

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark one)

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the Quarterly Period Ended July 31, 2003

or

Transition Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the transition period from _____
to _____

Commission File Number: 0-13351

NOVELL, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

87-0393339
(I.R.S. Employer
Identification No.)

1800 South Novell Place
Provo, Utah 84606
(Address of principal executive offices and zip code)

(801) 861-7000
(Registrant's telephone number, including area code)

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

YES NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act)

YES NO

As of August 29, 2003, there were 373,426,470 shares of the registrant's common stock outstanding.

Part I. Financial Information
Item 1. Financial Statements

NOVELL, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS

	<u>July 31, 2003</u> (Unaudited)	<u>October 31, 2002</u>
<i>In thousands, except share and per share data</i>		
Assets		
Current assets:		
Cash, cash equivalents, and short-term investments	\$ 738,777	\$ 635,858
Receivables (less allowances of \$29,539 – July 31, 2003 and \$39,676 – October 31, 2002)	217,230	214,827
Prepaid expenses	27,596	24,077
Deferred income taxes	19,677	21,204
Other current assets	<u>22,820</u>	<u>23,572</u>
Total current assets	1,026,100	919,538
Property, plant and equipment, net	258,908	369,189
Goodwill	178,297	179,534
Intangible assets	4,360	36,351
Long-term investments	51,039	73,452
Deferred income taxes	96,245	74,323
Other assets	<u>7,792</u>	<u>12,678</u>
Total assets	<u>\$ 1,622,741</u>	<u>\$ 1,665,065</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 48,263	\$ 57,241
Accrued compensation	96,233	87,778
Other accrued liabilities	121,678	134,850
Income taxes payable	24,980	36,294
Deferred revenue	<u>295,786</u>	<u>275,344</u>
Total current liabilities	<u>586,940</u>	<u>591,507</u>
Minority interests	<u>8,016</u>	<u>8,016</u>
Stockholders' equity:		
Common stock, par value \$.10 per share:		
Authorized – 600,000,000 shares;		
Issued – 371,828,779 shares-July 31, 2003,		
367,537,926 shares-October 31, 2002	37,183	36,753
Preferred stock, par value \$.10 per share;		
Authorized – 500,000 shares, Issued – 0 shares	--	--
Additional paid-in capital	304,655	297,139
Retained earnings	685,763	738,663
Accumulated other comprehensive income	4,633	57
Other	<u>(4,449)</u>	<u>(7,070)</u>
Total stockholders' equity	<u>1,027,785</u>	<u>1,065,542</u>
Total liabilities and stockholders' equity	<u>\$ 1,622,741</u>	<u>\$ 1,665,065</u>

See notes to consolidated unaudited condensed financial statements.

NOVELL, INC.
CONSOLIDATED UNAUDITED CONDENSED STATEMENTS OF OPERATIONS

	Three Months Ended	
	July 31, 2003	July 31, 2002
<i>In thousands, except per share data</i>		
Net revenue		
New software licenses	\$ 69,255	\$ 82,894
Maintenance and services	<u>213,554</u>	<u>199,379</u>
Net revenue	<u>282,809</u>	<u>282,273</u>
Cost of revenue		
New software license costs	5,886	8,098
Maintenance and services	<u>101,591</u>	<u>101,724</u>
Cost of revenue	<u>107,477</u>	<u>109,822</u>
Gross profit	<u>175,332</u>	<u>172,451</u>
Operating expenses:		
Sales and marketing	92,470	87,487
Product development	48,178	44,130
General and administrative	28,379	29,566
Purchased in-process research and development	--	3,000
Restructuring	<u>26,350</u>	<u>--</u>
Total operating expenses	<u>195,377</u>	<u>164,183</u>
Income (loss) from operations	<u>(20,045)</u>	<u>8,268</u>
Other income (expense), net:		
Investment income (expense)	(5,016)	5,268
Other, net	<u>1,299</u>	<u>1,962</u>
Other income (expense), net	<u>(3,717)</u>	<u>7,230</u>
Income (loss) before taxes	(23,762)	15,498
Income tax benefit	<u>(11,362)</u>	<u>5,549</u>
Net loss	<u>\$ (12,400)</u>	<u>\$ 9,949</u>
Basic and diluted net loss per share	<u>\$ (0.03)</u>	<u>\$ 0.03</u>
Basic weighted average shares outstanding	371,484	364,211
Diluted weighted average shares outstanding	371,484	364,247

See notes to consolidated unaudited condensed financial statements.

NOVELL, INC.
CONSOLIDATED UNAUDITED CONDENSED STATEMENTS OF OPERATIONS

	Nine Months Ended	
	July 31, 2003	July 31, 2002
<i>In thousands, except per share data</i>		
Net revenue		
New software licenses	\$ 194,758	\$ 224,980
Maintenance and services	<u>623,989</u>	<u>609,005</u>
Net revenue	<u>818,747</u>	<u>833,985</u>
Cost of revenue		
New software license costs	17,070	21,711
Maintenance and services	<u>296,742</u>	<u>318,508</u>
Cost of revenue	<u>313,812</u>	<u>340,219</u>
Gross profit	<u>504,935</u>	<u>493,766</u>
Operating expenses:		
Sales and marketing	292,512	255,108
Product development	139,454	129,528
General and administrative	86,663	90,946
Purchased in-process research and development	--	3,000
Restructuring	<u>35,025</u>	<u>19,100</u>
Total operating expenses	<u>553,654</u>	<u>497,682</u>
Loss from operations	<u>(48,719)</u>	<u>(3,916)</u>
Other income (expense), net:		
Investment income (expense)	(22,615)	(9,323)
Other, net	<u>234</u>	<u>8,625</u>
Other income (expense), net	<u>(22,381)</u>	<u>(698)</u>
Loss before taxes and cumulative effect of accounting change	(71,100)	(4,614)
Income tax expense (benefit)	<u>(18,200)</u>	<u>6,835</u>
Loss before cumulative effect of accounting change	(52,900)	(11,449)
Cumulative effect of accounting change	<u>--</u>	<u>(143,702)</u>
Net loss	<u>\$ (52,900)</u>	<u>\$ (155,151)</u>
Basic and diluted net loss per share:		
Before cumulative effect of accounting change	\$ (0.14)	\$ (0.03)
Cumulative effect of accounting change	<u>--</u>	<u>(0.40)</u>
Basic and diluted net loss per share	<u>\$ (0.14)</u>	<u>\$ (0.43)</u>
Basic and diluted weighted average shares outstanding	369,435	363,131

See notes to consolidated unaudited condensed financial statements.

NOVELL, INC.
CONSOLIDATED UNAUDITED CONDENSED STATEMENTS OF CASH FLOWS

<i>In thousands</i>	Nine Months Ended	
	July 31, 2003	July 31, 2002
Cash flows from operating activities:		
Net loss	\$ (52,900)	\$ (155,151)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Gain on sale of property, plant and equipment	(25,299)	(8,762)
Depreciation and amortization	49,174	49,175
Loss on impaired goodwill and intangible assets, net of tax	13,935	143,702
Loss on impaired investments	32,563	29,839
Non-cash restructuring charges	23,226	16,426
In-process research and development expense	--	3,000
(Increase) decrease in receivables	(2,403)	29,346
(Increase) decrease in prepaid expenses	(3,519)	4,756
(Increase) decrease in deferred income taxes	(10,507)	963
Decrease in other current assets	752	8,372
Decrease in accounts payable	(8,978)	(21,564)
Decrease in other current liabilities, net	(34,476)	(78,168)
Increase (decrease) in deferred revenue	<u>20,442</u>	<u>(3,332)</u>
Net cash provided by operating activities	<u>2,010</u>	<u>18,602</u>
Cash flows from financing activities:		
Issuance of common stock, net	<u>7,805</u>	<u>6,861</u>
Net cash provided by financing activities	<u>7,805</u>	<u>6,861</u>
Cash flows from investing activities:		
Expenditures for property, plant and equipment	(30,605)	(18,676)
Proceeds from the sale of property, plant and equipment	125,000	16,050
Purchases of short-term investments	(455,719)	(1,191,184)
Maturities of short-term investments	72,556	907,134
Sales of short-term investments	265,923	425,534
Cash acquired from acquisition of SilverStream	--	108,286
Cash paid for acquisition of SilverStream	--	(210,847)
Cash paid for Volera minority interest shares	(1,050)	--
Expenditures for long-term investments	(11,285)	(7,882)
Other	<u>12,055</u>	<u>(2,955)</u>
Net cash (used for) provided by investing activities	<u>(23,125)</u>	<u>25,460</u>
Net (decrease) increase in cash and cash equivalents	(13,310)	50,923
Cash and cash equivalents - beginning of period	<u>463,987</u>	<u>337,927</u>
Cash and cash equivalents - end of period	450,677	388,850
Short-term investments - end of period	<u>288,100</u>	<u>218,460</u>
Cash and short-term investments - end of period	<u>\$ 738,777</u>	<u>\$ 607,310</u>

See notes to consolidated unaudited condensed financial statements.

NOVELL, INC.
NOTES TO CONSOLIDATED UNAUDITED CONDENSED FINANCIAL STATEMENTS

A. Quarterly Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. As discussed under the subheading “Critical Accounting Policies” in Part I, Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” actual results could differ materially from those estimates. The accompanying consolidated unaudited condensed financial statements have been prepared in accordance with the instructions to Form 10-Q but do not include all of the information and footnotes required by generally accepted accounting principles and should, therefore, be read in conjunction with our fiscal 2002 Annual Report on Form 10-K. These financial statements do include all normal recurring adjustments that we believe are necessary for a fair presentation of the statements. The interim operating results are not necessarily indicative of the results for a full year. Certain reclassifications, none of which affected net loss, have been made to the prior year’s amounts in order to conform to the current year’s presentation.

B. Foreign Currency Translation

Due to increased activity in non-U.S. dollar currencies, beginning November 1, 2002, we have determined the functional currency of all of our international subsidiaries, except for our Irish subsidiaries, to be the local currency. These subsidiaries generate and expend cash primarily in their respective local currency. Assets and liabilities of these subsidiaries are translated at current month-end exchange rates. Revenue and expenses are translated monthly at the average monthly exchange rate. Such translation adjustments are recorded in accumulated other comprehensive income. Previously, the functional currency of our international subsidiaries, except Novell Japan, Novell India, and the international subsidiaries of Cambridge Technology Partners (“Cambridge”) and SilverStream, was the U.S. dollar.

C. Cash, Cash Equivalents, and Short-term Investments

We consider all highly liquid debt instruments purchased with a term to maturity of three months or less to be cash equivalents. Short-term investments are widely diversified, consisting primarily of investment grade securities that either mature within the next 12 months or have other characteristics of short-term investments. These include:

- Variable rate preferred stock instruments that are publicly traded and earn dividends periodically at a rate set in an auction. These instruments have auction dates within 180 days of the prior auction date.
- Fixed income securities, which have contractual maturities ranging from zero to seven years. These securities are available to be used for current operations and thus are classified as short-term investments, even though some maturities may extend beyond one year.

No other short-term investments have contractual maturities. All marketable debt and equity securities that are included in cash and short-term investments are considered available-for-sale and are carried at fair market value. The unrealized gains and losses related to these securities are included in accumulated other comprehensive income, net of tax, after any applicable tax valuation allowances (see Note M). Fair market values are based on quoted market prices when available; if quoted market prices are not available, the fair market values are based on quoted market prices of similar instruments of companies that are comparable in size, product offerings, and market sector. When securities are sold, their cost is determined based on the specific identification method.

The following is a summary of cash and short-term investments, all of which are considered available-for-sale.

<i>In thousands</i>	Cost at July 31, 2003	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value at July 31, 2003
Cash and cash equivalents:				
Cash	\$ 131,130	\$ --	\$ --	\$ 131,130
Government and agency securities	22,794	--	--	22,794
Corporate obligations	20,212	--	--	20,212
Money market funds	<u>276,541</u>	<u>--</u>	<u>--</u>	<u>276,541</u>
Total cash and cash equivalents	<u>450,677</u>	<u>--</u>	<u>--</u>	<u>450,677</u>
Short-term investments:				
Variable rate instruments	37,500	36	--	37,536
Government and agency securities	111,950	372	(215)	112,107
Corporate obligations	132,170	1,441	(227)	133,384
Equity securities	<u>4,872</u>	<u>323</u>	<u>(122)</u>	<u>5,073</u>
Total short-term investments	<u>286,492</u>	<u>2,172</u>	<u>(564)</u>	<u>288,100</u>
Total cash and short-term investments	<u>\$ 737,169</u>	<u>\$ 2,172</u>	<u>\$ (564)</u>	<u>\$ 738,777</u>

<i>In thousands</i>	Cost at October 31, 2002	Gross Unrealized Gains	Gross Unrealized Losses	Fair Market Value at October 31, 2002
Cash and cash equivalents:				
Cash	\$ 179,098	\$ --	\$ --	\$ 179,098
Government and agency securities	60,121	--	--	60,121
Corporate obligations	23,219	--	--	23,219
Money market funds	<u>201,549</u>	<u>--</u>	<u>--</u>	<u>201,549</u>
Total cash and cash equivalents	<u>463,987</u>	<u>--</u>	<u>--</u>	<u>463,987</u>
Short-term investments:				
Variable rate instruments	14,499	1	--	14,500
Government and agency securities	38,025	379	--	38,404
Corporate obligations	110,746	2,533	(113)	113,166
Equity securities	<u>5,982</u>	<u>368</u>	<u>(549)</u>	<u>5,801</u>
Total short-term investments	<u>169,252</u>	<u>3,281</u>	<u>(662)</u>	<u>171,871</u>
Total cash and short-term investments	<u>\$ 633,239</u>	<u>\$ 3,281</u>	<u>\$ (662)</u>	<u>\$ 635,858</u>

During the third quarter of fiscal 2003, we realized gains of \$0.6 million and realized losses of \$0.1 million from the sale of short-term investments. During the third quarter of fiscal 2002, we realized gains of \$1.9 million and realized losses of \$0.8 million from the sale of short-term investments. During the first nine months of fiscal 2003, we realized gains of \$1.7 million and realized losses of \$0.4 million from the sale of short-term investments. During the first nine months of fiscal 2002, we realized gains of \$7.4 million and realized losses of \$1.0 million from the sale of short-term investments.

