

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

Form 10-Q

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended January 31, 2004**

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.)

**404 Wyman Street
Waltham, MA 02451**

(Address of principal executive offices and zip code)

(781) 464-8000

(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 Act) Yes No

As of February 27, 2004, there were 383,849,036 shares of the registrant's common stock outstanding.

Part I. Financial Information

Item 1. Financial Statements

NOVELL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Amounts in thousands, except share and per share data)

	<u>January 31, 2004</u>	<u>October 31, 2003</u>
	(Unaudited)	
Assets		
Current assets:		
Cash, cash equivalents and short-term investments	\$605,154	\$751,852
Receivables (less allowances of \$26,106—January 31, 2004 and \$26,852—October 31, 2003)	176,287	232,492
Prepaid expenses	28,810	23,005
Other current assets	25,380	23,204
Total current assets	835,631	1,030,553
Property, plant and equipment, net	254,236	255,526
Long-term investments	51,798	50,948
Goodwill	401,973	213,300
Intangible assets	52,728	10,800
Other assets	6,371	6,526
Total assets	<u>\$1,602,737</u>	<u>\$1,567,653</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$57,275	\$50,258
Accrued compensation	92,332	101,164
Other accrued liabilities	113,579	117,073
Income taxes payable	39,690	35,493
Deferred revenue	294,343	322,470
Total current liabilities	597,219	626,458
Deferred income taxes	17,097	—
Minority interests	7,035	6,725
Stockholders' equity:		
Preferred stock, par value \$.10 per share Authorized—500,000 shares, Issued—0 shares	—	—
Common stock, par value \$.10 per share Authorized—600,000,000 shares Issued—382,883,801 shares—January 31, 2004; 376,460,107 shares— October 31, 2003	38,288	37,646
Additional paid-in capital	351,739	319,016
Retained earnings	586,895	576,759
Accumulated other comprehensive income	14,244	7,068
Other	(9,780)	(6,019)
Total stockholders' equity	981,386	934,470
Total liabilities and stockholders' equity	<u>\$1,602,737</u>	<u>\$1,567,653</u>

See notes to unaudited condensed consolidated financial statements.

NOVELL, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Amounts in thousands, except per share data)

	Three Months Ended	
	January 31, 2004	January 31, 2003
Net revenue		
New software licenses	\$54,769	\$61,038
Maintenance and services	212,338	198,933
Net revenue	<u>267,107</u>	<u>259,971</u>
Cost of revenue		
New software license costs	4,922	5,222
Maintenance and service costs	89,954	92,342
Cost of revenue	<u>94,876</u>	<u>97,564</u>
Gross profit	<u>172,231</u>	<u>162,407</u>
Operating expenses:		
Sales and marketing	81,769	98,305
Product development	50,199	42,922
General and administrative	26,257	27,345
Total operating expenses	<u>158,225</u>	<u>168,572</u>
Income (loss) from operations	<u>14,006</u>	<u>(6,165)</u>
Other income (expense), net:		
Investment income (expense)	3,512	(7,140)
Other, net	(1,035)	951
Other income (expense), net	<u>2,477</u>	<u>(6,189)</u>
Income (loss) before taxes	16,483	(12,354)
Income tax expense (benefit)	<u>6,348</u>	<u>(466)</u>
Net income (loss)	<u>\$10,135</u>	<u>\$(11,888)</u>
Net income (loss) per share:		
Basic	<u>\$0.03</u>	<u>\$(0.03)</u>
Diluted	<u>\$0.03</u>	<u>\$(0.03)</u>
Weighted average shares outstanding:		
Basic	380,106	368,075
Diluted	392,111	368,075

See notes to unaudited condensed consolidated financial statements.

NOVELL, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)

	Three Months Ended	
	January 31, 2004	January 31, 2003
Cash flows from operating activities		
Net income (loss)	\$10,135	\$(11,888)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Gain on sale of fixed assets	—	(365)
Depreciation and amortization	16,152	17,252
Loss on impaired investments and fixed assets	1,146	10,800
Decrease in receivables	64,248	55,117
(Increase) in prepaid expenses.....	(5,177)	(6,817)
(Increase) in deferred income taxes.....	(17,310)	(684)
Decrease in other current assets	270	2,252
Increase (decrease) in accounts payable.....	4,660	(3,416)
Decrease in accrued liabilities	(6,521)	(29,252)
Decrease in deferred revenue	(36,582)	(10,124)
Net cash provided by operating activities	31,021	22,875
Cash flows from financing activities		
Issuance of common stock	28,493	1,147
Net cash provided by financing activities	28,493	1,147
Cash flows from investing activities		
Expenditures for property, plant and equipment.....	(11,973)	(13,852)
Proceeds from the sale of property, plant and equipment.....	—	785
Purchases of short-term investments.....	(214,526)	(204,587)
Maturities of short-term investments	65,034	11,156
Sales of short-term investments	194,758	26,780
Cash paid for Volera minority interest shares.....	—	(1,050)
Cash paid for acquisition of SUSE, net of cash acquired	(200,298)	—
Other	6,400	4,581
Net cash used for investing activities	(160,605)	(176,187)
Total decrease in cash and cash equivalents	(101,091)	(152,165)
Cash and cash equivalents—beginning of period	366,932	463,987
Cash and cash equivalents—end of period	265,841	311,822
Short-term investments—end of period	339,313	338,933
Cash, cash equivalents and short-term investments—end of period	\$605,154	\$650,755

See notes to unaudited condensed consolidated financial statements.

NOVELL, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
January 31, 2004

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. Actual results could differ materially from those estimates. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q but do not include all of the information and notes required by accounting principles generally accepted in the United States and should, therefore, be read in conjunction with our fiscal 2003 Annual Report on Form 10-K. These financial statements 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

The functional currency for most of our international subsidiaries is the local currency. The functional currency of our Irish operating subsidiaries and related entities is the U.S. dollar. 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. Revenues and expenses are translated monthly at the average monthly exchange rate. Such translation adjustments are recorded in accumulated other comprehensive income.

C. Acquisition of SUSE LINUX

On January 12, 2004, we purchased substantially all of the outstanding stock of SUSE LINUX AG ("SUSE"), a privately-held company and a leading provider of Linux-based products, for approximately \$210 million in cash, plus estimated merger and transaction costs of \$7 million. The acquisition of SUSE enables us to offer a full range of enterprise solutions on the Linux platform, from the server to the desktop. This transaction was accounted for as a purchase. SUSE's results of operations have been incorporated into ours beginning on the acquisition date of January 12, 2004.

The purchase price was preliminarily allocated as follows:

	<u>Estimated Acquisition Cost</u>	<u>Asset Life</u>
	(Amounts in thousands)	
Fair value of net tangible assets acquired.....	\$1,599	N/A
Identifiable intangible assets:		
Customer relationships	13,385	3 years
Internal use software	5,864	3 years
Trademarks/trade names	24,221	Indefinite
Goodwill.....	188,673	Indefinite
	<u>\$233,742</u>	

We recorded additional goodwill and a deferred income tax liability of \$17 million resulting from the future tax consequences of the non-deductibility of identified net intangible assets recorded in connection with this acquisition.

