LLC>: Thanks. How about let's talk about the intermediate term-business model. You were pretty responsive in controlling operating expenses. You mentioned a 17% operating margin this quarter. Is there sort of an intermediate target we should be thinking about, and how will you sort of manage to that target?

<A – Nicholas Noviello – NetApp, Inc.>: Yeah, so, hey, Glenn, this is Nick.

<Q – Glenn Hanus – Needham & Co. LLC>: Hi, Nick.

<A – Nicholas Noviello – NetApp, Inc.>: Just to help you understand on the operating expense perspective, we've taken some measures there. What you see in the 17% is the impact from Thailand though, right? So that is something that we have to build into our planning and really driving that change from what you might see on the business model side, and on that 18%-plus model that we've been aiming at so far. And you'll see it actually in the gross margins that I gave you the guidance on earlier.

<A – Thomas Georgens – NetApp, Inc.>: Yeah, the one thing I'd – just from a point of view of managing the business, I think from this particular quarter, I think once again we proved that when we want to put some control on expense, that we can snap back. To use the 2007 analogy, I think

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when things started to slow down, we said we'd be back on the model in a year, and we were back in a quarter. The one thing, though, that's a little bit different this time is, on the matter of Thailand, clearly, there's concern about availability of drives, but there's also concern about pricing of drives. And from the point of view of managing to the P&L and managing to the business model, I think under normal circumstances, clearly, we would modulate operating expenses to protect the business model, but if we think that we're going to get a hit to gross margin as a result of this transaction, then certainly we're modeling some of that in.

And that's going to temporary in nature, and I don't want to whipsaw the operation and modulate operating expenses based on pricing of disk drives. So frankly, to the extent that the gross margin is impacted by the drive situation, that's going to flow through the bottom line on a temporary basis, and the operating expense is going to be more modulated by the overall size of the opportunity that we see.

<Q – Glenn Hanus – Needham & Co. LLC>: Okay. Thank you.

Operator: Our next question comes from Keith Bachman from Bank of Montreal. Please go ahead.

<Q – Keith Bachman – BMO Capital Markets (United States)>: Hi. I have a similar question. So, Steve or Nick, just to be clear, the software margins that you expect in January and the services margins, those will both be roughly comparable to July margins? In other words, there was that blip there in services – I just want to make sure I'm clear – so that the variance therefore is all in the product side. That's part A, and I have something I want to follow with on the product side. Could you just confirm that that's accurate?

<A – Steven Gomo – NetApp, Inc.>: Yeah, I think that's accurate, Keith. Steve here. You're going to see a little bounce back, as I mentioned in my narrative, in the services margin.

<Q – Keith Bachman – BMO Capital Markets (United States)>: Right. Will it clear 60%, Steve?

<A – Steven Gomo – NetApp, Inc.>: I'm sorry?

<Q – Keith Bachman – BMO Capital Markets (United States)>: Will it clear 60%?

<A – Steven Gomo – NetApp, Inc.>: It will be on the order of 60%.

<Q – Keith Bachman – BMO Capital Markets (United States)>: Okay.

<A – Steven Gomo – NetApp, Inc.>: And then there's not going to be virtually any change at all in the SEM margin. So to your point, the entire impact is in the product margin side of the house.

<Q – Keith Bachman – BMO Capital Markets (United States)>: Okay. And is it all, Steve, HDDs, or is there something on mix, say, with the new product that would also negatively impact margins as we look out?

<A – Nicholas Noviello – NetApp, Inc.>: Yeah, Keith, this is Nick. In the third quarter, we're going to expect to see some impact on those product margins from customer mix, from OEM, as we get into the third quarter and the end of the calendar year. Those things are built into the guidance, and they show up on the product margin side.

<Q – Keith Bachman – BMO Capital Markets (United States)>: Okay. So – sorry, Nick, just to be clear – so what I'm really trying to slice is that product margin a number of different ways. Is pricing in there as one of the variables? And then I promise I'll cede the floor.