We routinely review all of our investments for impairment. We did not record any impairment losses on short-term investments during the first nine months of fiscal 2003 or fiscal 2002.

D. Long-term Investments

The primary components of long-term investments as of July 31, 2003 were investments made through the Novell Venture account or the Cambridge Technology Capital Fund I L.P. ("CTC I"), and direct investments we made for strategic purposes in equity securities of privately-held companies. Long-term investments are accounted for initially at cost and written down to fair market value when indicators of impairment are deemed to be other than temporary.

We routinely review our investments in private securities and venture funds for impairment. To assess impairment, we analyze forecasted financial performance of the investees, the liquidation preference value of the stock we hold, and our estimate of the potential for investment recovery based on all these factors. During the third quarter and first nine months of fiscal 2003, we recognized impairment losses on long-term investments totaling \$8.0 million and \$32.6 million, respectively. During the third quarter of fiscal 2002, we did not recognize an impairment loss. During the first nine months of fiscal 2002, we recognized impairment losses of \$24.4 million. As of July 31, 2003 and 2002, there were no unrealized gains or losses on our long-term equity investments.

E. Goodwill and Intangible Assets

Goodwill includes approximately \$126.7 million from the July 2002 acquisition of SilverStream Software, Inc. ("SilverStream"), approximately \$42.5 million from the July 2001 acquisition of Cambridge, and approximately \$9.1 million related to the acquisition of several small technology-related companies. Beginning November 1, 2002, we reorganized our operations and began reporting our financial results in four segments; three are based on geographic area and the fourth being Celerant management consulting. The geographic segments are Americas, EMEA, and Asia Pacific.

- Americas – includes the United States, Canada, and Latin America
- EMEA – includes Eastern and Western Europe, Middle East, and Africa
- Asia Pacific –includes China, Japan, Southeast Asia, Australia, New Zealand, and India

Prior to November 1, 2002, we operated and reported financial results based on three business segments: product, consulting, and Volera, Inc.

The following is a summary of goodwill, which has been reallocated to the new segments, which we consider to be reporting units for allocating and evaluating goodwill:

<i>In thousands</i>	<u>Americas</u>	<u>EMEA</u>	<u>Asia Pacific</u>	<u>Celerant</u>	<u>Total</u>
Balance as of November 1, 2002	\$ 69,842	\$ 60,447	\$ 6,745	\$ 42,500	\$ 179,534
Adjustments	<u>(623)</u>	<u>(552)</u>	<u>(62)</u>	<u>--</u>	<u>(1,237)</u>
Balance as of July 31, 2003	<u>\$ 69,219</u>	<u>\$ 59,895</u>	<u>\$ 6,683</u>	<u>\$ 42,500</u>	<u>\$ 178,297</u>

Adjustments relate to a true up of SilverStream merger-related liabilities.

The following is a summary of intangible assets:

<i>In thousands</i>	<u>July 31, 2003</u>	<u>October 31, 2002</u>
Developed technology	\$ 3,800	\$ 32,769
Trade names	<u>560</u>	<u>3,582</u>
Total intangible assets	<u>\$ 4,360</u>	<u>\$ 36,351</u>

Developed technology at October 31, 2002 related primarily to the exteNd product line that we acquired as a part of our July 2002 acquisition of SilverStream Software, Inc. Trade names relate to the SilverStream individual product names, which we continue to use. During the third quarter of fiscal 2003, we determined that there existed impairment indicators related to the developed technology and trade names we acquired from SilverStream as a result of unexpected revenue declines for the exteNd products. Based on an independent valuation of these assets, we recorded a \$23.6 million charge to write down these assets to fair value.

Because the intangibles were determined to be impaired, we also analyzed our other long-lived assets for indicators of impairment. This included goodwill and fixed assets acquired from SilverStream. Goodwill is reflective of the segment to which it is allocated, not necessarily the company or technology from which it originated, thus the analysis of goodwill is performed on geographic segment performance. No indicators of impairments were noted. Fixed assets consisted mainly of computers and software, none of which had become impaired. Our annual goodwill impairment analysis is performed during our fourth fiscal quarter of each year.

Developed technology is being amortized over three years. Amortization for the third quarter and first nine months of fiscal 2003 was \$2.1 million and \$8.5 million, respectively. Amortization for the third quarters and first nine months of fiscal 2002 was \$0.6 million and \$2.9 million, respectively. Trade names have an indefinite life and therefore are not amortized but are reviewed for impairment at least annually.

F. Income Taxes

Our effective tax rate before investment impairment losses for the third quarter and first nine months of fiscal 2003 was 30%. The actual tax benefit rate for the third quarter of fiscal 2003 was 48% and the actual tax benefit rate for the first nine months of fiscal 2003 was 26%. The effective tax rate for fiscal 2002 was 12%. The actual rate for the third quarter and the first nine months of 2003 is after adjusting for the impairment of the SilverStream intangibles. Furthermore, a portion of the gain realized on the sale of the San Jose property qualifies as capital gain and was offset by capital loss carryforwards. The investment impairment was not realized for tax purposes, and as noted with respect to earlier periods, corporations can only offset capital gains with capital losses and Novell could not be assured at quarter end that it could realize sufficient capital gains during the five-year carry over period for capital losses. The effective tax rate for the first nine months of fiscal 2003 differed from the fiscal 2002 effective tax rate primarily because of differences in the amount of non-deductible and non-taxable items in each period. A valuation allowance has been established against the capital loss amounts that we may not be able to recognize.

We paid income taxes of \$7.6 million in the first nine months of fiscal 2003 and \$14.7 million during the same period of fiscal 2002.

G. Line of Credit

We currently have a \$15 million unsecured revolving bank line of credit, which expires on March 3, 2004. The line can be used for either letter of credit or working capital purposes and is subject to the terms of a loan agreement containing financial covenants and restrictions, none of which are expected to significantly affect our operations. At July 31, 2003, there were \$12.9 million of standby letters of credit outstanding under this agreement.

Our subsidiary in China has a \$0.9 million short-term revolving line of credit, which expires on February 29, 2004. The line is being used for our China operations, where there are restrictions on transfers of cash into the country. This line is collateralized by standby letters of credit, discussed above. At July 31, 2003, there was \$0.9 million outstanding under this revolving line.

H. Restructuring

Third quarter of fiscal 2003

During the third quarter of fiscal 2003, we recorded a pre-tax restructuring charge of approximately \$27.8 million resulting from the restructuring of our operations in response to changes in general market conditions, changing customer demands, and the evolution of our business strategy relative to the identity management and secure web services areas of our business and our revised strategy. This strategy includes plans to support the Linux kernel in addition to the NetWare kernel, by offering Novell products and services that run on both Netware and Linux platforms. These changes in strategy and company structure were made to address the current revenue declines. Specific actions taken included reducing our workforce worldwide by approximately 600 employees (approximately 10%) across all functions and geographies, with a majority coming from product development, sales, and general and administrative functions, primarily in the United States. In addition, we consolidated facilities, and disposed of excess equipment. By reporting segment, the Americas accounted for \$19.4 million, EMEA accounted for \$6.0 million, and Asia Pacific accounted for \$2.4 million.

The following table summarizes the activity during the third quarter of 2003 related to this restructuring.

	<u>Original Charge</u>	<u>Cash Payments</u>	<u>Non-cash Adjustments</u>	<u>Balance at July 31, 2003</u>
<i>In thousands</i>				
Severance and benefits	\$ 20,287	\$ (11,671)	\$ --	\$ 8,616
Excess facilities and property and equipment	5,778	--	218	5,996
Other restructuring-related costs	1,729	(67)	(261)	1,401
	<u>\$ 27,794</u>	<u>\$ (11,738)</u>	<u>\$ (43)</u>	<u>\$ 16,013</u>

As of July 31, 2003, the remaining balance of the third quarter of fiscal 2003 restructuring charge included accrued liabilities related to severance and benefits, which will be paid out over the remaining severance obligation period, not to exceed two years, lease costs for redundant facilities, which will be paid over the respective remaining contract terms, and various severed employee related costs, which will be paid over the next four quarters.

During the third quarter of fiscal 2003, we also released approximately \$1.4 million related to excess restructuring reserves related to the second quarter fiscal 2002 restructuring event. This release is reflected in the second quarter fiscal 2002 table below. The net impact of the third quarter fiscal 2003 restructuring and the release of the excess fiscal 2002 reserves was a charge of \$26.4 million.

Second quarter of fiscal 2003

During the second quarter of fiscal 2003, we determined that the amount we had originally accrued for facility-related costs in previous restructurings was too low and accrued an additional \$8.7 million. The original liability was based on estimated sublease rates and timing, which have been affected by the decline in the real estate market. This additional amount, which pertains to three separate restructuring events, is included in the following tables.

Second quarter of fiscal 2002

During the second quarter of fiscal 2002, we recorded a pre-tax restructuring charge of approximately \$20 million resulting from our continued migration towards becoming a solutions provider and as a result of changing business needs. Specific actions taken included reducing our workforce worldwide by approximately 50 employees (less than 1%), consolidating facilities, closing offices in unprofitable locations, and disposing of excess property and equipment.

As noted above, during the second quarter of fiscal 2003, we determined that the amount we had originally accrued for facility-related costs was too low and accrued an additional \$7.7 million. The original liability for lease costs was based on estimated sublease rates and timing, which have been affected by the decline in the real estate market. Additionally, during the third quarter of fiscal 2003 we released approximately \$1.4 million of excess restructuring reserves related to excess severance costs

The following table summarizes the activity during fiscal 2003 related to the second quarter of fiscal 2002 restructuring.

	Original Charge	Balance at October 31, 2002	Cash Payments	Adjustments	Balance at July 31, 2003
<i>In thousands</i>					
Severance and benefits	\$ 14,748	\$ 4,258	\$(2,851)	\$ (100)	\$ 1,307
Excess facilities and property and equipment	5,146	4,221	(2,445)	6,391	8,167
Other restructuring-related costs	<u>492</u>	<u>300</u>	<u>--</u>	<u>--</u>	<u>300</u>
	<u>\$ 20,386</u>	<u>\$ 8,779</u>	<u>\$(5,296)</u>	<u>\$ 6,291</u>	<u>\$ 9,774</u>

As of July 31, 2003, the remaining balance of the second quarter of fiscal 2002 restructuring charge included accrued liabilities related to severance and benefits, which will be paid out over the remaining severance obligation period, and lease costs for redundant facilities and other fixed contracts, which will be paid over the respective remaining contract terms.

Fourth quarter of fiscal 2001

During the fourth quarter of fiscal 2001, we recorded \$51 million of pre-tax restructuring charges resulting from the restructuring of our operations in light of changes in general market conditions, changing customer demands, and the evolution of our business strategy. The execution of this strategy included refining our consulting initiatives, refocusing research and development efforts, defining sales and marketing efforts to be more customer and solutions oriented, and adjusting our overall cost structure given current revenue levels and our direction.

Specific actions included reducing our workforce worldwide by approximately 1,100 employees (approximately 16%), consolidating excess facilities and disposing of excess property and equipment, terminating a management consulting contract that no longer fit with our strategic focus, and abandoning and writing off technologies that no longer fit within our new strategy. We also realigned our remaining resources to better manage our business. As noted above, during the second quarter of fiscal 2003, we determined that the amount we had originally accrued for facility-related costs was too low and accrued an additional \$0.3 million. The original liability was based on estimated sublease rates and timing, which have been affected by the decline in the real estate market.

The following table summarizes the costs and activities during fiscal 2003 related to the fourth quarter of 2001 restructuring.

	Original Charge	Balance at October 31, 2002	Cash Payments	Adjustments	Balance at July 31, 2003
<i>In thousands</i>					
Severance and benefits	\$ 32,793	\$ 1,117	\$ (907)	\$ --	\$ 210
Excess facilities and property and equipment	10,896	4,651	(2,051)	262	2,862
Other restructuring-related costs	<u>6,973</u>	<u>624</u>	<u>(439)</u>	<u>--</u>	<u>185</u>
	<u>\$ 50,662</u>	<u>\$ 6,392</u>	<u>\$ (3,397)</u>	<u>\$ 262</u>	<u>\$ 3,256</u>

As of July 31, 2003, the remaining balance of the fourth quarter fiscal 2001 restructuring charge included accrued liabilities largely related to severance and benefits, which will be paid out during fiscal 2003, and lease costs for excess facilities, which will be paid over the respective remaining lease terms.

Third quarter of fiscal 2001

During the third quarter of fiscal 2001, we recorded a pre-tax restructuring charge of approximately \$30 million as a result of our July 2001 acquisition of Cambridge Technology Partners and changes in our business to move towards a Net business solutions strategy. Specific actions included reducing our workforce worldwide by approximately 280 employees across all functional areas (approximately 5% before the addition of Cambridge), consolidating facilities and disposing of excess property and equipment, abandoning and writing off technologies that no longer fit within our new strategy, and discontinuing unprofitable product lines. As noted above, during the second quarter of fiscal 2003, we determined that the amount we had originally accrued for facility-related costs was too low and accrued an additional \$0.7 million. The original liability was based on estimated sublease rates and timing, which have been affected by the decline in the real estate market.