Goodwill from the SUSE acquisition resulted from our belief that SUSE's technology is valuable to our product offerings. The purchase price allocation will be adjusted as integration plans, including restructuring, are finalized, as allowed by Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations." We used an independent valuation firm to estimate the fair values of the intangible assets.

As integration plans are finalized, the goodwill arising from the SUSE acquisition will be allocated to our geographic segments. Revenues of \$2.2 million and expenses of \$2.9 million were recorded by SUSE for the period from January 12, 2004 to January 31, 2004, and are included in the EMEA geographic segment and the Cross-Platform Services solutions group (see Note M). If the SUSE acquisition had occurred at November 1, 2003, the estimated pro forma revenues, net income and net income per share (basic and diluted), for the first quarter of fiscal 2004 would have been \$275.0 million, \$9.2 million and \$0.02, respectively. If the SUSE acquisition had occurred at November 1, 2002, the estimated pro forma revenues, net loss and net loss per share (basic and diluted), for the first quarter of fiscal 2003 would have been \$267.8 million, \$16.1 million, and \$0.04, respectively.

D. 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 diversified, primarily consisting of investment grade securities that either mature within the next 12 months or have other characteristics of short-term investments.

All marketable debt and equity securities that are included in cash, cash equivalents 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 (loss), net of tax, after any applicable tax valuation allowances (see Note O). Unrealized gains and losses at January 31, 2004 were \$1.6 million and \$0.1 million, respectively. Unrealized gains and losses at October 31, 2003 were \$2.1 million and \$0.3 million, respectively. Fair market values are based on quoted market prices where 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.

At January 31, 2004, Novell had cash and cash equivalents of \$266 million and short-term investments of \$339 million. During the first quarter of fiscal 2004, we realized gains of \$1.9 million and losses of \$0.1 million from the sale of short-term investments. During the first quarter of fiscal 2003, we realized gains of \$0.4 million and losses of \$0.1 million from the sale of short-term investments. No impairment losses were recorded on short-term investments during the first quarters of fiscal 2004 and fiscal 2003.

E. Long-Term Investments

At January 31, 2004, long-term investments mainly consist of investments made in venture capital partnerships and other direct investments we made for strategic purposes in equity securities of privately-held securities. Long-term investments are accounted for initially at cost and written down to fair value when indicators of impairment are deemed to be other than temporary.

We routinely review our long-term investments 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 first quarters of fiscal 2004 and fiscal 2003, we recognized impairment losses on long-term investments totaling \$1.1 million and \$10.8 million, respectively.

F. Goodwill and Intangible Assets

Goodwill

The following is a summary of goodwill resulting from the following acquisitions:

	January 31, 2004	October 31, 2003
	(Amounts in thousands)	
SUSE	\$188,673	\$—
SilverStream	126,689	126,689
Cambridge Technology Partners	42,500	42,500
Ximian	35,002	35,002
Other technology companies	9,109	9,109
Total goodwill	<u>\$401,973</u>	<u>\$213,300</u>

Goodwill is allocated to our operating segments—Americas, EMEA, Asia Pacific, and Celerant Management Consulting. We consider these segments to be the reporting units for allocating and evaluating goodwill.

Goodwill recorded in connection with the SUSE acquisition is not yet allocated to our geographic operating segments because integration is still underway. We expect to make this allocation in the second quarter of fiscal 2004.

Goodwill is allocated to our operating segments as follows:

	Americas	EMEA	Asia Pacific	Celerant Management Consulting	Unallocated SUSE	Total
	(Amounts in thousands)					
Balance as of Oct 31, 2003	\$86,817	\$74,100	\$9,883	\$42,500	\$—	\$213,300
Acquisition of SUSE	—	—	—	—	188,673	188,673
Balance as of Jan 31, 2004	<u>\$86,817</u>	<u>\$74,100</u>	<u>\$9,883</u>	<u>\$42,500</u>	<u>\$188,673</u>	<u>\$401,973</u>

Intangibles

The following is a summary of identifiable intangible assets, net of accumulated amortization:

	January 31, 2004	October 31, 2003
	(Amounts in thousands)	
Developed technology	\$7,892	\$8,410
Customer relationships	13,014	—
Internal use software	5,701	—
Trademarks/trade names	26,121	2,390
Total identifiable intangible assets	<u>\$52,728</u>	<u>\$10,800</u>

Developed technology relates primarily to the exteNd product line that we acquired as a part of our July 2002 acquisition of SilverStream Software, Inc. Customer relationships relate to values allocated for service contracts, partner memberships and alliances entered into by SUSE, which we will continue to use. Internal use software relates to software internally developed by SUSE, which we will continue to use. Trademarks and trade names relate to SUSE brand names (\$24.2 million), Ximian brand names (\$1.2 million) and SilverStream brand names (\$0.7 million), which we continue to use. Developed technology, customer relationships and internal use software are being amortized over three years. Amortization for the first quarters of fiscal 2004 and fiscal 2003 was \$1.5 million and \$3.0 million, respectively. Trade names have an indefinite life and therefore are not amortized but are reviewed for impairment at least annually.

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," we do not amortize goodwill or intangible assets with indefinite lives. We review these assets periodically for potential impairment. During the fourth quarters of fiscal 2002 and fiscal 2003, we completed our annual impairment review based on August 1, 2002 and 2003 balances and determined that there was no impairment as of those dates. Additionally, we determined that no goodwill or intangible asset impairments existed in any of our operating segments at January 31, 2004.

In connection with the SUSE acquisition, we recorded additional goodwill and a deferred income tax liability of \$17.1 million resulting from the future tax consequences of the non-deductibility of identified net intangible assets recorded in this transaction.

G. Income Taxes

Income tax expense for the first quarter of fiscal 2004 was \$6.3 million and relates primarily to income tax expenses incurred on foreign earnings. These foreign earnings cannot be offset by net operating losses, which are primarily related to the U.S. tax jurisdiction. The effective tax rate on income for the first quarter of fiscal 2004 and the estimated effective tax rate for fiscal 2004 is 38.5%. The effective tax rate for fiscal 2003 was 194.3%. The fiscal 2004 effective tax rate differed from the effective tax rate for 2003 because of the establishment of a full valuation allowance resulting in adjustments of \$131 million during fiscal 2003. This valuation allowance was recorded as a result of our analysis of the facts and circumstances at the time, which led us to conclude that we could no longer forecast future U.S. taxable income under the more likely than not standard required by SFAS No. 109, "Accounting for Income Taxes." The Company's cumulative pre-tax book loss for three consecutive years ended October 31, 2003, imposed a high standard for compelling, positive evidence of the likelihood of, and ability to forecast, future taxable income in the near term.