<A – Nicholas Noviello – NetApp, Inc.>: Okay. So what's in there is certainly Thailand is in there, right? And we're building that in. In addition to that is a customer mix and an OEM mix. Those are the big drivers that are going to be built into that and are built into the product margin guidance for the third quarter.

<A – Steven Gomo – NetApp, Inc.>: Pricing from the point of view of material pricing to us, particularly disk drives; that's factored in.

<A – Nicholas Noviello – NetApp, Inc.>: That's right.

<A – Nicholas Noviello – NetApp, Inc.>: As far as pricing to end users, our expectation is that's not going to be materially different than what we saw this quarter.

<Q – Keith Bachman – BMO Capital Markets (United States)>: Okay. That's exactly what I was asking. Thanks very much.

Operator: Our next question comes from Kaushik Roy from Merriman Capital. Please go ahead.

<Q – Kaushik Roy – Merriman Capital, Inc.>: Thanks. Tom, can you comment on the use of Flash? We know you use Flash Cache as well as SSDs, but can you comment on your offering for maybe PCIe SSDs in the servers?

<A – Thomas Georgens – NetApp, Inc.>: So, yeah, we kind of dropped the Flash out of our commentary because Flash is now bundled into more and more and more of our systems. It's just becoming an integral part of these types of arrays, and the ability of Flash and ATA drives in lieu of higher-cost enterprise-class drives clearly drives a cost point that's very, very competitive, and it's driven up adoption. So the fact that they're bundled in and not exactly tied to customer preference makes it hard to talk about Flash adoption. But I would venture to guess, certainly on the 6000 and the majority of the 3000, it's an integral part of the solution.

In terms of where we go from here, I think you'll continue to see innovation on the Flash side from NetApp, both inside the array and outside the array. I don't want to preannounce any products. I think for the planning horizon, the model that you guys are trying to put up for Q3, I think you should expect our Flash strategy to be substantially the way it is.

As far as PCI Flash products, you need to be clear on what the opportunity is there. I think, for us, things that are going to represent permanent storage we want to bring into our data management methodology, so that's clearly our interest. As far as Flash-based PCI boards as a revenue opportunity on a standalone basis, that's not nearly as interesting to us, but as a vehicle to sell software and broaden our footprint, clearly, that's the vector that we'll be pushing.

<Q – Kaushik Roy – Merriman Capital, Inc.>: Thank you.

Operator: Our next question comes from Brian Freed from Wunderlich Securities. Please go ahead.

<Q – Brian Freed – Wunderlich Securities, Inc.>: Hey, guys, a real quick question on ONTAP 8.1. First, is it currently shipping as a GA product, or is it still a release candidate on the FAS 6000 and 3000 product family? And related to that, can you talk any about what you're seeing from a win rate perspective? Are you seeing any visible signs of improvement, particularly in the scale-out NAS space?

<A – Thomas Georgens – NetApp, Inc.>: Well, from a 2000, it's an every-unit item out of the factory, so it's basically the standard operating system that we ship. For the 3000 and the 6000, it's still obviously an option. They're shipping actually a prior version of ONTAP 8 as of the fall, and

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they can actually ship a 7.x for some of the models also. So in terms of win rates, particularly around scale-out NAS, it isn't just about 8.1. We're certainly competing with cluster mode in that technology with the existing functionality of 8.x.

And I think what 8.1 brings to us is not only the performance that you saw – the new operating system on the new platforms clearly is compelling – but what it also does is it reduces the tradeoff necessary of trading off clustering versus the premium software features, so many of the premium software features in our standard version of ONTAP are now fully clusterable. And from that perspective, obviously, the product has much broader appeal, not just in scale-out NAS, but really around traditional business applications.

And we really have very, very rich data management, which is not typical of products in traditional business applications, and they're clustering to basically give tremendous flexibility in both scale of performance, of capacity, and also clustering is a key enabling technology of true non-stop operation. So from our perspective, the scale-out NAS is just about one data point. The real focus of our 8.x journey is effectively the bringing clustering and premium software features into the traditional business applications area, which have been relatively modest sort of from an innovation perspective for a long period of time.