The following table summarizes the activity during fiscal 2003 related to the third quarter of fiscal 2001 restructuring costs.

	Original Charge	Balance at October 31, 2002	Cash Payments	Adjustments	Balance at July 31, 2003
<i>In thousands</i>					
Severance and benefits	\$ 15,978	\$ --	\$ --	\$ --	\$ --
Excess facilities and property and equipment	10,740	3,889	(1,778)	678	2,789
Other restructuring-related costs	<u>3,675</u>	<u>137</u>	<u>(137)</u>	<u>--</u>	<u>--</u>
	<u>\$ 30,393</u>	<u>\$ 4,026</u>	<u>\$(1,915)</u>	<u>\$ 678</u>	<u>\$ 2,789</u>

As of July 31, 2003, the remaining balance of the third quarter of fiscal 2001 restructuring charge included accrued liabilities related to lease costs for excess facilities, which will be paid over the respective remaining lease terms.

I. Guarantees

During the first quarter of fiscal 2002, we sold our subsidiary in the Czech Republic. As a part of this transaction, we provided a guarantee to the landlord of the building we lease in the Czech Republic whereby we agreed to pay any and all monies due under the lease, including legal fees if the new lessee defaults on the lease. During fiscal 2003, we paid approximately \$0.1 million against this guarantee and have accrued an additional \$0.4 million, which represents our liability exposure if the new lessee continues in default, excluding legal fees.

As an element of our standard contract terms, we include an indemnification clause in our agreements with our customers that indemnifies the licensee against certain liability and damages arising from intellectual property infringement claims arising from their use or distribution of our software. These terms are common in the high technology industry. We do not record a liability for potential litigation claims related to indemnification agreements with our customers. We do not believe the likelihood of a material obligation is probable.

We also have some outstanding intercompany guarantees, which guarantee payment of certain obligations of our subsidiaries.

J. Commitments and Contingencies

In 1997, the Board of Directors established the Novell Venture account within our investment portfolio for the purpose of promoting our business and strategic objectives by making investments in privately-held companies, mainly small capitalization stocks in the high technology industry sector, and in funds managed by venture capitalists. As of July 31, 2003, we had a balance of \$47.2 million related to investments in various venture capital funds and had commitments to contribute an additional \$57.6 million to these funds over the next three to four years, upon the request of the fund managers. As a result of our acquisition of Cambridge, we also own both limited and general partnership interests in CTC I of approximately 24%. As of July 30, 2003, we had an investment balance of \$0.2 million in CTC I and had commitments to contribute up to an additional \$0.3 million over the next three to four years. We do not intend to make any new long-term investments through the Novell

Venture account or in venture capital funds.

In May 2002, France Telecom SA and U.S. Philips Corporation, alleged co-owners of a U.S. patent, filed suit in the U.S. District Court, District of Delaware, against Novell. The plaintiffs allege that Novell's NetWare client software infringes the patent. In the suit, the plaintiffs seek unspecified monetary damages and an injunction prohibiting infringement of the patent. We intend to vigorously defend ourselves in this suit. Although there can be no assurance as to the ultimate disposition of the suit, we do not believe that the resolution of this litigation will have a material adverse effect on our financial position, results of operations or cash flows.

SilverStream and several of its former officers and directors, as well as the underwriters who handled SilverStream's two public offerings, were named as defendants in several class action complaints that were filed on behalf of certain former stockholders of SilverStream who purchased shares of SilverStream common stock between August 16, 1999 and December 6, 2000. These complaints are closely related to several hundred other complaints that the same plaintiffs have brought against other issuers and underwriters. These complaints all allege violations of the Securities Exchange Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. In particular, they allege, among other things, that there was undisclosed compensation received by the underwriters of the public offerings of all of these issuers, including SilverStream's. The plaintiffs are seeking monetary damages, statutory compensation and other relief that may be deemed appropriate by the court. A Consolidated Amended Complaint with respect to all of these complaints was filed in the U.S. District Court, Southern District of New York, on April 19, 2002. All issuers, including SilverStream, filed a Motion to Dismiss on July 15, 2002. We believe that SilverStream and its former officers and directors have meritorious defenses to the claims made in the complaints and intend to contest the claims against SilverStream and its former directors and officers vigorously. While there can be no assurance as to the ultimate disposition of the litigation, we do not believe that its resolution will have a material adverse effect on our financial position, results of operations or cash flows.

In February 1998, a suit was filed in the U.S. District Court, District of Utah, against us and certain of our officers and directors, alleging violation of federal securities laws by concealing the true nature of our financial condition and seeking unspecified damages. The lawsuit was brought as a purported class action on behalf of purchasers of our common stock from November 1, 1996 through April 22, 1997. After a first dismissal of the suit on November 3, 2000 and a subsequent amendment to the complaint filed on February 20, 2001, the U.S. District Court dismissed the amended complaint with prejudice for failure to state a claim. Much of the District Court's Order of Dismissal was recently affirmed by the Tenth Circuit Court of Appeals while certain claims were remanded for the District Court's further review. Novell believes it has meritorious defenses to these remaining claims. While there can be no assurance as to the ultimate disposition of the lawsuit, we do not believe that the resolution of this litigation will have a material adverse effect on our financial position, results of operations or cash flows.

We are a party to a number of additional legal claims arising in the ordinary course of our business. We believe that the ultimate resolution of these claims will not have a material adverse effect on our financial position, results of operations or cash flows.

K. Segment Information

Beginning November 1, 2002, we reorganized our operations and began reporting our financial results in four segments; three are based on geographic areas and the fourth is Celerant management consulting. The geographic segments are Americas, EMEA, and Asia Pacific. Performance is evaluated by our Chief Executive Officer and Worldwide Management Committee, our chief decision makers, and is based on reviewing revenue and segment operating income (loss) information for each of the geographic segments and for the Celerant management consulting segment.

The geographic segments include:

- Americas – includes the United States, Canada, and Latin America
- EMEA – includes Eastern and Western Europe, Middle East, and Africa
- Asia Pacific –includes China, Japan, Southeast Asia, Australia, New Zealand, and India

All geographic segments sell our software, licenses and services offerings (except Celerant management consulting services). These offerings are sold in the U.S. via direct, OEM, reseller, and distributor channels, and internationally are sold directly and through distributors who sell to dealers and end users.

Operating results by segment

	<u>Three months July 31, 2003</u>		<u>Three months July 31, 2002</u>	
	<u>Net Revenue</u>	<u>Operating Income (Loss)</u>	<u>Net Revenue</u>	<u>Operating Income (Loss)</u>
<i>In thousands</i>				
Americas	\$ 135,635	\$ 61,671	\$ 151,255	\$ 64,755
EMEA	87,400	31,512	79,383	29,658
Asia Pacific	23,235	5,667	20,094	4,894
Common unallocated operating costs	--	<u>(92,939)</u>	--	<u>(89,653)</u>
Total geographic segments	246,270	5,911	250,732	9,654
Celerant management consulting	36,539	894	31,541	1,614
Unallocated integration costs and restructuring adjustments	--	<u>(26,850)</u>	--	<u>(3,000)</u>
Total	<u>\$ 282,809</u>	<u>\$ (20,045)</u>	<u>\$ 282,273</u>	<u>\$ 8,268</u>
	<u>Nine months ended July 31, 2003</u>		<u>Nine months ended July 31, 2002</u>	
	<u>Net Revenue</u>	<u>Operating Income (Loss)</u>	<u>Net Revenue</u>	<u>Operating Income (Loss)</u>
<i>In thousands</i>				
Americas	\$ 396,979	\$ 163,372	\$ 448,707	\$ 196,446
EMEA	257,800	90,857	233,492	90,080
Asia Pacific	62,000	8,982	59,062	10,535
Common unallocated operating costs	--	<u>(277,107)</u>	--	<u>(280,279)</u>
Total geographic segments	716,779	(13,896)	741,261	16,782
Celerant management consulting	101,968	3,074	92,723	4,058
Unallocated integration costs and restructuring adjustments	--	<u>(37,897)</u>	--	<u>(24,756)</u>
Total	<u>\$ 818,747</u>	<u>\$ (48,719)</u>	<u>\$ 833,984</u>	<u>\$ (3,916)</u>

Common unallocated operating costs include corporate services common to all segments such as corporate sales and marketing, product development, corporate general and administrative costs, and corporate infrastructure costs. Celerant does not utilize these corporate services.

In addition to reviewing geographic and Celerant management consulting segment results, our chief decision makers review net revenue by solution category. These solution categories are:

- Identity management and secure web services - solutions that help customers with their identity management and security issues. Products include Secure-Login/Single Sign-On, DirXML, iChain, exteNd, and BorderManager. Products in this category are branded as Nsure and exteNd.
- Cross platform services - solutions that offer an effective and open approach to networking and collaboration services, including file, print, messaging, scheduling, workspace, etc. while using a cross-platform approach. Products include NetWare, GroupWise, ZEN, and Novell iFolder. Products in this category are branded as Nterprise.
- Worldwide services - comprehensive worldwide IT consulting, education, and support services that apply Net business solutions to our customers' business situations, providing the business knowledge and technical

expertise to help our customers implement our identity management, secure web services, and cross platform services. Services in this category are branded as Ngage.

- Celerant management consulting— operational strategy and implementation consulting services offered to a wide range of customers across various sectors, worldwide.

Revenue by solution category

	<u>Three months ended July 31,</u>		<u>Nine months ended July 31,</u>	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
<i>In thousands</i>				
Identity management and secure web services	\$ 26,318	\$ 19,576	\$ 72,132	\$ 53,055
Cross platform services	<u>144,376</u>	<u>153,208</u>	<u>422,242</u>	<u>450,264</u>
Total software licenses and maintenance	170,694	172,784	494,374	503,319
Worldwide services	<u>75,576</u>	<u>77,949</u>	<u>222,406</u>	<u>237,943</u>
Total IT software and solutions	246,270	250,733	716,780	741,262
Celerant management consulting	<u>36,539</u>	<u>31,541</u>	<u>101,969</u>	<u>92,723</u>
Total net revenue	<u>\$ 282,809</u>	<u>\$ 282,274</u>	<u>\$ 818,749</u>	<u>\$ 833,985</u>

Separate financial information is not evaluated by business segment with regard to asset allocation. Prior to November 1, 2002, we operated and reported financial results based on three business segments: product, consulting, and Volera, Inc.

For the third quarters of fiscal 2003 and fiscal 2002, sales in the U.S. were \$129.3 million and \$143.3 million, respectively, and sales to international customers were approximately \$153.5 million and \$139.0 million, respectively. In the third quarters of fiscal 2003 and fiscal 2002, 74% of our international sales were in EMEA.

On a year-to-date basis, sales in the U.S. were \$378.8 million in fiscal 2003 and \$433.8 million in fiscal 2002, and sales to international customers were \$439.9 million in fiscal 2003 and \$400.2 million in fiscal 2002. For the first nine months of fiscal 2003 and fiscal 2002, international sales in EMEA accounted for 75% and 73%, respectively, of our total international sales.

No single international country accounted for more than 10% of our total revenue.

L. Net Income (Loss) Per Share

Earnings per share for the third quarters and first nine months of fiscal 2003 and 2002 were calculated as follows:

	<u>Three months ended July 31,</u>		<u>Nine months ended July 31,</u>	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
<i>In thousands, except per share data</i>				
<u>Basic net loss per share:</u>				
Net income (loss)	<u>\$ (12,400)</u>	<u>\$ 9,949</u>	<u>\$ (52,900)</u>	<u>\$ (155,151)</u>
Weighted average shares outstanding	371,484	364,211	369,435	363,131
Basic net income (loss) per share	<u>\$ (0.03)</u>	<u>\$ 0.03</u>	<u>\$ (0.14)</u>	<u>\$ (0.43)</u>
<u>Diluted net loss per share:</u>				
Net income (loss)	<u>\$ (12,400)</u>	<u>\$ 9,949</u>	<u>\$ (52,900)</u>	<u>\$ (155,151)</u>
Weighted average shares outstanding	371,484	364,247	369,435	363,131
Diluted net income (loss) per share	<u>\$ (0.03)</u>	<u>\$ 0.03</u>	<u>\$ (0.14)</u>	<u>\$ (0.43)</u>

M. Comprehensive Income (Loss)

The components of comprehensive income (loss), net of tax, for the third quarters and year-to-date periods of fiscal 2003 and 2002, were as follows:

<i>In thousands</i>	<u>Three months ended July 31,</u>		<u>Nine months ended July 31,</u>	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Net income (loss)	\$ (12,400)	\$ 9,949	\$ (52,900)	\$(155,151)
Change in net unrealized gain/(loss) on investments	(1,022)	(672)	(757)	(4,687)
Change in cumulative translation adjustment	<u>5,004</u>	<u>(843)</u>	<u>5,333</u>	<u>(1,157)</u>
Comprehensive income (loss)	<u>\$ (8,418)</u>	<u>\$ 8,434</u>	<u>\$ (48,324)</u>	<u>\$(160,995)</u>

The components of accumulated other comprehensive income (loss), net of related tax, at July 31, 2003 and October 31, 2002 are as follows:

<i>In thousands</i>	<u>July 31, 2003</u>	<u>October 31, 2002</u>
Net unrealized gain on investment	\$ 1,447	\$ 2,204
Cumulative foreign currency translation adjustment	<u>3,186</u>	<u>(2,147)</u>
Accumulated other comprehensive income	<u>\$ 4,653</u>	<u>\$ 57</u>

N. Stock Option and Other Equity Plans

Pursuant to an Exchange Offer dated May 14, 2003, which was implemented after our stockholders approved amendments to our stock option plans at our 2003 Annual Meeting held on May 1, 2003, we offered a stock option exchange program to our non-executive employees giving them the right to exchange outstanding stock options with an exercise price of \$5.03 per share or more for new options to be issued six months and one day subsequent to the closing of the tender offer. The closing of the tender offer was on June 12, 2003. The options tendered under the program will be replaced with options to purchase a fewer number of shares than the original options would have provided, based upon an exchange ratio primarily dependent upon the exercise price of the tendered option.