In connection with our acquisition of all the outstanding stock of SUSE, we recorded a \$17.1 million deferred income tax liability resulting from the future tax consequences of the non-deductibility of identified intangible assets of \$43.5 million recorded in the transaction.

We paid income taxes of \$1.2 million in the first quarter of fiscal 2004 and \$3 million for the first quarter of fiscal 2003.

H. Line of Credit

We have a \$20 million bank line of credit available for letter of credit purposes. At January 31, 2004, there were standby letters of credit of \$15.3 million outstanding under this line, \$13 million of which is secured by cash. The bank line expires at April 1, 2004 and is expected to be renewed at that time. The bank line is subject to the terms of a credit agreement containing financial covenants and restrictions, none of which are expected to affect our operations. We are in compliance with all financial covenants as of January 31, 2004. In addition, at January 31, 2004, we had outstanding letters of credit of an insignificant amount at some other banks.

I. Restructuring

We recorded no restructuring charges during the first quarter of fiscal 2004. We did record pretax restructuring charges related to plans of restructuring announced in the third quarter of fiscal 2003, the second quarter of fiscal 2002, the fourth quarter of fiscal 2001 and the third quarter of fiscal 2001. These restructuring charges were in response to changes in general market conditions, changing customer demands and the evolution of our business strategy relative to the identity management and web services area of our business and our revised strategies. The full details of these restructurings are disclosed in our Annual Report on Form 10-K for the 2003 fiscal year.

The following table summarizes the activity during the first quarter fiscal 2004 related to these restructurings:

	2003 Restructuring	2002 Restructuring	Fourth Quarter 2001 Restructuring	Third Quarter 2001 Restructuring
	(Amounts in thousands)			
Balance at October 31, 2003:				
Severance benefits.....	\$6,879	\$1,006	\$104	\$—
Excess facilities, property and equipment.....	8,434	4,142	2,732	2,653
Other restructuring-related costs.....	1,842	300	185	—
	<u>\$17,155</u>	<u>\$5,448</u>	<u>\$3,021</u>	<u>\$2,653</u>
Payments during first quarter of fiscal 2004:				
Severance benefits.....	(6,527)	—	(105)	—
Excess facilities, property and equipment.....	(2,555)	(457)	(121)	(363)
Other restructuring-related costs.....	1,646	—	—	—
Balance at January 31, 2004:				
Severance benefits.....	\$352	\$1,006	\$(1)	\$—
Excess facilities, property and equipment.....	5,879	3,685	2,611	2,290
Other restructuring-related costs.....	3,488	300	185	—
	<u>\$9,719</u>	<u>\$4,991</u>	<u>\$2,795</u>	<u>\$2,290</u>

As of January 31, 2004, the remaining balances include 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 three quarters.

J. 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 leased 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 \$100,000 against this guarantee and at January 31, 2004, we have accrued an additional \$0.7 million, which represents our liability exposure if the new lessee continues in default, excluding legal fees. In addition, we have provided a guarantee in the amount of \$2 million related to a foreign tax audit. No amounts have been paid against this guarantee. It is expected the term of the guarantee will continue until the conclusion of the audit.

As an element of our standard contract terms, we include an indemnification clause in our agreements with our customers that indemnify 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 relatively common in the high technology industry. We do not record a liability for potential litigation claims related to indemnification agreements with our customers, unless and until we conclude the likelihood of a material obligation is probable.

During the first quarter of fiscal 2004, we implemented our Novell Linux Indemnification Program. Under this program, indemnification is offered for copyright infringement claims made by third parties against registered Novell customers who obtain SUSE™ Enterprise Linux Server 8 and who, after January 12, 2004, obtain upgrade protection and a qualifying technical support contract from us or a participating Novell or SUSE channel partner. At January 31, 2004, we did not record a liability for potential claims related to the Novell Linux Indemnification Program because we do not believe the likelihood of a material obligation is probable or estimable.

K. Commitments and Contingencies

As of January 31, 2004, we had a carrying value of \$47.7 million related to long-term investments in various venture capital funds and had commitments to contribute an additional \$47.5 million to these funds, of which approximately \$13.2 million could be contributed in fiscal 2004, approximately \$16.1 million in fiscal 2005, and approximately \$18.2 million thereafter as requested by the fund managers.

L. Legal Proceedings

In January 2004, the SCO Group, Inc. ("SCO") filed suit against us in the Third Judicial District Court of Salt Lake County, State of Utah. Novell removed the claim to the U.S. District Court, District of Utah. SCO alleges that our public statements and filings regarding the ownership of the copyrights in UNIX and UnixWare have harmed SCO's business reputation and affected its efforts to protect its ownership interest in UNIX and UnixWare. SCO seeks to require us to assign all copyrights that we have registered in UNIX and UnixWare to SCO, to prevent us from representing that we have any ownership interest in the UNIX and UnixWare copyrights, to require us to withdraw all representations we have made regarding our ownership of the UNIX and UnixWare copyrights, and actual, special and punitive damages in an amount to be proven at trial. We believe that we have meritorious defenses to these claims and 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.

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. While

Novell believes that SilverStream and its former officers and directors have meritorious defenses to the claims, a Memorandum of Understanding has been reached between many of the defendants and the plaintiffs, which contemplate a settlement of the claims. The finalization of any settlement, however, has not been completed. 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 currently party to various legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. While the outcome of these matters cannot be predicted with certainty, we do not believe that the outcome of any of these claims or any of the above mentioned legal matters will have a material adverse effect on our consolidated financial position, results of operations or cash flow.

M. Segment Information

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 a 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 segments. These 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 products, services and solution offerings. These offerings are sold direct or via OEM, reseller, and distributor channels. Operating results by segment are as follows:

	Three Months Ended			
	January 31, 2004		January 31, 2003	
	Net Revenue	Operating Income (Loss)	Net Revenue	Operating Income (Loss)
	(Amounts in thousands)			
Americas.....	\$121,548	\$62,880	\$131,841	\$53,870
EMEA.....	87,851	27,067	81,727	29,075
Asia Pacific.....	20,375	4,314	17,857	918
Common unallocated operating costs.....	—	(86,329)	—	(89,703)
Total geographical segments.....	229,774	7,932	231,425	(5,840)
Celerant Management Consulting.....	37,333	6,074	28,546	(70)
Unallocated integration costs.....	—	—	—	(255)
Operating income (loss) per statement of operations.....	<u>\$267,107</u>	<u>\$14,006</u>	<u>\$259,971</u>	<u>\$(6,165)</u>

Revenue of \$2.2 million and expenses of \$2.9 million were recorded by SUSE during the period from January 12, 2004 through January 31, 2004. This revenue is included in the EMEA segment for the first quarter of fiscal 2004.