<Q – Brian Freed – Wunderlich Securities, Inc.>: Okay. Thanks.

Operator: Our next question comes from Richard Gardner from Citigroup. Please go ahead.

<Q – Richard Gardner – Citigroup Global Markets (United States)>: Okay. Tom, sorry to beat a dead horse, but I did want to go back to the issues in the nine accounts. On the one hand, it sounds like it's either macro or company-specific-driven, but you also suggested that some of these accounts are on the ascendancy with NetApp and have decided to put plans on hold, and it sounds like there might be maybe a situation where you're displacing a competitor, and those customers have decided to slow down their adoption of NetApp technology. So I guess that what I'm really asking is how much of this really is company-specific and macro, and how much if it is due to competitive dynamics in these accounts?

<A – Thomas Georgens – NetApp, Inc.>: Yeah, I'd also want to be clear. I want to go back to my first answer, is the real dynamic here is not the overall fundamental health of those accounts. It's the performance of those accounts this quarter against our expectation of their performance this quarter that we had 90 days ago. So there are clearly some accounts that might be problematic growth accounts for company-specific reasons, and we knew that going in, and those weren't factored in. And those might be accounts that might be tough for us to drive growth in over time, whether we gain share on them or not.

On the other hand, these are accounts where we had higher expectations than what they did, which isn't to say that they're broken or they're damaged or that we're losing ground, and some of these accounts are accounts where we've made a lot of progress. And they all did spend money. It's just a question of not as much.

So I think from that perspective – I realize that it's ultimately not leading to a satisfactory answer; you keep coming back to it – but I'd say that, overall, the point is that the major accounts in general, being a proxy for the broader environment, have certainly seen pressure, both from a pricing perspective and a demand perspective. And I think that those accounts, being large, as they stop and go have a much bigger impact on our business. So those nine accounts had a disproportionate amount of our business relative to our expectation, which isn't to say we're in trouble in any of them. Like I said, I think the competitive pressures are really only relevant in one.

And they aren't necessarily the nine worst accounts, because clearly we have accounts that we know are going to be problematic and certainly sectors that are going to be problematic, but those

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were already factored into our forecast. So I just want to be clear, is that it's not like we only have nine accounts that we're not happy with. I think these accounts will be very strong for us going forward, and there will be other accounts that are not on this list that we know are problematic, and that was factored into our guidance and is continuing to be factored into our guidance going forward.

Operator: Our next question comes from Scott Craig from Bank of America Merrill Lynch. Please go ahead.

<Q – Scott Craig – Bank of America Merrill Lynch>: Yeah, thanks. Good afternoon. Just a clarification on the guidance – I think I heard you say that you were assuming a pickup in the major accounts. Maybe just clarify that. And then secondly, if that pickup doesn't happen, Nick, what are you guys prepared to do on the OpEx line, and what can you do to sort of mitigate some of a potential revenue shortfall if we see continued slowdown? Thanks.

<A – Nicholas Noviello – NetApp, Inc.>: Yeah, hey, Scott. This is Nick. Just in terms of your comment on pickup in major accounts, first of all, again, we go through an account planning and build a view of where major accounts are going to go this coming quarter. Similar to what Tom has said, there wasn't a lot of growth built into last quarter, so we're not expecting a lot this coming quarter. We do it bottoms up. That's built in, and that's how we've kind of come up with the guidance on those.

On the OpEx side of the fence, and really back to the question of operating margin, the operating margin shortfall is really reflected in the gross margin shortfall, and the gross margin shortfall is driven by the cost pressure that we believe is going to come and we're seeing a little bit of in terms of the drive situation that's out there. So that's built into product gross margins; that flows through to the overall operating margin line. And I made reference before to the OpEx as a percentage of revenue is basically flat, so the expense structure we've managed pretty well.