Options to purchase approximately 17 million shares of our common stock were tendered, representing 64% of the options that were eligible for the exchange. These options were cancelled and are no longer outstanding. Not less than six months and one day after the closing of the tender offer, we estimate we will issue new options at the then-current fair market value on that date to purchase an aggregate of approximately 9.3 million shares of our common stock. After the issuance of the new options, we anticipate retiring approximately 7.7 million options, which would reduce our total overhang to approximately 28.5%.

The program was structured to comply with current accounting guidelines so that we will not be subject to variable accounting and thus will not recognize compensation expense in connection with the grant of the replacement options. If the current accounting standards or guidelines are changed prior to the issuance of the new options, we will have to comply with the changed accounting treatment.

At July 31, 2003, we had authorized stock option and other equity plans under which options or rights to purchase shares of our common stock and awards of stock could be granted to employees, consultants and outside directors. We apply the intrinsic value method in accounting for our stock option and equity plans. Accordingly, no compensation expense (except compensation expense related to restricted stock purchase grants, below-market option grants, and grants to non-employees) has been recognized for our stock option and other equity plans. If compensation expense for our stock option and other equity plans had been determined based on the fair value method of accounting for stock grants, using the Black-Scholes option pricing model, our net loss and net loss per share would have been the pro forma amounts indicated in the following table.

	<u>Three months ended July 31,</u>		<u>Nine months ended July 31,</u>	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
<i>In thousands, except per share data</i>				
Net income (loss):				
As reported	\$ (12,400)	\$ 9,949	\$ (52,900)	\$ (155,151)
Pro forma	\$ (17,568)	\$ (2,405)	\$ (73,383)	\$ (198,879)
Net income (loss) per share:				
As reported basic and diluted	\$ (0.03)	\$ 0.03	\$ (0.14)	\$ (0.43)
Pro forma basic and diluted	\$ (0.05)	\$ (0.01)	\$ (0.20)	\$ (0.55)

During the third quarter and first nine months of fiscal 2003, we recognized a pre-tax expense of \$0.9 million and \$2.5 million in compensation expense compared to \$0.9 million and \$5.6 million during the same periods of fiscal 2002. Pro forma amounts have been adjusted to reflect the impact of additional compensation expense related to our stock option and other equity plans. For the three months ended July 31, 2003 and 2002, pro-forma compensation expense, pre-tax, was \$8.4 million and \$20.1 million, respectively. For the nine months ended July 31, 2003 and 2002, pro-forma compensation expense, pre-tax, was \$32.2 million and \$72.4 million respectively.

For purposes of the above table, the fair value of each option grant was estimated as of the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in the third quarters of fiscal 2003 and fiscal 2002: a risk-free interest rate of approximately 2.19% and 3.75%, respectively; a dividend yield of 0.0% for both quarters; a weighted-average expected life of five years for both quarters, except for the shares to be tendered as a part of a Tender Offer which has an average expected life of three years; and a volatility factor of the expected market price of our common stock of 0.81 and 0.87, respectively. The weighted average fair value of options granted in the third quarters of fiscal 2003 and fiscal 2002 were \$2.02 and \$1.51, respectively.

For the first nine months of fiscal 2003 and fiscal 2002 assumptions included: a risk-free interest rate of approximately 2.36% and 3.65%, respectively; a dividend yield of 0.0% for both periods; a weighted-average expected life of five years for both periods, except for the shares to be tendered as a part of a Tender Offer which has an average expected life of three years; and a volatility factor of the expected market price of our common stock of 0.82 and 0.87, respectively. The weighted average fair value of options granted in the first nine months of fiscal 2003 and fiscal 2002 were \$2.30 and \$1.70, respectively.

For purposes of the above table, the Company does not recognize compensation expense related to employee purchase rights under the Purchase Plan. Pro forma compensation expense is estimated for the fair value of the employees' purchase right using the Black-Scholes option pricing model with the following assumptions for the shares issued in the third quarters of fiscal 2003 and fiscal 2002: risk-free interest rate of approximately 2.3% and 1.5%, respectively; a dividend yield of 0.0% for both periods; a weighted-average expected life of 6 months for both periods; and a volatility factor of the expected market price of our common stock of 0.88 and 0.87, respectively. The weighted average fair value of the purchase rights issued in the third quarters of fiscal 2003 and fiscal 2002 was \$0.93 and \$1.52.

O. Derivative Instruments

A large portion of our revenue, expense, and capital purchasing activities are transacted in U.S. dollars. However, we do enter into transactions in other currencies, primarily the Euro, Japanese yen, and certain other European, Latin American, and Asian currencies. To protect against reductions in value caused by changes in foreign exchange rates, we have established balance sheet and intercompany hedging programs. We hedge currency risks of some assets and liabilities denominated in foreign currencies through the use of one-month foreign currency forward contracts.

We enter into these one-month hedging contracts two business days before the end of each month and settle them at the end of the following month. Due to the short period of time between entering into the forward contracts and the quarter-end, the fair value of the derivatives as of July 31, 2003 is insignificant. Gains and losses recognized during the quarter on these foreign currency contracts are recorded as other income or expense and would generally be offset by corresponding losses or gains on the related hedged items, resulting in negligible net exposure to our financial statements. We do not currently hedge currency risks related to revenue or expenses denominated in foreign currencies.

P. Subsequent Event

On August 4, 2003, we acquired Ximian, Inc., a privately-held company and leading provider of desktop and server solutions that enable enterprise Linux adoption, for approximately \$40 million. The acquisition of Ximian expands Novell's ability to support Linux solutions, providing Novell with Linux desktop, groupware and management technologies. The acquisition also brings leaders in the open source community and a strong core of Linux developers to Novell.

Q. New Accounting Pronouncement

Financial Accounting Standards Board Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), was issued in January 2003. FIN 46 requires that if an entity is the primary beneficiary of a variable interest entity, the assets, liabilities and results of operations of the variable interest entity should be included in the consolidated financial statements of the entity. The provisions of FIN 46 are effective immediately for all arrangements entered into after January 31, 2003. We have not invested in any variable interest entities after January 31, 2003. For those arrangements entered into prior to January 31, 2003, the provisions of FIN 46 are required to be adopted at the beginning of the first interim or annual period beginning after June 15, 2003. We are reviewing our arrangements with variable interest entities entered into prior to January 31, 2003. We do not believe that our arrangements with these entities will require consolidation of their financial information in our financial statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") and other parts of this Form 10-Q contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties. In some cases, such forward-looking statements may be identified by the use of words such as "may," "will," "expects," "plans," "anticipates," "estimates," "potential," or "continue" or the negative thereof or other comparable words. Such forward-looking statements include statements regarding, among other things, our revenue expectations, future business strategies, market conditions and opportunities, and liquidity. All forward-looking statements are based on management's current expectations and information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our actual results may differ materially from management's expectations and the results discussed in such forward-looking statements as a result of a number of factors, which include, but are not limited to, those set forth below in the section titled "Risk Factors Affecting Future Results of Operations."

Introduction

Novell, Inc. has been a pioneer in the field of computer networking since our development and release of NetWare in the mid 1980s. As a result of our 20 years of experience as a leader in the field of computer networking, we have some of the best networking engineers in the world. These engineers, together with our consulting force, work to create world-class IT solutions. We are extraordinarily proud of our people, the skills that they have and the dedication that they bring to our company. Leveraging this expertise, we expect to continue our evolution of our cross platform strategy and become a leading company in providing cross platform solutions, secure Web services, and identity management. Our solutions leverage our network expertise and the Web to help to create a world without information boundaries.

Today we provide Net business solutions across a myriad of platforms designed to secure and empower the networked world, helping organizations solve complex business challenges, simplify their systems and processes, and capture new opportunities. Net business solutions include software applications and consulting services that were developed using open Internet standards and our own eDirectoryTM network infrastructure products, support highly distributed network solutions and capitalize on the growth of the Internet. With both software and services offerings, we can determine how Net business solutions can be used by an organization and the requirements necessary to ensure proper security and access. This can then be turned into a Net solutions approach that helps our customer deliver the right information, to the right individual, at the right time, and on the right device.

In addition, our Net business solutions include essential network management, messaging, and collaboration capabilities integrated through our directory services. Networks are inherently a varied mix of business process, infrastructure, computer systems, applications, and other devices. Our software provides the framework and applications for managing, maintaining, and accessing the information and services of these networks. During fiscal 2003, we announced our strategy to support the Linux kernel in addition to the NetWare kernel. This would give our customers a choice by providing Novell products and services that run on both Netware and Linux platforms.

Our training, service and support, and consulting groups also support our Net business solutions by providing worldwide consulting, training, developer, and distribution channel programs that support our product offerings.

Critical Accounting Policies

An accounting policy is deemed to be critical if it requires us to make an accounting estimate based on assumptions about matters that are highly uncertain at the time the accounting estimate is made, and if different estimates that reasonably could have been used, or if changes in the accounting estimate that are reasonably likely to occur periodically, could materially impact the financial statements. We consider certain accounting policies related to revenue recognition, restructuring, impairment of long-lived assets, and valuation of deferred tax assets to be critical accounting policies due to the estimation processes involved in each.

Revenue recognition. Revenue from our Celerant management consulting segment and about half of the revenue from our IT consulting group within our worldwide services business is derived from fixed-price, fixed-time contracts, which require the accurate estimation of the cost, scope, and duration of each engagement. Revenue and the related costs for these projects are recognized using the percentage-of-completion method, using time-to-completion to measure the percent complete, with revisions to estimates reflected in the period in which changes become known. If we do not accurately estimate the resources required or the scope of work to be performed, or do not manage our projects properly within the planned periods of time or satisfy our obligations under the contracts, future consulting margins may be significantly and negatively affected or losses on existing contracts may need to be recognized. Any such resulting reductions in margins or contract losses could be material to our results of operations.

We record a provision against revenue for estimated sales returns and allowances on product and service related sales in the same period as the related revenues are recorded. We also record a provision to operating expense for bad debts resulting from customers' inability to pay for the products or services they have received due to such factors as bankruptcy. These estimates are based on historical sales returns and bad debt data, analysis of credit memo data, and other known factors. If the historical data we use to calculate these estimates does not properly reflect future returns or bad debts, revenue or net income could be overstated or understated.

Restructuring Liabilities. From time to time, as business conditions or other factors change requiring us to change or modify our strategy, we are required to restructure our business. This typically involves eliminating excess headcount, consolidating facilities, or exiting or abandoning unprofitable product lines or geographic areas. When we consolidate facilities or exit or abandon unprofitable product lines or geographic areas, we must make certain assumptions regarding the sublease rates and timing for the exited facilities and estimated future cash flows from products lines or geographic locations. If we do not accurately estimate these factors, our estimated liabilities may not be fairly stated. Any such resulting changes in estimates could be material to our results of operations. For example, during the second quarter of fiscal 2003, we were required to increase our restructuring reserves by approximately \$8.7 million due to changes in estimated sublease rates and timing, which have been affected by the decline in the real estate market.

Long-lived Assets. Our long-lived assets include property, plant and equipment, long-term investments, goodwill and other intangible assets. At July 31, 2003, our long-lived assets included \$258.9 million of net property, plant and equipment, \$51.0 million of long-term investments, \$178.3 million of goodwill, \$4.4 million of identifiable intangible assets, and \$115.9 million of current and non-current net deferred tax assets.

Property, Plant and Equipment. We periodically review our property, plant and equipment for impairment in accordance with Statement of Financial Accounting Standards No. 144 ("SFAS 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets." In determining whether an asset is impaired, we must make assumptions regarding recoverability of costs, estimated future cash flows from the asset, intended use of the asset, and other related factors. If these estimates or their underlying assumptions change, we may be required to record impairment charges for these assets. For example, in the fourth quarter of fiscal 2002, we determined that our facilities in San Jose, California and a small building in Provo, Utah had become impaired due to changes in the intended use of the facilities, as well as changes in the local commercial real estate market. This resulted in a pre-tax, non-cash impairment charge of \$80 million. Depending upon relevant factors, such as a decision to sell a facility, or a continuation of the decline in real estate market conditions, we could be required to record additional impairment charges.

Long-term Investments. The fair value of long-term investments is dependant on the actual financial performance of the companies and venture funds in which we have invested, the investee's market value, and the volatility inherent in the external markets for these investments. In assessing potential impairment for these privately-held equity investments, we consider these factors as well as the forecasted financial performance of our investees, liquidation preference value of the stock we hold, and estimated potential for investment recovery based on all these factors. If any of these factors indicate that the investment has become other-than-temporarily impaired, we will have to record additional impairment charges not previously recognized. During the first nine months of fiscal 2003, we recognized \$32.6 million of impairment losses related to our long-term investments due to poor performance and general market conditions. If general market conditions do not improve, or if any of the companies or venture funds included in long-term investments do not meet performance goals, our investments could become further impaired on an other-

than-temporary basis as their values decline, causing us to record further investment impairment charges.