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, the chief decision makers review revenue by solution category, all of which are included in the geographic segment revenue. These solution categories are:

- Identity management and 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®, ZENworks®, and Novell iFolder®. Products in this category are branded as Nterprise™. Currently, our Ximian and SUSE offerings are included in this category.
- Worldwide services—comprehensive worldwide IT consulting, education, and support services that apply business solutions to our customers' business situations, providing the business knowledge and technical expertise to help our customers implement our identity management, web services, and cross platform services. Services in this category are branded as Ngagesm.
- Celerant Management Consulting—operational strategy and implementation consulting services offered to a wide range of customers across various sectors, worldwide.

Revenues by solution category are as follows:

	Three Months Ended	
	January 31, 2004	January 31, 2003
	(Amounts in thousands)	
Identity management and web services	\$22,472	\$22,903
Cross platform services.....	136,539	136,094
Total software licenses and maintenance	159,011	158,997
Worldwide services	70,763	72,428
Total IT software and solutions.....	229,774	231,425
Celerant Management Consulting	37,333	28,546
Total net revenue	<u>\$267,107</u>	<u>\$259,971</u>

For the first quarter of fiscal 2004 and 2003, revenues in the U.S were \$117 million and \$124 million, respectively and sales to customers outside the U.S were \$150 million and \$136 million, respectively. During the first quarter of fiscal 2004 and 2003, sales in EMEA accounted for 76% of our sales outside the U.S. No single customer and no country outside the U.S. accounted for more than 10% of total revenue during the first quarter of fiscal 2004 or 2003.

N. Net Income (Loss) Per Share

Earnings per share were calculated as follows:

	Three Months Ended	
	January 31, 2004	January 31, 2003
	(Amounts in thousands, except per share data)	
<i>Basic net income (loss) per share computation:</i>		
Net income (loss)	\$10,135	\$(11,888)
Weighted average shares outstanding	380,106	368,075
Basic net income (loss) per share	<u>\$0.03</u>	<u>\$(0.03)</u>
<i>Diluted net income (loss) per share computation:</i>		
Net income (loss)	\$10,135	\$(11,888)
Weighted average shares outstanding	380,106	368,075
Incremental shares attributable to exercise of outstanding options (treasury stock method)	12,005	—
Total.....	392,111	368,075
Diluted net income (loss) per share	<u>\$0.03</u>	<u>\$(0.03)</u>

The assumed exercise of outstanding stock options have an anti-dilutive effect for the quarter ended January 31, 2003 because of the net loss. As a result, these shares have been excluded in the calculation of diluted net loss per share for the first quarter of fiscal 2003.

O. Comprehensive Income (Loss)

The components of comprehensive income (loss), net of tax, for the first quarters of fiscal 2004 and 2003, were as follows:

	Three Months Ended	
	January 31, 2004	January 31, 2003
	(Amounts in thousands)	
Net income (loss)	\$10,135	\$(11,888)
Change in net unrealized gain/loss on investments.....	(341)	301
Cumulative pension liability	(1,349)	—
Change in cumulative translation adjustment.....	8,866	(371)
Comprehensive income (loss).....	<u>\$17,311</u>	<u>\$(11,958)</u>

The components of accumulated other comprehensive income, net of related tax, at January 31, 2004 and October 31, 2003 are as follows:

	January 31, 2004	January 31, 2003
		(Amounts in thousands)
Net unrealized gain on investment	\$1,158	\$1,499
Increase in pension liability.....	(1,349)	—
Cumulative translation adjustment.....	14,435	5,569
Accumulated other comprehensive income	<u>\$14,244</u>	<u>\$7,068</u>

P. Stock-Based Compensation

We account for our stock-based compensation plans under the intrinsic value method of accounting as defined by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. We apply the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure."

At January 31, 2004, we had authorized several stock-based compensation plans. Under these plans, options to purchase shares of our common stock can be granted to employees, consultants, and outside directors. We generally grant employees stock options at an exercise price equal to the fair market value of our common stock. Thus, in accordance with the intrinsic values method, no compensation expense (except compensation expense related to restricted stock purchase rights, restricted units, below-market option grants, and grants to non-employees) has been recognized for our stock-based compensation. If compensation expense for our stock-based compensation had been

determined based on the fair value of the stock grants, our net income (loss) and net income (loss) per share would have been the pro forma amounts indicated below:

	Three Months Ended	
	January 31, 2004	January 31, 2004
	(Amounts in thousands, except per share data)	
Net income (loss):		
As reported	\$10,135	\$(11,888)
Less: total stock-based compensation expense determined under fair value-based method for all awards, net of related tax effects	(10,627)	(9,898)
Add: total stock-based compensation expense recorded in the statement of operations	1,111	906
Pro forma	<u>\$619</u>	<u>\$(20,880)</u>
Net income (loss) per share:		
As reported basic	\$0.03	\$(0.03)
Pro forma basic	\$0.00	\$(0.06)
As reported diluted	\$0.03	\$(0.03)
Pro forma diluted	\$0.00	\$(0.06)

For the purpose of the above table, the fair value of each option grant is 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 first quarters of fiscal 2004 and fiscal 2003: a risk-free interest rate of approximately 3.1% and 2.85%, 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 tendered as a part of a tender offer which have an average expected life of three years; and a volatility factor of the expected market price of our common stock of 0.79 and 0.89, respectively. The weighted average fair value of options granted in the first quarters of fiscal 2004 and fiscal 2003 was \$5.65 and \$2.13, respectively.

For purposes of the above table, pro forma compensation expense is estimated for the fair value of the employees' purchase rights using the Black-Scholes option pricing model with the following assumptions if shares had been issued in the first quarters of fiscal 2004 and fiscal 2003: risk-free interest rate of approximately 0.6% and 1.07%, respectively; a dividend yield of 0.0% for both periods; a weighted-average expected life of six months for both periods; and a volatility factor of the expected market price of our common stock of 0.79 and 0.89, respectively. The weighted average fair value of the purchase rights issued in the first quarters of fiscal 2004 and fiscal 2003 was \$2.24 and \$1.07, respectively.

Q. Derivative Instruments

A large portion of our revenue, expense, and capital purchasing activities are transacted in U.S. dollars. We do not currently hedge currency risks related to revenue or expenses denominated in foreign currencies. However, 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, primarily on the Euro, Japanese yen, and certain other European, Latin American and Asian currencies.

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 January 31, 2004 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.

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. ("Novell") has been a thought leader in the field of computer networking since our development and release of NetWare™ in 1983. Building on this foundation, we recently acquired two companies that are key players in the Linux market. As a result of our 20 years of experience as a leader in the field of computer networking, and the expertise in the companies that we recently acquired, we believe we employ some of the best engineers in the world. These engineers, in collaboration with our consulting professionals, create world-class information technology ("IT") solutions. We are proud of our people, their skills, and the dedication they give the company. Leveraging this expertise, we expect to continue the evolution of our cross-platform strategy and become a leader in providing cross-platform solutions, web services, and identity management. During fiscal 2003, we announced our strategy to support Linux as well as NetWare, giving our customers a choice by providing Novell™ products and services that run on both NetWare and Linux platforms. Our solutions leverage our network expertise and the Web to help to create a world without information boundaries.