<A – Thomas Georgens – NetApp, Inc.>: Yeah, I think going forward, if we were going to try to crank back on operating expenses, it would be all the usual things. It would be programs. It would be hiring and things of that nature. If you look at this quarter similar to last quarter, we came in over the top on the EPS side, and clearly the revenue didn't quite come up to our forecast in either case, so we're quite cognizant of that. So the issue that we're trying to solve here, obviously, is we're trying to drive growth, as opposed to deal with operating expense. On the other hand, with some uncertainty ahead, both macroeconomically and also with the Thailand flooding, we need to be careful about where the top line is going, and therefore we were prudent this particular quarter.

So we still hired 300-and-something people. It's not like we were sitting idly by. But that's a balance that we need to have going forward, is how do we modulate the spending in proportion to the business. But I also wanted to be clear, as I said earlier, is the impact of the Thailand flood we expect to be temporary, and I'm not going to modulate operating expense too much on that because a) it's going to be hard to predict, and I'd hate to just kind of jerk the organization around, around a set of data points that are changing every day.

<A – Nicholas Noviello – NetApp, Inc.>: Thank you.

<A – Tara Dhillon – NetApp, Inc.>: Next question?

Operator: Our next question comes from Maynard Um from UBS. Please go ahead.

<Q – Maynard Um – UBS Securities LLC>: Hi. Thanks. I think you more broadly addressed this issue, but I was hoping if you could be a little bit more direct. Are there any changes within your customer base around the way they're thinking about their storage architectures or their technologies? And I'm curious, just given kind of EMC's commentary that its Isilon product has

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been displacing, what they say, a NAS vendor that couldn't scale for general purpose needs. Can you just help kind of clear the air there, what you're seeing in the market from that standpoint? Thanks.

<A – Thomas Georgens – NetApp, Inc.>: Well, I think specifically on the Isilon case, certainly we see them – we see them certainly replacing a lot of Solera. We certainly see them agitating in our accounts. I think when we think about Isilon, clearly, they were targeting us before EMC bought them, and certainly that has not let up. [ph] As the approximate cause (49:45) in these accounts, like I said, the accounts that are on the ascendancy that suddenly stopped buying or paused for a period of time, that wasn't an intercept of the business by a competitive activity. Certainly, if that was a threat, it would have been factored into the forecast 90 days ago. Things like that don't happen that quickly.

As far as Isilon itself, if you look at the value points that it has around NAS performance and the other value point it has really about manageability of large content pools. From a straight performance perspective, since that's objectively measured, clearly the E-Series for high-performance computing is clearly much higher performance. Certainly, the benchmark that we just did around SPEC NFS around NAS performance and NAS scalability at dramatically less hardware. So I think from a performance perspective, NetApp is more than able to hold its own, and in fact has a compelling leadership position there.

On the general question of manageability, that's kind of a tough thing to objectively benchmark, but if you look at where we're going with that, now with 8.1, the marriage of all the premium features which don't exist in that particular product and therefore makes it difficult to sell into traditional business applications, and also kind of the merger of where we're heading with the Bycast acquisition and object-oriented stuff effectively going to be bringing the functionality of both an Atmos and an Isilon together, if you will.

So I feel good about our roadmap. I think, clearly, from a performance perspective, NetApp has really clearly retaken the high ground. And I think from a manageability perspective, obviously, that's a little bit harder to objectively measure, but I think you'll see much better functionality from NetApp and continued competitiveness on that front.

So I guess where I see Isilon is some of the premium side of the business around performance and key scientific applications. I'm more than comfortable with our stance there. In terms of large content repository pools, kind of lower-value data, that's primarily a manageability play, and you'll certainly hear more from NetApp, both with 8.1 and in future releases. So, from us, do we see them? Yeah. Were they part and parcel of the dynamics of the major accounts? Certainly, we see them, but they were not the primary cause of what we saw from 90 days ago.