Goodwill and Intangible Assets. In assessing the recoverability of our goodwill and other intangible assets, we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. This process is subjective and requires judgment at many points throughout the analysis. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for these assets not previously recorded.

We periodically review our goodwill and intangibles for indicators of impairment. We also perform an annual impairment review under Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets," in the fourth quarter of each fiscal year, based on August 1 balances, to determine whether there are any indicators of impairment as of that date. Various assumptions will be made as a part of this analysis that could affect the resulting outcome. For example, to estimate the fair value of our reporting units, management will make estimates and judgments about future cash flows based on our fiscal 2003 forecast and current long-range plans used to manage the business. These long-range estimates could change in the future depending on changes in the Company as well as external factors. Future changes in estimates could possibly result in a non-cash goodwill impairment that could have a material adverse impact on our financial condition and results of operations.

In connection with our acquisition of SilverStream, we acquired developed technology related to SilverStream's exteNd products that could be combined with our products and services. We periodically review our identifiable intangible assets for impairment in accordance with SFAS No. 144. In determining whether an intangible asset is impaired, we must make assumptions regarding estimated future cash flows from the asset, intended use of the asset and other related factors. If the estimates or the related assumptions used to determine the value of the intangible assets change, we may be required to record further impairment charges for these assets. For example, if we were to abandon our products which integrate the exteNd Web-based technology that we acquired from SilverStream, or if the sales forecasts for these secure Web services products were to change, we could be required to record an impairment charge in future periods. During the third quarter of fiscal 2003, we determined that the developed technology and trade names we acquired from SilverStream had become impaired. Based on an independent valuation of these assets, we recorded a \$23.6 million dollar charge as a result of unexpected revenue declines for the exteNd products.

Deferred Tax Assets. The carrying value of our net deferred tax assets assumes that we will be able to generate sufficient future taxable income in certain tax jurisdictions based on estimates and assumptions. If these estimates and related assumptions change in the future, we may be required to record additional valuation allowances against our deferred tax assets resulting in additional income tax expense in our consolidated statement of operations. Management evaluates the realizability of the deferred tax assets quarterly and assesses the need for additional valuation allowances quarterly. During the nine months ended July 31, 2003, we recorded an additional \$16 million of valuation allowances related to the increase in our net deferred tax assets, primarily relating to investment impairments, that we may not be able to recognize in future periods.

Results of operations

Revenue

	<u>Three months ended July 31,</u>			<u>Nine months ended July 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>Change</u>	<u>2003</u>	<u>2002</u>	<u>Change</u>
<i>(Dollars in thousands)</i>						
New software licenses	\$ 69,255	\$ 82,894	(17)%	\$ 194,758	\$ 224,980	(13)%
Maintenance and services	<u>213,554</u>	<u>199,379</u>	7%	<u>623,989</u>	<u>609,005</u>	3%
Total net revenue	<u>\$ 282,809</u>	<u>\$ 282,273</u>	-%	<u>\$ 818,747</u>	<u>\$ 833,985</u>	(2)%

New software licenses revenue decreased in the third quarter and first nine months of fiscal 2003 compared to the same periods of fiscal 2002 primarily due to decreased demand for our solutions in the United States as a result of the weak economic environment and a continuing decline in the demand for our NetWare products. Maintenance and services revenue, which includes software maintenance, technical support, education, and consulting services grew in the third quarter and first nine months of fiscal 2003 compared to the same periods in fiscal 2002 largely due

to growth in software maintenance revenue (increase of 13% and 8%, respectively), increased Celerant management consulting revenue (increase of 16% and 10%, respectively), and favorable Euro exchange rates. These increases were partially offset by decreased demand for IT consulting services (decrease of 3% and 7%, respectively), which is largely the result of weak sales in the United States as a result of the poor economy.

Beginning November 1, 2002, we reorganized our operations and began reporting our financial results in four new segments; three are based on geographic area and the fourth is Celerant management consulting. The geographic segments include:

- Americas – includes the United States, Canada, and Latin America
- EMEA – includes Eastern and Western Europe, Middle East, and Africa
- Asia Pacific –includes China, Japan, Southeast Asia, Australia, New Zealand, and India

Company performance is evaluated by our Chief Executive Officer and senior executive officers, our chief decision makers, based on reviewing revenue and segment operating income (loss) for the geographic segments listed above and the Celerant management consulting segment. Separate financial information is not evaluated by business segment in regards to asset allocation.

	<u>Three months ended July 31,</u>			<u>Nine months ended July 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>Change</u>	<u>2003</u>	<u>2002</u>	<u>Change</u>
<i>(Dollars in thousands)</i>						
Americas	\$ 135,635	\$ 151,255	(10)%	\$ 396,979	\$ 448,707	(12)%
EMEA	87,400	79,383	10%	257,800	233,492	10%
Asia Pacific	23,235	20,094	11%	62,000	59,062	5%
Celerant	<u>36,539</u>	<u>31,541</u>	16%	<u>101,968</u>	<u>92,723</u>	10%
Total net revenue	<u>\$ 282,809</u>	<u>\$ 282,273</u>	--%	<u>\$ 818,747</u>	<u>\$ 833,984</u>	(2)%

Revenue in the Americas decreased during the third quarter and first nine months of fiscal 2003 compared to the same periods of fiscal 2002 due to decreased software and consulting revenue reflecting poor market conditions in the United States and Latin America, declining Netware revenue and lower IT consulting demand and billing rates. In addition, revenue in the Americas was negatively affected during the first nine months of fiscal 2003 by a temporary distraction to our selling efforts in the United States while we transferred certain of our customer accounts from our sales force to our channel partners and restructured the sales organization. Revenue increased in EMEA during the third quarter and first nine months of fiscal 2003 due to favorable foreign exchange rates and recovering European market conditions, which resulted in greater demand for our products and services. The increase in revenue in Asia Pacific during the third quarter of fiscal 2003 was primarily due to strong sales in Japan and Australia. For the first nine months of fiscal 2003, Asia Pacific sales increased primarily due to strong sales in Australia and India, offset somewhat by lower sales in Japan due to a weak economy during the first half of fiscal 2003. Celerant worldwide revenue increased in the third quarter and first nine months of fiscal 2003 due primarily to improved revenue growth in Europe, which resulted in greater demand for Celerant's consulting services, revenue recognized on a number of large completed contracts, and favorable foreign exchange rates. Revenue outside the U.S. represented 54% of total revenue in the third quarter of fiscal 2003 compared to 49% in the third quarter of fiscal 2002. Revenue outside the U.S. for the first nine months of fiscal 2003 was 54% compared to 48% in the first nine months of fiscal 2002.

In addition to reviewing geographic and Celerant management consulting segment results, our chief decision makers review net revenue by solution category. These solutions categories are:

- Identity management and secure web services - solutions that help customers with their identity management and security issues. Products include Secure-Login/Single SignOn, DirXML, iChain, exteNd, and BorderManager. This category is branded as Nsure and exteNd.
- Cross platform services - solutions that offer an effective and open approach to networking and collaboration services, including file, print, messaging, scheduling, workspace, etc. while using a cross-platform approach. Products include NetWare, GroupWise, ZEN, and Novell iFolder. This category is branded as Nterprise.
- Worldwide services - comprehensive worldwide consulting, education, and support services that apply Net business solutions to our customers' business situations, providing the business knowledge and technical expertise to help our customers implement our identity management, secure web services, and cross platform services. This category is branded as Ngage.
- Celerant management consulting – provides operational strategy and implementation consulting services, which result in quantifiable value, to a wide range of customers across various sectors, worldwide.

	Three months ended July 31,			Nine months ended July 31,		
	2003	2002	Change	2003	2002	Change
<i>(Dollars in thousands)</i>						
Identity management and secure web services	\$ 26,318	\$ 19,576	34%	\$ 72,132	\$ 53,055	36%
Cross platform services	144,376	153,208	(6)%	422,242	450,264	(6)%
Worldwide services	75,576	77,949	(3)%	222,406	237,943	(7)%
Celerant management consulting	<u>36,539</u>	<u>31,541</u>	16%	<u>101,969</u>	<u>92,723</u>	10%
Total net revenue	<u>\$ 282,809</u>	<u>\$ 282,274</u>	--%	<u>\$ 818,749</u>	<u>\$ 833,985</u>	(2)%

Identity management and secure web services revenue increased in the third quarter and first nine months of fiscal 2003 compared to the same periods of fiscal 2002 due to the addition of the SilverStream secure web services products in July 2002, which added \$4.4 million and \$9.6 million, respectively, and increased demand for our Secure Login/Single SignOn and DirXML products as the secure identity market continues to grow. Cross platform services declined in the third quarter and first nine months of fiscal 2003 compared to the same periods in fiscal 2002 primarily due to the decline in demand for our NetWare products (decrease of 12% for both periods), offset slightly by increased demand for our Groupwise and ZEN products. Worldwide services revenue declined in the third quarter and first nine months of fiscal 2003 compared to the same periods in fiscal 2002 primarily due to the weakened demand for our IT consulting services in the U.S. and lower billing rates as a result of the weak economic environment.

At July 31, 2003, we had \$295.8 million of deferred revenue, representing revenue that is expected to be recognized in future periods. The majority of this deferred revenue relates to maintenance contracts, which are recognized ratably over the maintenance period. We have either received payment or recorded a receivable for the deferred revenue, and have determined collectability to be reasonably certain. Direct costs incurred to fulfill these maintenance obligations are relatively small and are recognized as work is performed.

Forward-looking revenue trends

Due to the uncertainty in the U.S. and global economies, heightened political conflicts throughout the world, and continued volatility in the information technology marketplace, we are unable to predict when the information technology or consulting markets will recover, in the U.S. or globally. We anticipate some continued declines in our NetWare revenue. However, with the enhancements added to our future releases of NetWare, which will include network services running on both the NetWare kernel and the Linux kernel, and our recent acquisition of Ximian we have begun to deliver on our Linux strategy. We believe this will help to slow the NetWare revenue decline by retaining existing customers and attracting new customers by providing them with a migration path to Linux, should they choose to pursue those alternatives. We also believe that the identity management and secure web services markets will continue to grow as they mature, which may improve revenue from our offerings in these areas.

As previously disclosed, we have decided not to provide specific revenue forecast information for the remainder of

fiscal 2003 or future periods.

Gross profit

	<u>Three months ended July 31,</u>			<u>Nine months ended July 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>Change</u>	<u>2003</u>	<u>2002</u>	<u>Change</u>
<i>(Dollars thousands)</i>						
Gross profit	\$ 175,332	\$ 172,451	2%	\$ 504,935	\$ 493,766	2%
Percentage of revenue	62%	61%		62%	59%	

Gross profit in total and as a percentage of sales increased in the third quarter and first nine months of fiscal 2003 compared to the same periods of fiscal 2002 primarily due to improved consulting margins resulting from headcount reductions in fiscal 2002 and 2003 and improved performance in our Celerant management consulting segment. Gross margins on new software licenses were 92% and 91% in the third quarter and first nine months of fiscal 2003, respectively, compared to 90% and 90% for the same periods of fiscal 2002. Gross margins on maintenance and services were 52% and 49% in the third quarter and first nine months of fiscal 2003, respectively, compared to 52% and 48% for the same periods of fiscal 2002. We are continuing to address ways to improve our gross margin percentage in future periods, such as improving utilization, increasing IT consulting billing rates, and reducing expenses. However, due to the uncertainty in the U.S. and global economies, heightened political conflicts throughout the world, and continued volatility in the information technology marketplace, we are unable to predict when we will see significant improvements in our gross margin percentages. As previously disclosed, we have decided not to provide specific forecasted earnings information for the remainder of fiscal 2003 or future periods.

Operating expenses

	<u>Three months ended July 31,</u>			<u>Nine months ended July 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>Change</u>	<u>2003</u>	<u>2002</u>	<u>Change</u>
<i>(Dollars in thousands)</i>						
Sales and marketing	\$ 92,470	\$ 87,487	6%	\$292,512	\$ 255,108	15%
Percentage of revenue	33%	31%		36%	31%	
Product development	\$ 48,178	\$ 44,130	9%	\$ 139,454	\$ 129,528	8%
Percentage of revenue	17%	16%		17%	16%	
General and administrative	\$ 28,379	\$ 29,566	(4)%	\$ 86,663	\$ 90,946	(5)%
Percentage of revenue	10%	11%		11%	11%	
Restructuring	\$ 26,350	\$ --	--%	\$ 35,025	\$ 19,100	83%
Percentage of revenue	9%	--%		4%	4%	
In-process R&D	\$ --	\$ 3,000	(100)%	\$ --	\$ 3,000	(100)%
Percentage of revenue	--%	1%		--%	--%	
Total operating expenses	\$ 195,377	\$ 164,183	19%	\$ 553,654	\$ 497,682	11%
Percentage of revenue	69%	58%		68%	60%	

Operating expenses, in total and as a percentage of revenue, increased in the third quarter and first nine months of fiscal 2003 compared to the same periods in fiscal 2002 primarily due to a third quarter fiscal 2003 restructuring charge, additional operating expenses related to the SilverStream acquisition in the third quarter of fiscal 2002, increased sales and marketing headcount, and increased marketing costs for our new advertising campaign that was rolled out during the first quarter. These expenses were offset somewhat by lower salary expenses as a result of lower bonus accruals and lower headcount due to the restructuring and other headcount reductions in fiscals 2003 and 2002.