In the first quarter of fiscal 2004, due to a challenging information technology environment, we have taken steps to stabilize our core business and reposition Novell to focus on key growth areas. We reported basic and diluted net income per share of \$0.03 for the first quarter of fiscal 2004 compared to a net loss per share of \$0.03 per share for the same period of fiscal 2003 due to increased revenues, favorable foreign exchange rates, lower sales and marketing expenses, an improved gross profit margin and lower impairment charges on long-term assets offset by increased product development costs.

We made considerable progress on our Linux initiatives. On January 12, 2004, we acquired SUSE LINUX AG ("SUSE"), a privately-held company and a leading distributor of commercial Linux for enterprise servers. On August 4, 2003, we acquired Ximian, Inc. ("Ximian"), a privately-held company and leading provider of desktop and server solutions that enable enterprise Linux adoption. These acquisitions expand our ability to support and distribute a complete package of Linux solutions, provide us the ability to offer the most complete open source application stack available and bring leaders in the open source community and a strong core of Linux developers to Novell.

With the acquisitions of SUSE and Ximian, we believe we will be the only vendor who can provide complete, industry-leading network services on Linux from the server to the desktop, giving organizations a safe, secure, reliable, mature, and proven approach with worldwide enterprise-level support for investing in Linux.

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 an accounting estimate is made, and if different estimates that reasonably could have been used or changes in the accounting estimate that are reasonably likely to occur periodically could materially change the financial statements. We consider certain accounting policies related to revenue recognition, impairment of long-lived assets, and valuation of deferred tax assets to be critical policies due to the estimation processes involved in each.

Revenue Recognition. Revenue from software license fees is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable and collection is probable. If the fee due from the customer is not fixed or determinable, revenue is recognized as payments become due from the customer. If collection is not considered probable, revenue is recognized when the fee is collected. Allowances for estimated sales returns and allowances are recorded in the same period as the related revenue. We recognize revenue on the sale of shrink-wrapped box product through our distributor channel on a sell-through basis.

Revenue from maintenance contracts, support and other similar services, is recognized as services are performed. Certain sales require continuing service, support and performance by us, and accordingly, a portion of the revenue is deferred until the future service, support, and performance are provided. Revenue recognized on multiple-element arrangements is allocated to each element of the arrangement based on the relative fair values of the elements, which may include software products, unspecified product upgrade protection, software support services, consulting, and training. Fair value is determined by vendor-specific objective evidence of the price charged to other customers when each element is sold separately. We have established sufficient vendor-specific objective evidence of the fair value of all elements of a multiple element arrangement.

Consulting project contracts are either time-and-materials or fixed-price contracts. Revenue from consulting projects is recognized only if a signed contract exists, the fee is fixed or determinable, and collection of the resulting receivable is probable. Revenue from fixed-price contracts is recognized using the proportional performance method, using the estimated time-to-completion to measure the percent complete. The cumulative impact of any revision in estimates of the percent complete or recognition of losses on contracts is reflected in the period in which the changes or losses become known.

We record provisions against revenue for estimated sales returns and allowances on product and service-related sales in the same period as the related revenue is recorded. We also record a provision to operating expenses 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 expense, analyses of credit memo data, and other known factors. If the historical data we use to calculate these estimates do not properly reflect future returns or bad debts, revenue or net income could be overstated or understated.

Long-lived Assets. Our long-lived assets include fixed assets, long-term investments, goodwill, and other intangible assets. At January 31, 2004, our long-lived assets included \$254 million of net fixed assets, \$52 million of long-term investments, \$402 million of goodwill, and \$53 million of identifiable intangible assets.

Property, Plant, and Equipment. We periodically review our property, plant, and equipment for impairment in accordance with Statement of Financial Accounting Standards ("SFAS") No. 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 related assumptions change, we may be required to record impairment charges for these assets.

Long-term Investments. The fair value of the long-term investments is dependent on the actual financial performance of the companies or 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 private 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 may have to record additional impairment charges not previously recognized. During the first quarters of fiscal 2004 and fiscal 2003, we recognized \$1.1 million and \$10.8 million, respectively, of impairment losses related to our long-term investments. 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 other-than-temporarily impaired 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, or if actual cash flows are below our estimates, we may be required to record impairment charges for these assets not previously recorded. During the fourth quarters of fiscal 2002 and fiscal 2003, we completed our annual impairment review based on August 1, 2002 and 2003 balances and determined that there was no impairment as of those dates.

Additionally, during our review of goodwill and intangible assets during the first quarter 2004, we noted no significant changes in market conditions, our assumptions and other factors since we performed our annual impairment test. However, changes in the assumptions used in the analysis could have changed the resulting outcome. For example, to estimate the fair value of our reporting units, we made estimates and judgments about future cash flows based on our fiscal 2004 forecast and current long-range plans used to manage the business. These long-range estimates could change in the future depending on internal changes in our company as well as external factors. Future changes in estimates or in the manner we report and evaluate our operating segments could possibly result in a non-cash goodwill impairment charge that could have a material adverse impact on our results of operations.

During the third quarter of fiscal 2003, we determined that impairment indicators existed related to the developed technology and trade names we acquired from SilverStream, mainly as a result of failure to achieve revenue growth targets for the exteNd™ products. Based on an independent valuation of these assets, we recorded a \$23.6 million impairment charge to write down these assets to their estimated fair value. This charge was included in cost of revenue.

As a result of the impairment recorded on these intangible assets, we also analyzed our other long-lived assets for indicators of impairment, as required by SFAS No. 142, in the third quarter. This analysis included goodwill and fixed assets acquired from SilverStream. Applying the provisions of SFAS No. 142 and SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets," we noted no additional indicators of impairment.

Developed technology and internal use software are amortized over three years as a cost of revenue. Trade names have an indefinite life and therefore are not amortized but are reviewed for impairment at least annually.

Deferred Tax Assets. We perform quarterly and annual assessments of the realization of our deferred tax assets considering all available evidence, both positive and negative. Assessments of the realization of deferred tax assets require that management make significant judgments about many factors, including the amount and likelihood of future taxable income. As a result of these assessments, we previously established valuation allowances on select deferred tax assets that were considered to be at risk due to their unique characteristics and limitations, such as capital loss carryovers and acquired tax attributes. Through the third quarter of fiscal 2003, we concluded that it was more likely than not that the remaining recognized deferred tax assets would be realized. The valuation allowance established in the fourth quarter of fiscal 2003 was recorded as a result of our analysis of the facts and circumstances at that time, which led us to conclude that we could no longer forecast future U.S. taxable income under the more likely than not standard required by SFAS No. 109, "Accounting for Income Taxes." The Company's cumulative pre-tax book loss for three consecutive years ended October 31, 2003 imposed a high standard for compelling, positive evidence of the likelihood of, and ability to forecast, future taxable income in the near term. As a result, in the fourth fiscal quarter 2003 and the first quarter 2004, we provided a full valuation allowance against net deferred tax assets carried on our balance sheet. As deferred tax assets or liabilities increase or decrease in the future, or if a portion or all of the valuation allowance is no longer deemed to be necessary, the adjustments to the valuation allowance will increase or decrease future income tax provisions.