<Q – Maynard Um – UBS Securities LLC>: Great. Thank you.

Operator: Our next question comes from Brent Bracelin from Pacific Crest. Please go ahead.

<Q – Brent Bracelin – Pacific Crest Securities LLC>: Thank you. One quick clarification for Nick, and then a question for Tom. Nick, on the gross margin, obviously, the guide down here implies close to a 350-basis point product margin decline. Should we think about the vast majority of that assumption being tied to higher drive costs and temporary in nature?

<A – Nicholas Noviello – NetApp, Inc.>: Hi, Brent. Yeah, two points there to keep in mind, and yeah, it's pretty close in terms of that sequential decline in product gross margin. The two points are, first of all, you're going to have a product and customer mix, including the OEM and heavier OEM, that happens in the calendar third quarter of every year. That's impacting part of it, and then the Thailand drives are impacting the other part of it. That makes up the basic 3-point change and decline in the product gross margin.

<Q – Brent Bracelin – Pacific Crest Securities LLC>: Okay. That's helpful. And then, Tom, my question for you is less about the nine major accounts and more about the direct sales as a whole; on an absolute basis down two consecutive quarters, lowest absolute level since October of 2009. You obviously have a new software release, 8.1, the low-end refresh. Do you think we're bottoming here on the direct side? Obviously, the commentary that there's going to be a heavier OEM E-Series mix suggests maybe this isn't the bottom. What's your general sense? Is there a pipeline of new customers that could drive a rebound going forward? Help us understand the direct sales opportunities that you see now. Are we close to a bottom? Have we seen the bottom? And what gives you confidence that you can grow that business going forward?

<A – Thomas Georgens – NetApp, Inc.>: Yeah, the one thing I would – I guess the one caution I would put is that don't assume that the fulfillment model for the end customers are static. So the fact that some of our big accounts may choose to go through a channel partner or go through an integrator, or the systems integrator is now moving more hardware through their business. So the same involvement of our sales reps might actually have a different fulfillment model, and I think that's in play here too.

The flip side to that argument that I would also argue is don't assume that our channel business has zero touch from our direct sales organization. In some cases, I wish it was more independent, but our direct sales organization is actively involved in a lot of accounts. So I think our direct-selling motion is clearly creating demand, and the question is whether they fulfill it directly through NetApp or they prefer to go through a third party. In a lot of cases, that's a customer choice. So we don't actually measure demand creation by channel. So I wouldn't read into that the direct sales force numbers are necessarily indicative of lower direct sales force productivity.

<Q – Brent Bracelin – Pacific Crest Securities LLC>: Okay, that's fair enough. We'll discount the overall direct sales force business, but it's hard to discount the branded business that's slowing down overall, so I guess do you feel like 8.1 can help drive acceleration in branded overall?

<A – Thomas Georgens – NetApp, Inc.>: I think, clearly – I think 8.1 and the entire 8.x family is really revolutionary when it comes to storage for data center environments. The ability to bring true clustering and this premium feature set, I think, will help. Obviously the 2000 will help as well. Clearly, it's not uncommon for us to see pickups in demand. Certainly, the last product release was remarkably successful in terms of conversion of customer demand, so I expect the 2000 to pick up as well.

So from an overall branded business, like I said, I think the other thing that you need to put in context is just what you believe about the macro environment, so I think the year-over-year growth numbers are all interesting, but I think we're dealing with a different macro environment. Obviously, NetApp has got other elements of the portfolio now that we can rely upon for growth. And I think if you go back to the sequential number, I think the NetApp sequential product performance is actually pretty darn good this quarter, the nine accounts or the major accounts in general notwithstanding.

I think 5% sequential growth, and even despite everything else that's going on, 4% sequential growth from here, if we sustain that for the next couple years – or I should say if we can sustain that through a difficult period, I think that would be pretty good for us, and I think that put us in a share-gaining position.

<Q – Brent Bracelin – Pacific Crest Securities LLC>: Thanks for answering my question. Thank you.