Sales and marketing expense, in total and as a percentage of revenue, increased in the third quarter and first nine months of fiscal 2003 compared to the same periods in fiscal 2002 primarily as a result of increased marketing costs associated with our advertising campaign and increased sales headcount, primarily from the addition of SilverStream during fiscal 2003, prior to reductions related to the third quarter restructuring. We have spent approximately \$27 million during the first three quarters of fiscal 2003 on our new advertising campaign and anticipate spending approximately \$6 million during the remainder of fiscal 2003 in an effort to attract new customers and increase revenue. At the end of the third quarter of fiscal 2003, sales and marketing headcount decreased by 88 employees compared to the third quarter of fiscal 2002. Sales and marketing expenses can fluctuate as a percentage of revenue

in any given period due to product promotions, advertising, and other discretionary expenses.

Product development expenses, in total and as a percentage of revenue, increased in the third quarter and first nine months of fiscal 2003 compared to the same periods of fiscal 2002 due primarily to the addition of SilverStream in July of fiscal 2002. The increase in cost for the additional headcount in the first and second quarters of fiscal 2003 was offset slightly by savings related to lower bonus accruals in fiscal 2003 and a favorable settlement received in the first quarter of fiscal 2003 related to development obligations dating back to agreements signed in the 1990s. Product development headcount decreased by 81 employees compared to the third quarter of fiscal 2002, which includes the reductions related to the third quarter restructuring net of additional employees to support our Linux initiatives. We anticipate that our product development expenses will remain relatively flat or decrease slightly in remaining quarters of fiscal 2003 compared to the second quarter of fiscal 2003 amounts as we continue our cost cutting efforts.

General and administrative expenses in the third quarter and first nine months of fiscal 2003 decreased from the same periods of fiscal 2002 primarily due to lower bad debt expense and lower operating costs related to decreased headcount and integration costs. General and administrative headcount decreased by 61 employees at the end of the third quarter of fiscal 2003 after the reductions related to the restructuring compared to the same period of fiscal 2002. As a percentage of revenue, general and administrative costs remained relatively flat during the first nine months of fiscal 2003 compared to the same periods in fiscal 2002 partially as a result of lower revenue in fiscal 2003. We anticipate that our general and administrative expenses will remain relatively flat or decrease slightly during the remainder of fiscal 2003 as we continue our cost cutting efforts.

Restructuring

Third quarter of fiscal 2003

During the third quarter of fiscal 2003, we recorded a pre-tax restructuring charge of approximately \$27.8 million resulting from the restructuring of our operations in response to changes in general market conditions, changing customer demands, and the evolution of our business strategy relative to the identity management and secure web services areas of our business and our revised strategy. This strategy includes plans to support the Linux kernel in addition to the NetWare kernel, by offering Novell products and services that run on both Netware and Linux platforms. These changes in strategy and company structure were made to address the current revenue declines. Specific actions taken included reducing our workforce worldwide by approximately 600 employees (approximately 10%) across all functions and geographies, with a majority coming from product development, sales, and general and administrative functions, primarily in the United States. In addition, we consolidated facilities, and disposed of excess equipment. By reporting segment, the Americas accounted for \$19.4 million, EMEA accounted for \$6.0 million, and Asia Pacific accounted for \$2.4 million.

We anticipate the actions to produce annual savings of approximately \$75 million in operating expense relating to headcount and an additional \$25 million in annualized savings from lower non-salary-related operating expenses.

The following table summarizes the activity during the third quarter of 2003 related this restructuring.

	Original Charge	Cash Payments	Non-cash Adjustments	Balance at July 31, 2003
<i>In thousands</i>				
Severance and benefits	\$ 20,287	\$ (11,671)	\$ --	\$ 8,616
Excess facilities and property and equipment	5,778	--	218	5,996
Other restructuring-related costs	<u>1,729</u>	<u>(67)</u>	<u>(261)</u>	<u>1,401</u>
	<u>\$ 27,794</u>	<u>\$ (11,738)</u>	<u>\$ (43)</u>	<u>\$ 16,013</u>

As of July 31, 2003, the remaining balance of the third quarter of fiscal 2003 restructuring charge included accrued liabilities related to severance and benefits, which will be paid out over the remaining severance obligation period, not to exceed two years, lease costs for redundant facilities, which will be paid over the respective remaining contract terms, and various severed employee related costs, which will be paid over the next four quarters.

During the third quarter of fiscal 2003, we also released approximately \$1.4 million related to excess restructuring reserves related to the second quarter fiscal 2002 restructuring event. This release is reflected in the second quarter fiscal 2002 table below. The net impact of the third quarter fiscal 2003 restructuring and the release of the excess fiscal 2002 reserves was a charge of \$26.4 million.

Second quarter of fiscal 2003

During the second quarter of fiscal 2003, we determined that the amount we had originally accrued for facility-related costs in previous restructurings was too low and accrued an additional \$8.7 million. The original liability was based on estimated sublease rates and timing, which have been affected by the decline in the real estate market. This additional amount, which pertains to three separate restructuring events, is included in the following tables.

Second quarter of fiscal 2002

During the second quarter of fiscal 2002, we recorded a pre-tax restructuring charge of approximately \$20 million resulting from our continued migration towards becoming a solutions provider and as a result of changing business needs. Specific actions taken included reducing our workforce worldwide by approximately 50 employees (less than 1%), consolidating facilities, closing offices in unprofitable locations, and disposing of excess property and equipment.

As noted above, during the second quarter of fiscal 2003, we determined that the amount we had originally accrued for facility-related costs was too low and accrued an additional \$7.7 million. The original liability for lease costs was based on estimated sublease rates and timing, which have been affected by the decline in the real estate market. Additionally, during the third quarter of fiscal 2003 we released approximately \$1.4 million of excess restructuring reserves related to excess severance costs

The following table summarizes the activity during fiscal 2003 related to the second quarter of fiscal 2002 restructuring.

	Original Charge	Balance at October 31, 2002	Cash Payments	Adjustments	Balance at July 31, 2003
<i>In thousands</i>					
Severance and benefits	\$ 14,748	\$ 4,258	\$(2,851)	\$ (100)	\$ 1,307
Excess facilities and property and equipment	5,146	4,221	(2,445)	6,391	8,167
Other restructuring-related costs	<u>492</u>	<u>300</u>	<u>--</u>	<u>--</u>	<u>300</u>
	<u>\$ 20,386</u>	<u>\$ 8,779</u>	<u>\$(5,296)</u>	<u>\$ 6,291</u>	<u>\$ 9,774</u>

As of July 31, 2003, the remaining balance of the second quarter of fiscal 2002 restructuring charge included accrued liabilities related to severance and benefits, which will be paid out over the remaining severance obligation period, and lease costs for redundant facilities and other fixed contracts, which will be paid over the respective remaining contract terms.

Fourth quarter of fiscal 2001

During the fourth quarter of fiscal 2001, we recorded \$51 million of pre-tax restructuring charges resulting from the restructuring of our operations in light of changes in general market conditions, changing customer demands, and the evolution of our business strategy. The execution of this strategy included refining our consulting initiatives, refocusing research and development efforts, defining sales and marketing efforts to be more customer and solutions oriented, and adjusting our overall cost structure given current revenue levels and our direction.

Specific actions included reducing our workforce worldwide by approximately 1,100 employees (approximately 16%), consolidating excess facilities and disposing of excess property and equipment, terminating a management consulting contract that no longer fit with our strategic focus, and abandoning and writing off technologies that no longer fit within our new strategy. We also realigned our remaining resources to better manage our business. As noted above, during the second quarter of fiscal 2003, we determined that the amount we had originally accrued for facility-related costs was too low and accrued an additional \$0.3 million. The original liability was based on estimated sublease rates and timing, which have been affected by the decline in the real estate market.

The following table summarizes the costs and activities during fiscal 2003 related to the fourth quarter of 2001 restructuring.

<i>In thousands</i>	Original Charge	Balance at October 31, 2002	Cash Payments	Adjustments	Balance at July 31, 2003
Severance and benefits	\$ 32,793	\$ 1,117	\$ (907)	\$ --	\$ 210
Excess facilities and property and equipment	10,896	4,651	(2,051)	262	2,862
Other restructuring-related costs	<u>6,973</u>	<u>624</u>	<u>(439)</u>	<u>--</u>	<u>185</u>
	<u>\$ 50,662</u>	<u>\$ 6,392</u>	<u>\$ (3,397)</u>	<u>\$ 262</u>	<u>\$ 3,256</u>

As of July 31, 2003, the remaining balance of the fourth quarter fiscal 2001 restructuring charge included accrued liabilities largely related to severance and benefits, which will be paid out during fiscal 2003, and lease costs for excess facilities, which will be paid over the respective remaining lease terms.

Third quarter of fiscal 2001

During the third quarter of fiscal 2001, we recorded a pre-tax restructuring charge of approximately \$30 million as a result of our July 2001 acquisition of Cambridge Technology Partners and changes in our business to move towards a Net business solutions strategy. Specific actions included reducing our workforce worldwide by approximately 280 employees across all functional areas (approximately 5% before the addition of Cambridge), consolidating facilities and disposing of excess property and equipment, abandoning and writing off technologies that no longer fit within our new strategy, and discontinuing unprofitable product lines. As noted above, during the second quarter of fiscal 2003, we determined that the amount we had originally accrued for facility-related costs was too low and accrued an additional \$0.7 million. The original liability was based on estimated sublease rates and timing, which have been affected by the decline in the real estate market.

The following table summarizes the activity during fiscal 2003 related to the third quarter of fiscal 2001 restructuring costs.

	Original Charge	Balance at October 31, 2002	Cash Payments	Adjustments	Balance at July 31, 2003
<i>In thousands</i>					
Severance and benefits	\$ 15,978	\$ --	\$ --	\$ --	\$ --
Excess facilities and property and equipment	10,740	3,889	(1,778)	678	2,789
Other restructuring-related costs	<u>3,675</u>	<u>137</u>	<u>(137)</u>	<u>--</u>	<u>--</u>
	<u>\$ 30,393</u>	<u>\$ 4,026</u>	<u>\$(1,915)</u>	<u>\$ 678</u>	<u>\$ 2,789</u>

As of July 31, 2003, the remaining balance of the third quarter of fiscal 2001 restructuring charge included accrued liabilities related to lease costs for excess facilities, which will be paid over the respective remaining lease terms.

As a result of the fiscal 2002 and the two fiscal 2001 restructurings, we reduced our expenses by approximately \$50 million on a quarterly basis, before any increased strategic expenditures and the impact of the SilverStream acquisition. We could incur additional restructuring charges in the future as we continue to develop our Net solutions strategy using both Netware and Linux platforms and react to market conditions by reducing costs.

In-process research and development

The purchased in-process research and development charge in the third quarter of fiscal 2002 resulted from the acquisition of SilverStream and pertains mainly to research and development work for the next version of the current SilverStream products.

Employees

	July 31, 2003	July 31, 2002	Change
<i>(Dollars in thousands)</i>			
Employees at end of quarter (full time equivalents)	5,943	6,582	(10)%
Revenue per average employee for three months ended	\$ 186	\$ 182	

Headcount in the third quarter of fiscal 2003 decreased compared to the same period in fiscal 2002 due the second quarter fiscal 2002 and third quarter fiscal 2003 restructurings, which were previously discussed. We continue to monitor headcount to ensure our resources are aligned with expected business levels and our business strategy.

Other income (expense), net

	<u>Three months ended July 31,</u>			<u>Nine months ended July 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>Change</u>	<u>2003</u>	<u>2002</u>	<u>Change</u>
<i>(Dollars in thousands)</i>						
Other income (expense), net	\$ (3,717)	\$ 7,230	(151)%	\$ (22,381)	\$ (698)	(3,106)%
Percentage of revenue	(1)%	3%		(3)%	--%	

The primary components of other income (expense), net in the third quarter and first nine months of fiscal 2003, were a gain on the sale of our facility in San Jose, California of \$24.9 million, offset by a charge for impaired intangible assets of \$24.3 million. In addition, other income (expense), net in the third quarter of fiscal 2003 included a net investment loss of \$5.0 million, which was comprised of impairment losses on long-term investments totaling \$8.0 million offset by realized net gains and interest income on short-term securities of \$3.0 million. Other income (expense), net during the third quarter of fiscal 2002 included net investment income of \$5.3 million. There were no investment impairment losses during the third quarter of fiscal 2002.

Other income (expense), net during the first nine months of fiscal 2003 included impairment losses on long-term investments totaling \$32.6 million, realized net gains on the sale of short-term securities of \$1.3 million, and interest income of \$8.6 million, in addition to the gain on sale of our facility and impaired intangible asset charge, discussed previously. During the first nine months of fiscal 2002, other income (expense), net included investment income of \$20.5 million and a \$9 million gain on the sale of a building in the first quarter of fiscal 2002, offset by investment impairment losses of \$29.8 million.

Income tax expense (benefit)

	<u>Three months ended July 31,</u>			<u>Nine months ended July 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>Change</u>	<u>2003</u>	<u>2002</u>	<u>Change</u>
<i>(Dollars in thousands)</i>						
Income tax (benefit) expense	\$(11,362)	\$ 5,549	(305)%	\$ (18,200)	\$ 6,835	(366)%
Percentage of revenue	(4)%	2%		(2)%	1%	
Effective tax (benefit) expense rate	(48)%	36%		(26)%	148%	

Our actual effective tax benefit rate for the third quarter of fiscal 2003 was 48% compared to the effective tax expense rate of 36% for the same period in 2002. Our actual effective tax benefit rate for the first nine months of fiscal 2003 was 26% compared to the effective tax rate of 148% for the same period in 2002. The rate differs because of differences in the amount of non-deductible investment impairments taken in each period and non-taxable capital gains realized in the third quarter of 2003.