Results of Operations

Acquisition

On January 12, 2004, we purchased substantially all of the outstanding stock of SUSE, a privately-held company and a leading provider of Linux-based products, for approximately \$210 million in cash, plus estimated merger and transaction costs of \$7 million. The acquisition of SUSE enables us to offer a full range of enterprise solutions on the Linux platform, from the server to the desktop. This transaction was accounted for as a purchase. SUSE's results of operations have been incorporated into ours beginning on the acquisition date of January 12, 2004.

The purchase price was preliminarily allocated as follows:

	Estimated Acquisition Cost	Asset Life
	<u>(Amounts in thousands)</u>	
Fair value of net tangible assets acquired.....	\$1,599	N/A
Identifiable intangible assets:		
Customer relationships	13,385	3 years
Internal use software	5,864	3 years
Trademarks/trade names	24,221	Indefinite
Goodwill.....	188,673	Indefinite
	<u>\$233,742</u>	

We recorded additional goodwill and a deferred income tax liability of \$17 million resulting from the future tax consequences of the non-deductibility of identified net intangible assets recorded in connection with this acquisition.

Goodwill from the SUSE acquisition resulted from our belief that SUSE's technology is valuable to our product offerings. The purchase price allocation will be adjusted as integration plans are finalized, as allowed by Statement of Financial Accountings Standards (SFAS) No. 141, "Business

Combinations." We used an independent valuation firm to estimate the fair values of the intangible assets.

As integration plans are finalized, the goodwill arising from the SUSE acquisition will be allocated to our geographic segments. Revenues of \$2.2 million and expenses of \$2.9 million were recorded by SUSE for the period from January 12, 2004 to January 31, 2004, and are included in the EMEA geographic segment and the Cross-Platform Services solutions group. If the SUSE acquisition had occurred at November 1, 2003, the estimated pro forma revenues, net income and net income per share (basic and diluted), for the first quarter of fiscal 2004 would have been \$275.0 million, \$9.2 million and \$0.02, respectively. If the SUSE acquisition had occurred at November 1, 2002, the estimated pro forma revenues, net loss and net loss per share (basic and diluted), for the first quarter of fiscal 2003 would have been \$267.8 million, \$16.1 million, and \$0.04, respectively.

Acquisitions in previous periods are disclosed in our Annual Report on Form 10-K for the fiscal 2003 fiscal year.

Revenue

Operating segments. We sell our products, services, and solutions primarily to large-scale corporations, government entities, educational institutions, resellers, and distributors both domestically and internationally.

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 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 are:

- 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

The following summarizes revenue by segment:

	Three Months Ended,		Change
	January 31, 2004	January 31, 2003	
	(Amounts in millions)		
Americas.....	\$122	\$132	(8)%
EMEA	88	82	7%
Asia Pacific	20	18	11%
Celerant Management Consulting	37	28	32%
Total net revenue	<u>\$267</u>	<u>\$260</u>	<u>3%</u>

Revenue in the Americas decreased by 8% during the first quarter of fiscal 2004 compared to the same period of fiscal 2003 primarily as a result of a \$6.2 million decline in NetWare license sales. Identity Management and Web Services and IT consulting revenues were down \$4 million for the first quarter of fiscal 2004 compared to the same quarter of fiscal 2003 due to the difficult economy and flat corporate IT spending. These decreases in revenue were offset somewhat by increased customer maintenance and service revenue for the first quarter of fiscal 2004 compared to the same period in fiscal 2003.

Revenue in EMEA increased by 7% during the first quarter of fiscal 2004 compared to the same period of fiscal 2003 primarily as a result of positive foreign currency effects of approximately \$7 million. Revenue of \$2.2 million generated by SUSE during the period from January 12, 2004 through January 31, 2004 is included in the EMEA segment and the cross platform solutions category for the first quarter of fiscal 2004.

Revenue in Asia Pacific increased by 11% during the first quarter of fiscal 2004 compared to the same period of fiscal 2003 primarily as a result of positive foreign currency effects and increases in Identify Management and Web Services and Cross Platform Services licenses and maintenance revenues.

Revenue in our Celerant Management Consulting segment increased by 32% during the first quarter of fiscal 2004 compared to the same period of fiscal 2003 but was relatively flat with the previous three quarters. The year-over-year increase in revenue is due to favorable exchange rates and to delayed revenue recognition in the first quarter of fiscal 2003 due to a specific customer situation, which is not likely to recur.

Geographic information. For the first quarter of fiscal 2004 and fiscal 2003, revenues in the U.S. were \$117 million and \$124 million, respectively, and sales to customers outside the U.S. were \$150 million and \$136 million, respectively. During the first quarter of fiscal 2004 and fiscal 2003, sales in EMEA accounted for 76% of our sales outside the U.S. No single customer or country outside the U.S. accounted for more than 10% of total revenue during the first quarter of fiscal 2004 or fiscal 2003.

Solutions categories. 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 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®, ZENworks®, and Novell iFolder®. Products in this category are branded as Nterprise™. Currently, our Ximian and SUSE offerings are included in this category.
- Worldwide services—comprehensive worldwide IT consulting, education, and support services that apply business solutions to our customers' business situations, providing the business knowledge and technical expertise to help our customers implement our identity management, web services, and cross platform services. Services in this category are branded as Ngagesm.

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

	Three Months Ended		Change
	January 31, 2004	January 31, 2003	
	(Amounts in millions)		
Identity management and web services	\$22	\$23	(4)%
Cross platform services	137	136	1%
Worldwide services	71	73	(3)%
Celerant Management Consulting	37	28	32%
Total net revenue	<u>\$267</u>	<u>\$260</u>	<u>3%</u>

Identity management and web services revenue was relatively flat for the first quarter of fiscal 2004 compared to the same period of fiscal 2003 due to the difficult economy and flat corporate IT spending.

Cross platform services generates revenue through two solution categories—Services Platforms and Storage and Management and Collaboration. The Services Platforms and Storage category (primarily our NetWare offerings) generated \$76 million in revenues for the quarter. This represents a 7% decrease in revenues for the quarter as compared to the same quarter in fiscal 2003, which is improved from the 14% decrease in NetWare revenues between the first quarter of fiscal 2002 & 2003. This improvement is attributed to favorable foreign currency effects and, we believe, to customers who are choosing NetWare in response to our message of choice and flexibility surrounding Linux. The Management and Collaboration category (primarily our ZENworks and GroupWise offerings) generated revenue of \$61 million for the quarter. This represents an increase of 11% for the quarter compared to the same quarter in fiscal 2003. This improvement is somewhat linked to the improved NetWare trends for the quarter because our large customers that purchase Netware will often purchase ZENworks and GroupWise as well.