Operator: Our last question comes from Andrew Nowinski from Piper Jaffray. Please go ahead.

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<Q – Andrew Nowinski – Piper Jaffray, Inc.>: Great, thanks. Could you just comment on whether you saw a similar slowdown in the fed sector during the month of October that Dell called out last night? And then looking into the next 12 months, aside from the obvious looming budget cuts, do you anticipate any headwinds – or new headwinds from a competitive perspective now that EMC has qualified to VNX and is now on more GSA lists?

<A – Thomas Georgens – NetApp, Inc.>: On the federal side, clearly, that's been very, very successful for us. We're #1 in market share position. Obviously a lot of speculation on that particular business; I think, all things considered, over an extended period of time, a lot of other companies have talked about weakness in that area while the NetApp business continued its momentum. So we had strong sequential growth in that business last quarter. We had growth year-over-year. So with all the headlines, I think we have to be pretty pleased with the overall performance too.

Would I say that October would slow down? I don't think – first of all, I wouldn't overplay our granularity in that regard. One thing that happens in October we see a lot of the systems integrator business that they actually win before the fiscal year-end, it takes a little while to roll through to us, but I wouldn't say that we saw anything in October that made us any more or less pessimistic than what we saw in September when the deals were actually closing.

<A – Steven Gomo – NetApp, Inc.>: This is Steve. I'd just add, as far as this past quarter was concerned, remember that in the fed business also, we have contracts that are in existence today. We own the contracts. And what we're seeing I think a little bit in the slowdown is not as many POs as perhaps people had anticipated we would receive, I think it's tied more to the fiscal situation in the United States than it is to anything else.

<A – Thomas Georgens – NetApp, Inc.>: Yeah, I think on the question of VNX, in general, the VNX itself has not been that much of a change in the dynamic in many accounts. The VNXe in terms of EMC's channel incentives is something that we've seen more of. Certainly, if you look at the performance of our volume segments, clearly, that's been the strongest part of our portfolio, so I don't think they've slowed us down much. But nonetheless, I'd say that VNXe is something that we see, particularly because of their channel push, and I think that's been something that's generated more discussion within NetApp than actually the VNX itself. I think the VNX itself is – I think it's been inflicting more pain on Dell than it has been inflicting on NetApp.

<Q – Brent Bracelin – Pacific Crest Securities LLC>: Okay. Thank you.

Operator: We have run out of time for questions. I will now turn the call back over to management for closing remarks.

Thomas Georgens, President, Chief Executive Officer & Director

Thank you, Operator. Just one last thing before we wrap up is I wanted to bring up that we are quite aware of a number of press articles about NetApp products being deployed in Syria by a systems integrator named Area, and the one thing I wanted to be very, very clear about this, is I want to assure the people on the call, our customers, our partners, our employees that we absolutely do not support the sale of NetApp equipment to Syria. I'm not here to suggest that we've found a legal way to achieve an objective to sell products to a banned country. We have no intention of doing that, and we are just as disturbed that this product is in a banned country as anybody else.

The other thing is that NetApp produces storage products. We don't produce the applications that are being talked about in this particular article. And our products have been deployed in the solution and in a very generic way, and that NetApp has not produced this application or participated in its development at all. The last thing I'd probably want to point out is that NetApp has proactively reached out to the government, and we've offered our full assistance in reviewing the matter, sharing any information that we have about the situation, and ultimately get to the facts. At this point, we don't know even whether this story is true, but we're acting as if it were and taking all the appropriate precautions.

So I can assure you that this is a situation that we did not actively seek out. We did not choose to sell to the Syrian government. We did not deal with the Syrian government, and we're not looking for a way to circumstance vent U.S. law to sell to the Syrian government. We have no interest in providing product to a banned country, and I just wanted to make sure that was clear.

So with that, I'd like to thank you for your time today and your interest in NetApp, and we'll see you all in 90 days.

Operator: Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.

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