Net income (loss) and net income (loss) per share

	<u>Three months ended July 31,</u>			<u>Nine months ended July 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>Change</u>	<u>2003</u>	<u>2002</u>	<u>Change</u>
<i>(Dollars in thousands, except per share)</i>						
Net income (loss)	\$ (12,400)	\$ 9,949	(225)%	\$ (52,900)	\$(155,151)	66%
Percentage of revenue	(4)%	4%		(7)%	(19)%	
Net income (loss) per share:						
Basic and diluted	\$ (0.03)	\$ 0.03	(222)%	\$ (0.14)	\$ (0.43)	67%

The year-to-date fiscal 2002 net loss and net loss per share includes a \$143.7 million cumulative effect of an accounting change, which resulted from our adoption of SFAS No. 142. Through our initial SFAS No. 142 analysis, we determined that a portion of our goodwill related to the acquisition of Cambridge Technology Partners in July 2001 had become impaired. Before the cumulative effect of the accounting change, net loss per share was \$0.03 for the first nine months of fiscal 2002. The net loss per share during the third quarter and first nine months of fiscal 2003 was primarily due to the charge for long-term investment impairments, charges for impaired intangibles, higher sales and marketing expenses to roll out our new advertising campaign, and restructuring expenses, offset somewhat by the gain on the sale of a facility, as discussed previously. In addition, the net loss per share for the first nine months of fiscal 2003 included additional expenses related to the adjustments of previous restructuring and merger expenses incurred in the second quarter of fiscal 2003. At this time, we have decided not to provide specific forecasted earnings information for the remainder of fiscal 2003.

Liquidity and capital resources

	July 31, 2003	October 31, 2002	<u>Change</u>
<i>(Dollars in thousands)</i>			
Cash, cash equivalents, and short-term investments	\$ 738,777	\$635,858	16%
Percentage of total assets	46%	38%	

Cash, cash equivalents and short-term investments totaled \$738.8 million at July 31, 2003 compared to \$635.9 million at October 31, 2002. The increase in cash can be attributed to cash received from the sale of our facility in San Jose, California of \$125 million, cash provided by operations of \$2 million, cash proceeds from stock issuances under employee stock option or equity plans of \$7.8 million and the impact of foreign exchange fluctuations. These increases were offset somewhat by expenditures for fixed assets of \$30.6 million, cash paid to acquire Volera minority interest shares from Accenture of \$1.1 million, and net cash paid for long-term investments of \$11.3 million.

Our short-term investment portfolio is diversified among security types, industry groups, and individual issuers. To achieve potentially higher returns, a portion of our investment portfolio is invested in equity securities and mutual funds, which incur market risk. We mark our short-term investments to market each month. Our short-term investment portfolio includes gross unrealized gains of \$1.7 million and gross unrealized losses of \$0.1 million as of July 31, 2003. We monitor our investments and record losses when a decline in the investment's market value is determined to be other than temporary.

We have also invested excess cash in long-term investments through the Novell Venture account, CTC I, and direct investments in equity securities of privately-held companies. Investments made through the Novell Venture account and CTC I generally are in privately-held companies, including small capitalization stocks in the high technology industry sector, and expansion-stage privately-held companies. Within the Novell Venture account there are also investments in venture capital funds that are managed largely by external venture capitalists. CTC I is managed internally. The value of the investments made through the Novell Venture account and CTC I is dependent on the performance, successful acquisition, and/or initial public offering of the investees. As of July 31, 2003, we had commitments to contribute an additional \$57.8 million to the externally managed venture capital funds over the next three to four years, as requested by the fund managers, and commitments to the CTC I fund to contribute up to an additional \$300,000 over the next three to four years. We intend to fund these investments with cash from operations and cash income from short-term investments, and sales of short-term investments on hand.

As of July 31, 2003, we had cash and other short-term investments of \$442 million in accounts outside the U.S. Repatriation of any portion of this amount would be subject to U.S. federal income taxes. We have provided for the tax liability on these amounts for financial statement purposes except for \$15 million of earnings, which is permanently invested outside the U.S. Repatriation, however, could result in a loss of certain tax attributes of up to \$38.5 million and result in additional U.S. federal income tax payments of such amounts in future years.

During the first quarter of fiscal 2002, we sold our subsidiary in the Czech Republic. As a part of this transaction, we provided a guarantee to the landlord of our building there whereby we agreed to pay any and all monies due under the lease, including legal fees if the new lessee defaults on the lease. During the first nine months of fiscal 2003, we paid approximately \$0.1 million against this guarantee and have accrued a liability for an additional \$0.4 million that we could be required to pay, excluding legal fees, if the new lessee continues in default.

As an element of our standard contract terms, we include an indemnification clause in our agreements with our customers that indemnifies the licensee against certain liability and damages arising from intellectual property infringement claims arising from their use or distribution of our software. These terms are common in the high technology industry. We do not record a liability for potential litigation claims related to indemnification agreements with our customers. We do not believe the likelihood of a material obligation is probable.

On August 4, 2003, we acquired Ximian, Inc., a privately-held company and leading provider of desktop and server solutions that enable enterprise Linux adoption, for approximately \$40 million. The acquisition of Ximian expands Novell's ability to support Linux solutions, providing Novell with Linux desktop, groupware and management

technologies. The acquisition also brings leaders in the open source community and a strong core of Linux developers to Novell.

Our principal source of liquidity continues to be from operations, on-hand cash, and income from short-term investments. At July 31, 2003, our principal unused sources of liquidity consisted of cash on hand in the amount of \$450.7 million, short-term investments in the amount of \$288.1 million, and available borrowing capacity of under our \$15 million line of credit. Our liquidity needs are principally for financing of accounts receivable, acquisition of fixed assets and strategic investments, product development, and flexibility in a dynamic and competitive operating environment.

During the first nine months of fiscal 2003, we generated \$2 million of cash from operations. Through our third quarter fiscal 2003 restructuring, we will reduce our cost structure over the remainder of fiscal 2003 and anticipate positive net cash flows from operating and investing activities for the remainder of fiscal 2003. We anticipate being able to fund our current operations, any future acquisitions, any further integration, restructuring or any merger-related costs, and planned capital expenditures for the foreseeable future with existing cash on hand and short-term investments together with cash generated from operations, and investment income. We believe that additional borrowings under our credit facilities or offerings of equity or debt securities are possible if the need arises, although such offerings may not be available to us on acceptable terms. Investments will continue in product development and in new and existing areas of technology. Cash may also be used to acquire technology through purchases and strategic acquisitions. Capital expenditures in fiscal 2003 are anticipated to be approximately \$40 million, but could be reduced if our growth is less than presently anticipated.

During the fourth quarter of fiscal 2001, the Board of Directors extended our stock repurchase program through June 30, 2003 and authorized the use of up to \$500 million for the repurchase of additional outstanding shares of our common stock. This program was not extended beyond June 30, 2003.

New Accounting Pronouncement

Financial Accounting Standards Board Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), was issued in January 2003. FIN 46 requires that if an entity is the primary beneficiary of a variable interest entity, the assets, liabilities and results of operations of the variable interest entity should be included in the consolidated financial statements of the entity. The provisions of FIN 46 are effective immediately for all arrangements entered into after January 31, 2003. We have not invested in any variable interest entities after January 31, 2003. For those arrangements entered into prior to January 31, 2003, the provisions of FIN 46 are required to be adopted at the beginning of the first interim or annual period beginning after June 15, 2003. We are reviewing our arrangements with variable interest entities entered into prior to January 31, 2003. We do not believe that our arrangements with these entities will require consolidation of their financial information in our financial statements.

Factors Affecting Future Results of Operations

Our future results of operations involve a number of risks and uncertainties that could cause actual results to differ materially from expected and historic results. A number of these risks and uncertainties are discussed in the following paragraphs.

The Current Economic Climate and Outlook in the Technology Consulting, Operational Consulting, and Information Technology Services Sector Is Weak, Causing Our Business to Suffer

The weakened global economic climate, particularly in the technology sector, has had an adverse effect on our stock price and ability to sell products and services. Future economic projections for this sector do not anticipate a quick recovery. A continuation of the weakened global economy could have further negative effects on our stock price and ability to sell products and services in the future.

Our Financial and Operating Results May Vary, Negatively Affecting our Ability to Detect Trends

We often experience a higher volume of revenue at the end of each quarter and during our fourth quarter. Because of this, fixed costs that are out of line with revenue levels may not be detected until late in any given quarter and results of operations could be adversely affected.

Operating results have been, and may also continue to be, affected by other factors including, but not limited to:

- timing of orders from customers and shipments to customers;
- product mix, including a shift from higher margin to lower margin products or services;
- impact of foreign currency exchange rates on the price of our products in international locations;
- our responses to revenue declines experienced by our distribution partners;
- our ability to realize projected benefits from our restructurings and our corporate strategies; and
- our ability to deliver solutions as expected by our customers and systems integration partners.

We May Not Be Able to Successfully Compete in a Challenging Market for Computer Software, Operational Consulting, and IT Consulting Services

The market for networking applications and solutions as well as IT consulting is highly competitive and subject to rapid technological change. We expect competition to continue to increase both from existing competitors and new market entrants. We believe that competitive factors common to all of our solution categories include: the breadth of our offerings; the pricing of our products and services; and the timing and market acceptance of new solutions developed by us and our competitors.

Software licenses and maintenance

In addition to the factors listed above, key competitive factors related to our software licenses and maintenance include brand and product awareness; the performance, reliability and security of our products; the ability to preserve our legacy customer base; the completeness of our suite of product and solutions offerings; our ability to establish and maintain key strategic relationships with distributors, resellers and other partners; and the pricing strategies of our competitors. Our key competitors related to software licenses and maintenance revenue include Microsoft, IBM, BEA Systems, Sun Microsystems, Altiris, Netegrity, Computer Associates and Critical Path.

Worldwide IT Services

The key competitive factors faced by us related to IT consulting are attracting and retaining the highest quality consultants and the depth and breadth of our skills and expertise. The market for IT consulting services is highly competitive due to the existence of several large IT consulting firms specializing in the information systems area such as IBM, Accenture, EDS and Microsoft. Many of these companies have greater financial, technical and marketing resources and greater name recognition in the IT consulting area, which could inhibit our ability to grow our IT consulting business. Additionally, the worldwide marketplace for IT consulting services is highly fragmented. We often encounter different groups of competitors in different regions of the world. Many of these local

competitors may have niche consultancies carved out in a local market against whom it may be difficult to win business.

Celerant Management Consulting

Because of the extremely specialized nature of the implementation consulting services provided by Celerant, the main competitive factor faced by Celerant is not so much presented by rival consulting firms, but rather lies with prospective clients themselves. The primary decision often faced by Celerant's prospective clients is a weighing of the costs of a Celerant engagement against the measurable results and financial benefits to be realized during and after the engagement. Therefore, a key factor lies in convincing clients of Celerant's ability to deliver those results and benefits. An additional consideration potential clients factor into their decisions is a judgment as to whether they can successfully perform the work that they require themselves, or whether they need the assistance of a third party such as Celerant.

General

We do not have the product breadth and market power of Microsoft. Microsoft's ability to ship networking products with features and functionality that compete with ours, together with its greater ability to offer incentives to customers to purchase certain products in order to obtain favorable sales terms or necessary compatibility or information with respect to other products, may significantly inhibit our ability to grow our business. Microsoft has significant financial resources, which could allow it to aggressively price its products and services for long periods of time to the potential detriment of competitors. We believe, and the courts have agreed, that Microsoft exploits its desktop operating monopoly in anticompetitive ways designed to maintain that monopoly and, in our view, to extend its market power to quash competitive alternatives to Microsoft products. For example, in the past, Microsoft has employed tactics that limit or block effective and efficient interoperability with our products. We will ensure, to the best of our ability, that our products will interoperate with those of Microsoft as they enhance new operating systems and applications.

We May Not be Able To Attract and Retain Qualified Employees Because of the Intense Competition for Qualified Employees in the Computer and Consulting Industries

Our ability to maintain our competitive technological position will depend, in large part, on our ability to attract and retain highly qualified development, consulting, and managerial employees. Even in light of the current economic downturn, competition for employees of the highest caliber is intense in the software and consulting industries. The loss of a significant number of key employees would adversely affect our performance. The failure to successfully attract, hire, retain and promote qualified employees as we need them could have a material adverse effect on our business.

If We Are Not Successful in Developing a Strong Business with our Nsure and exteNd Products and Services, Our Long-Term Growth Will Be Negatively Impacted

The success of our net directory services products that comprise our Nsure and exteNd secure web services and identity management solutions sets is important to our strategy. The acquisition of SilverStream helped further our development of secure Web services products and enhanced our identity management product offerings. Our ability to achieve success with our Nsure and exteNd products and services is dependent on a number of factors including, but not limited to, the following: growth of the Web-based applications industry; acceptance of the Nsure and exteNd solution sets by clients; further development of key Nsure and exteNd product solutions and upgrades; and acceptance of those products by large industry partners and major accounts. If we are unable to grow the Nsure and exteNd products and services to become a major component of our business, our long-term growth will be negatively impacted.

If We Are Unable to Unify Our Diverse Cultures, the Benefits of Our Solutions Strategy May Not Be Fully Realized

We have a talented, energetic, and exciting group of employees. As a result of our acquisitions over the last couple of years, a number of these employees come from diverse geographic and corporate cultural backgrounds. We are in

the process of a cultural initiative to bring our whole company together towards a new common culture that revolves around our solutions offerings. If we are not successful in forging a new, vibrant culture with unified goals and a common vision that is solutions-based, employee energies may be diverted or diluted and we may not achieve the full benefits of our solutions strategy.