Worldwide services revenue decreased 3% due primarily to a 7% decrease in IT consulting (branded as Ngage) revenue for the quarter compared to the same quarter in fiscal 2003. Ngage consulting revenue was \$34 million for the quarter. This decrease in IT consulting is primarily due to transitions from large application development projects to solution engagements involving Identity Management and Web Services offerings. This decrease in revenue was partially offset by a 2% increase in Technical Services and Training revenues for the quarter compared to the same quarter in the prior year. Technical Services and Training generated revenues of \$36 million for the quarter.

The increase in revenue in Celerant Management Consulting revenue is discussed previously in the Operating Segments section.

Forward-looking revenue trends. NetWare revenue for fiscal 2003 was down 12% compared to fiscal 2002 and was down 15% from fiscal 2001 to fiscal 2002. These declines are primarily a result of loss of market share. In fiscal 2004, we expect NetWare revenue to continue to decrease. However, as previously discussed, a significant aspect of our overall corporate strategy is to embrace the open source movement, specifically, the Linux operating system. Our acquisitions of Ximian and SUSE make us the only major company to offer a complete vertically-integrated Linux system from server to desktop. Accordingly, we believe that our Linux initiatives provide revenue opportunities for the sale of new products and will help assist and augment our existing product revenue streams and trends as the Linux market grows in the future.

At January 31, 2004, we had \$294 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 of typically one year. We have either received payment or recorded a receivable for the deferred revenue, and have determined collectability to be probable. Direct costs incurred to fulfill these maintenance obligations are recognized as work is performed.

Gross profit

	Three Months Ended	
	January 31, 2004	January 31, 2003
	(Amounts in millions)	
New software license.....	\$50	\$56
As a percentage of software license revenue	91%	92%
Maintenance and service	122	106
As a percent of maintenance and service revenue	58%	54%
Total gross profit.....	\$172	\$162

The slight decrease in gross profit as a percentage of revenue on software licenses from 92% in the first quarter of fiscal 2003 to 91% in the first quarter of fiscal 2004 is result of competitive pricing pressure on new license sales.

Gross profit as a percentage of revenue on maintenance and services increased from 54% in the first quarter of fiscal 2003 to 58% for the first quarter of 2004. This increase is due primarily to our efforts in improving resource utilization in our IT consulting services via the elimination of over 200 consultants, mainly in the Americas.

Operating expenses

	Three Months Ended		Change
	January 31, 2004	January 31, 2003	
	(Amounts in millions)		
Sales and marketing	\$82	\$98	(16)%
Percentage of revenue.....	31%	38%	
Product development.....	\$50	\$43	16%
Percentage of revenue.....	19%	17%	
General and administrative.....	\$26	\$28	(7)%
Percentage of revenue.....	10%	11%	
Total operating expenses.....	\$158	\$169	(7)%
Percentage of revenue.....	59%	65%	

Sales and marketing expense, in total and as a percentage of revenue, decreased in the first quarter of fiscal 2004 compared to the same period of fiscal 2003. This decrease is due to lower headcount levels of over 200 employees, primarily in sales, and to reduced marketing spend of \$11.3 million in the first quarter of fiscal 2004, compared to the first quarter of fiscal 2003. Sales and marketing expenses can fluctuate as a percentage of revenue in any given period due to product promotions, advertising, and other discretionary expenses. We plan to increase the level of marketing expenses during the second quarter of fiscal 2004 in conjunction with our annual BrainShare® Conference and other marketing efforts.

Product development expenses, in total and as a percentage of revenue, increased in the first quarter of fiscal 2004 compared to the same period of fiscal 2003 due to increased research and development costs from the acquisitions of Ximian and SUSE and increased employee compensation

costs. Product development headcount increased in the first quarter of fiscal 2004 by 44 engineers compared to the same quarter of fiscal 2003 due to the acquisitions of Ximian in the fourth quarter of fiscal 2003 and the acquisition of SUSE on January 12, 2004, offset somewhat by internal headcount reductions.

General and administrative expenses in the first quarter of fiscal 2004 decreased by 7% from the first quarter of fiscal 2003 primarily due to a decrease in general and administrative headcount of 150 employees offset by increased legal fees and other employee compensation costs.

Restructuring

We recorded no restructuring charges in the first quarters of fiscal 2004 and fiscal 2003. Cash payments of \$10.4 million were made during the first quarter of fiscal 2004 which reduced the remaining accrued restructuring liabilities to \$19.8 million. The remaining restructuring liabilities include severance and benefits, which will be paid out over the remaining severance obligation period of approximately 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 approximately over the next three quarters.

Our restructuring activities in previous periods are disclosed in detail in Novell's Annual Report on Form 10-K for the 2003 fiscal year.

Other income (expense), net

	<u>Three Months Ended</u>		<u>Change</u>
	<u>January 31,</u> <u>2004</u>	<u>January 31,</u> <u>2003</u>	
	(Amounts in millions)		
Other income (expense), net.....	\$2	\$(6)	133%
Percentage of revenue	1%	(2)%	

The increase in other income (expense) is primarily due to a \$10.8 million impairment loss on long-term investments during the first quarter of fiscal 2003 compared to an impairment loss on long-term investments of \$1.1 million for the first quarter of fiscal 2004. Investment income for the first quarter of fiscal 2004 was \$4.7 million compared to investment income of \$3.7 million for the first quarter of fiscal 2003.

Income tax expense (benefit)

	<u>Three Months Ended</u>	
	<u>January 31,</u> <u>2004</u>	<u>January 31,</u> <u>2003</u>
	(Amounts in millions)	
Income tax expense (benefit)	\$6,348	\$(466)
Effective tax (benefit) rate.....	38.5%	(4)%

The income tax provision primarily represents income tax expenses incurred on foreign earnings that cannot be offset by U.S. net operating loss carryforwards. Our actual effective tax rate for the first quarter of fiscal 2004 was 38.5% compared to the effective tax rate of a negative 4% for the same period in 2003. The rate differs because of non-deductible investment impairments taken in the first quarter of 2003.

Liquidity and Capital Resources

	January 31, 2004	October 31, 2003	Change
	(Amounts in millions)		
Cash and short-term investments	\$605	\$752	19.5%
Percentage of total assets.....	38%	48%	

Cash and short-term investments decreased to \$605 million at January 31, 2004, compared to \$752 million at October 31, 2003. This decrease is due primarily to cash payments of \$210 million in connection with our purchase of SUSE and \$12 million for the purchases of property and equipment, primarily office and computer equipment, in the first quarter of fiscal 2004. Cash provided from operations and cash provided from the issuance of common stock for the first quarter of fiscal 2004 were \$31 million and \$28 million, respectively. Merger and acquisition costs of \$1.6 million incurred in connection with the acquisition of SUSE were paid in the first quarter of fiscal 2004, and an estimated \$5.4 million of further merger and acquisition costs will be paid in future periods.