Our Existing Product Revenue May Deteriorate More Rapidly Than Any Increase in Sales of Our New Products

We have several existing products, which we have been selling and upgrading for many years. Sales of these existing products, particularly NetWare, are declining at a faster rate than we are able to increase sales of new products or technologies. If we are unsuccessful in increasing sales of new products or technologies, particularly in our exteNd solution set and Net Directory Services product line, our long-term growth will be negatively impacted.

If We Do Not Generate New Customers, Our Ability to Grow Our Business Will Be Negatively Impacted

A significant percentage of our revenue is generated from existing customers. In order to achieve our growth objectives, we must accelerate the rate at which we generate new business. We are in the middle of several sales and marketing initiatives in order to accomplish this goal. If those initiatives are not successful, our ability to cultivate new customers may be adversely affected.

We Have Experienced Delays in the Introduction and Acceptance of New Products Due to Various Factors

As is common in the computer software industry, we have in the past experienced delays in the introduction of new products due to a number of factors, including the complexity of software products, the need for extensive testing of software to ensure compatibility of new releases with a wide variety of application software and hardware devices, and the need to "debug" products prior to extensive distribution. Significant delays in developing, completing, or shipping new or enhanced products would adversely affect our business.

Moreover, we may experience delays in market acceptance of new releases of our products as we engage in marketing and education of the user base regarding the advantages of and system requirements for new products and as customers evaluate the advantages and disadvantages of upgrading. We have encountered these issues on each major new release of our products, and expect that we will encounter such issues in the future. Our ability to achieve desired levels of revenue growth depends at least in part on the successful completion, introduction and sale of new versions of our products. There can be no assurance that we will be able to respond effectively to technological changes or new product announcements by others, or that our research and development efforts will be successful. Should we experience material delays or revenue shortfalls with respect to new product releases, our revenue and net income could be adversely affected.

If Third Parties Claim that We Infringed Upon Their Intellectual Property, Our Ability to Use Some Technologies and Products Could Be Limited and We May Incur Significant Costs to Resolve These Claims

Litigation regarding intellectual property rights is common in the Internet and software industries. We have in the past received letters or been the subject of claims suggesting that we are infringing upon the intellectual rights of others. For example, in May 2002 a suit was filed by France Telecom SA and U.S. Philips Corporation against us alleging that Novell's NetWare client software infringes upon a patent allegedly co-owned by them and seeking unspecified damages and an injunction. In addition, we have faced and expect to continue to face from time to time disputes over rights and obligations concerning intellectual property. We expect third-party infringement claims involving Internet technologies and software products and services to increase because it has become more common for companies to work with attorneys on a contingency basis to bring these kinds of claims. While we have no reason to think we would not have strong defenses to such claims, the cost and time of defending ourselves can be significant. In addition, we have agreed, and may agree in the future, to indemnify customers against claims that our products infringe upon the intellectual property rights of others. We could incur substantial costs in defending ourselves and our customers against infringement claims. If an infringement claim is successful, we and our customers may be required to obtain one or more licenses from third parties, and we may be obligated to pay or reimburse our customers for monetary damages. In such instances, we or our customers may not be able to obtain necessary licenses from third parties at a reasonable cost or at all, and may face delays in product shipment while

developing or arranging for alternative technologies.

We May Not Be Able to Protect Our Confidential Information, Which May Adversely Affect Our Business

We generally enter into contractual relationships with our employees to protect our confidential information. In the event that our trade secrets or other proprietary information are misappropriated, our business could be seriously harmed. In addition, we may not be able to timely detect unauthorized use of our intellectual property and take appropriate steps to enforce our rights. In the event we are unable to enforce these contractual obligations and our intellectual property rights, our business could be adversely affected.

We Face Increased Risks in Conducting a Global Business, Which May Damage Business Results

We are a multi-national corporation with offices and subsidiaries around the world and, as such, we face risks in doing business abroad that we do not face domestically. Certain aspects inherent in transacting business internationally could negatively impact our operating results, including:

- costs and difficulties in staffing and managing international operations;
- unexpected changes in regulatory requirements;
- tariffs and other trade barriers;
- difficulties in enforcing contractual and intellectual property rights;
- longer payment cycles;
- local political and economic conditions;
- potentially adverse tax consequences, including restrictions on repatriating earnings and the threat of "double taxation"; and
- fluctuations in currency exchange rates, which can affect demand and increase Novell's costs.

Some of Our Short-term, Long-term, and Venture Capital Fund Investments Have Become Impaired and Additional Investments Could Become Impaired

Our investment portfolio includes short-term investments in publicly traded equity securities, long-term equity investments in privately-held companies, small capitalization stocks in the high-technology industry sector, and funds managed by venture capitalists. Many of these investments might become other-than-temporarily impaired. During the first nine months of fiscal 2003, we recorded an impairment charge of \$32.6 million related to some of the investments in our portfolio in cases where their market value had experienced an other-than-temporary decline. As of July 31, 2003, we had net unrealized gains, after taxes, on investments totaling approximately \$1.4 million; however, there can be no assurances that these gains will be realized and that losses will not occur. If the companies and funds in which we have invested suffer poor financial performance, or if the privately-held companies in which we have invested are not successfully acquired or do not experience initial public offerings, the value of our investments will decrease.

Our Existing Relationships With Other Information Technology Services Organizations May Be Impaired and We Could Lose Business

We maintain relationships with IT services organizations that recommend, design and implement solutions for their customers' eBusiness that include Novell Net services products. At the same time, our service offerings compete with those of these same organizations. Although many companies in high technology industries co-exist in a similar state of competition, any of these organizations could decide at any time to not continue to do business with us or to recommend our products. A change in the willingness of these IT service organizations to do business with us could

adversely affect our business.

Our Business May Be Negatively Affected if We Do Not Continue to Adapt to Rapid Technological Change, Evolving Business Practices and Changing Consumer Requirements

The software industry and IT consulting market is characterized by rapidly changing technology, evolving business practices and changing client needs. Accordingly, our future success will depend in part on our ability to continue to adapt and meet these challenges. Among the most important challenges we face is the need to continue to:

- effectively identify and use leading technologies;
- enhance strategic and technical expertise;
- influence and respond to emerging industry standards and other technology changes and to orient management teams to capitalize on these changes;
- recruit and retain qualified project personnel;
- enhance current services;
- develop new services that meet changing customer needs; and
- effectively advertise and market Net business solutions.

Our Consulting Services Contracts Contain Pricing Risks and, If Our Estimates Prove Inaccurate, We Could Incur Additional Costs or Not Realize Anticipated Revenue

Revenue from our Celerant consulting business and about half of the revenue from our IT consulting group within our worldwide services is derived from fixed-price, fixed-time contracts. Because of the complex nature of the services provided, it is sometimes difficult to accurately estimate the cost, scope, and duration of particular client engagements. If we do not accurately estimate the resources required for a project, do not accurately assess the scope of work associated with a project, do not manage the project properly, or do not satisfy our obligations in a manner consistent with the contract, then our costs to complete the project could increase substantially. We have occasionally had to commit unanticipated additional resources to complete projects, and we may have to take similar action in the future. We may not be compensated for these additional costs or the commitment of these additional resources. Additionally, our Celerant management consulting business derives a meaningful portion of our revenues from projects priced on a contingency basis. If results are not met, or if a dispute arises, potentially large revenues may not be realized.

Our IT Consulting and Celerant Consulting Clients Can Cancel or Reduce the Scope of Their Engagements With Us on Short Notice

If our clients cancel or reduce the scope of an engagement with the IT consulting group within our worldwide services business or the Celerant management consulting business, we may be unable to reassign our professionals to new engagements without delay. Personnel and related costs constitute a substantial portion of our operating expenses. Because these expenses are relatively fixed in the short term, and because we establish the levels of these expenses well in advance of any particular quarter, cancellations or reductions in the scope of client engagements could result in the under-utilization of our consultants, causing significant reductions in operating results for a particular quarter.

Actions Taken By the SCO Group Could Impact the Acceptance of the Linux Operating System, Negatively Affecting Novell's Linux Initiatives

Novell recently announced some important Linux initiatives. These include an upcoming NetWare version based on the Linux kernel, as well as collaboration and resource management solutions for Linux. The SCO Group ("SCO")

has recently written a "Letter to Linux Customers" that states that Linux infringes on SCO's Unix intellectual property and other rights, and that SCO intends to aggressively protect and enforce those rights. SCO's actions have the potential to disrupt business relations that might otherwise form at a critical time around Linux technologies, and could potentially deprive Novell of important economic opportunities. It is possible that SCO's actions, if carried forward, could lead to the loss of sales and jobs, delayed projects, canceled financing, and a balkanized Linux community, any of which could hurt Novell's Linux initiatives.

Our Stock Price Will Fluctuate

Our future earnings and stock price could be subject to significant volatility, particularly on a quarterly basis. Due to analysts' expectations of continued growth, any shortfall in anticipated earnings can be expected to have an immediate and significant adverse effect on the trading price of our common stock in any given period. Revenue fluctuations may also contribute to the volatility of the trading price of our common stock in any given period.

In addition, the market prices for securities of software companies have been, and continue to be, very volatile. The market price of our common stock, in particular, has been subject to wide fluctuations in the past. As a result of the foregoing factors and other factors that may arise in the future, the market price of our common stock may be subject to significant fluctuations within a short period of time. These fluctuations may be due to factors specific to us, to changes in analysts' earnings estimates, or to factors affecting the computer industry or the securities markets in general.

Item 7A. *Qualitative and Quantitative Disclosures About Market Risk*

We are exposed to financial market risks, including changes in interest rates, foreign currency exchange rates, and the market prices of equity securities. To mitigate some of these risks, we utilize currency forward contracts and currency options. We do not use derivative financial instruments for speculative or trading purposes, and no significant derivative financial instruments were outstanding at July 31, 2003.

Interest Rate Risk

The primary objective of our short-term investment activities is to preserve principal while maximizing yields without significantly increasing risk. The strategy we use to achieve this objective is to invest in widely diversified short-term investments, consisting primarily of investment grade securities, substantially all of which either mature within the next twelve months or have characteristics of short-term investments. A hypothetical 50 basis point increase in interest rates would result in an approximately \$1.2 million decrease (less than 0.5% of total investments) in the fair value of our available-for-sale securities.

Market Risk

We also hold available-for-sale equity securities in our short-term investment portfolio. As of July 31, 2003, gross unrealized gains, before tax effect, on the short-term public equity securities totaled \$0.2 million. A reduction in prices of 10% of these short-term equity securities would result in approximately a \$0.5 million decrease (less than 0.1% of total investments) in the fair value of our short-term investments.

In addition, we invest in equity securities of privately-held companies, which are included in our long-term portfolio of investments, primarily for the promotion of business and strategic objectives. These investments are generally in small capitalization stocks in the high technology industry sector or venture capital funds. Because of the nature of these investments, we are exposed to risks that the value of these equity securities will change. We typically do not attempt to reduce or eliminate our market exposure on these securities. A 10% adverse change in equity prices of equity securities of privately-held companies would result in an approximately \$5 million decrease in the fair value of our available-for-sale long-term securities.

Foreign Currency Risk

We use derivatives to hedge those net assets and liabilities that, when translated or remeasured according to accounting principles generally accepted in the U.S., impact our condensed consolidated statement of operations. Currency forward contracts are utilized in these hedging programs. All forward contracts that we enter into are components of hedging programs and are entered into for the sole purpose of hedging an existing or anticipated currency exposure, not for speculation or trading purposes. Gains and losses on these currency forward contracts would generally be offset by corresponding losses and gains on the foreign currency assets and liabilities that they hedge, resulting in negligible net gain or loss overall on the hedged exposures. When hedging balance sheet exposures, all gains and losses on forward contracts are recognized in other income and expense in the same period as when the gains and losses on translation or remeasurement of the foreign currency denominated assets and liabilities occur. All gains and losses related to foreign exchange contracts are included in cash flows from operating activities in the condensed consolidated statement of cash flows. Our hedging programs reduce, but do not always entirely eliminate, the impact of foreign currency exchange rate movements. If we did not hedge against foreign currency exchange rate movement, an increase or decrease of 10% in exchange rates would result in an increase or decrease in income before taxes of approximately \$1 million. This number represents the exposure related to balance sheet remeasurement and intercompany translation only and assumes that all currencies move in the same direction at the same time relative to the U.S. dollar.

All of the potential changes noted above are based on sensitivity analyses performed on our financial position at July 31, 2003. Actual results may differ materially.

Item 4. Controls and Procedures**(a) Evaluation of Disclosure Controls and Procedures**

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures as of the end of the period covered by this report were designed and functioning effectively to provide reasonable assurance that the information required to be disclosed by the Company in reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. The Company believes that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

(b) Change in Internal Control over Financial Reporting

No change in the Company's internal control over financial reporting occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II. Other Information

Except as listed below, all information required by items in Part II is omitted because the items are inapplicable or the answer is negative.

Item 1. Legal Proceedings.

The information required by this item is incorporated herein by reference to Note J of our financial statements contained in Part I, Item 1 of this Form 10-Q.

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

None

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

(a) Exhibits

<u>Exhibit Number</u>	<u>Description</u>
31.1	Certification pursuant to 18 U.S.C. Section 1350 Sarbanes-Oxley Act of 2002
31.2	Certification pursuant to 18 U.S.C. Section 1350 Sarbanes-Oxley Act of 2002
99.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K.

Form 8-K dated May 5, 2003, reporting under Item 5.

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.

Novell, Inc.
(Registrant)

Date: September 12, 2003

/s/ Joseph S. Tibbetts, Jr.
Joseph S. Tibbetts, Jr.
Chief Financial Officer
(Principal Financial Officer and
Principal Accounting Officer)