As of January 31, 2004, we had cash and other short-term investments of \$283 million held in accounts outside the United States. 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. Our short-term investment portfolio includes gross unrealized gains and losses of \$1.6 and \$0.1 million, respectively, as of January 31, 2004. We monitor our investments and record losses when a decline in the investment's market value is determined to be other than temporary.

We also invest excess cash in long-term investments mainly consisting of investments made in venture capital partnerships for the promotion of our business and strategic objectives. As of January 31, 2004, we had a carrying value of \$47.7 million related to investments in various venture capital funds and had commitments to contribute an additional \$47.5 million to these funds, of which we estimate approximately \$13.2 million could be contributed in fiscal 2004, approximately \$16.1 million in fiscal 2005, and approximately \$18.2 million thereafter as requested by the fund managers. We intend to fund these investments with cash from operations and cash on hand.

As of January 31, 2004, we have various operating leases related to our facilities with remaining terms of more than one year. These leases have minimum annual lease commitments of \$32 million in fiscal 2004, \$27 million in fiscal 2005, \$22 million in fiscal 2006, \$18 million in fiscal 2007, \$13 million in fiscal 2008, and \$16 million thereafter. Furthermore, we have \$40 million of minimum rentals to be received in the future from subleases.

Our principal source of liquidity continues to be from operations, cash on hand, and short-term investments. At January 31, 2004, our principal unused sources of liquidity consisted of cash in the amount of \$266 million, short-term investments in the amount of \$339 million, and available borrowing capacity of approximately \$4.7 million under our lines of credit. Our liquidity needs are principally for financing of accounts receivable, fixed assets, strategic investments, product development, and flexibility in a dynamic and competitive operating environment.

We anticipate generating positive cash flows from operations in addition to investment income in fiscal 2004 sufficient to fund operations and other anticipated cash requirements. 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 and short-term investments together with cash generated from operations and investment income. We believe that 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, given current market conditions. 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. For example, on January 12, 2004, we purchased SUSE for approximately \$210 million in cash, not including merger and transaction costs.

Factors Affecting Future Results of Operations

Our future results of operations involve a number of risks and uncertainties. A number of these risks and uncertainties are discussed below.

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

The weakened global economic climate, particularly in the technology sector, has had an adverse effect on our ability to sell products and services. Future economic projections for this sector are uncertain. A continuation of the weakened global economy could have further negative effects on our ability to sell products and services in the future.

We May Not Be Able to Successfully Compete in a Challenging Market for Computer Software and 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 operating segments include: our ability to sell both products and services as part of an overall solution; 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.

Geographic segments

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 operating segments include: our ability to sell both products and services as part of an overall solution; 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. In addition to the factors listed above, other key competitive factors 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 in our geographic segments include Microsoft, IBM, Sun, Altiris, Inc., Netegrity, Inc., and Computer Associates. Our competitors in the Linux market include BEA Systems, Inc., Red Hat, and Turbolinux, Inc. One pervasive factor facing all companies doing business in our industry is the presence—and dominance—of Microsoft. In a decision upheld by a federal appellate court, Microsoft was found to have violated Section 2 of the Sherman Act by unlawfully acting to maintain its monopoly over desktop operating systems. We remain concerned, however, that Microsoft may continue to engage in business practices that unfairly inhibit the growth of its competitors, including Novell, and that the settlement of the litigation between the Department of Justice and Microsoft will not significantly affect Microsoft's practices. This concern seems increasingly to be shared by the Department of Justice and the litigating states. For example, in the past, Microsoft has employed tactics that limit or block effective and efficient interoperability between Novell and Microsoft products. At the most recent status conference in *U.S. v. Microsoft* held on January 23, 2004, the Department of Justice expressed concern that the license Microsoft is offering for its communications protocols, as required by the court to facilitate interoperability, might not be having the desired effect of fostering competition. 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.

Celerant Management Consulting segment

The key competitive factors faced by the Celerant segment are attracting and retaining the highest quality consultants; the depth of our skills and expertise; the breadth of consulting capabilities; and having expertise in key functional areas. The market for management consulting services is highly competitive due to the existence of various large consulting firms. Many of these companies have greater financial, technical and marketing resources and greater name recognition in the consulting area, which could inhibit our ability to grow our consulting business. Additionally, the worldwide marketplace for consulting services is highly fragmented. In different regions of the world, there may be multiple competitors, many with niche consultancies. Examples of possible competitors include A.T. Kearney, McKinsey & Co., Thomas Group Inc., IBM Services, Cap Gemini, and The Management Consulting Group PLC.

General

If We Are Not Successful in our Strategy of Taking a Competitive Position in the Linux Market, Our Revenue Will Not Grow at the Rate We Anticipate

A significant aspect of our overall corporate strategy is to embrace the open source movement, specifically, the Linux operating system. It is our goal to stabilize the decline in our NetWare revenue by offering our customers a clear migration path to Linux should they decide to adopt an open source solution, and yet enable them to stay with NetWare until they are ready to make that decision. Over the past year, we have increasingly demonstrated our commitment to the open source development model, embraced open source technologies in our own offerings, invested significant energy and resources in key open source initiatives, and contributed to the open source movement. We plan to continue to do so in the future. We are strengthening our ability to sell and support Linux in addition to NetWare. Our ability to achieve success with our Linux and open source products and services is dependent on a number of factors including, but not limited to, the following: the growth of the Linux market; the acceptance of Linux solutions by clients; development of key Linux product solutions and upgrades; and the acceptance of those products by large industry partners and major accounts. If we are unable to grow the Linux products and services to become a major component of our business, our long-term growth will be negatively impacted.

If We Are Not Successful in Developing a Strong Business with Our exteNd Products and Services, Our Revenue Will Not Grow at the Rate We Anticipate

One key element of our strategy is to be a leading force in the development of solutions that make the process of developing open-standards, Web-based applications fast, simple, and cost effective. Our exteNd solution set leverages the power of standards such as Java and XML to unify relevant information and services while enabling customers to leverage prior technology investments and help them rapidly deliver Web-based applications that are scalable, reliable, and secure. The acquisition of SilverStream helped further our development of web services products and enhanced our business solutions product offerings. Our ability to achieve success with our exteNd products and services is dependent on a number of factors including, but not limited to, the following: the growth of the Web-based applications industry; the acceptance of the exteNd solution set by clients; development of key exteNd product solutions and upgrades; and the acceptance of those products by large industry partners and major accounts. If we are unable to grow the exteNd products and services, our long-term growth will be negatively impacted.

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 are declining at a faster rate than we are able to increase sales of new products or technologies. Overall, revenue in the Americas segment declined by \$73 million in fiscal 2003, primarily as a result of declining NetWare license and maintenance sales and IT consulting sales. If we are unsuccessful in increasing sales of new products or technologies, particularly in our identity management and web 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 have initiated several new 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.

The Legal Actions Being Taken By the SCO Group Could Adversely Affect Our Revenues Because of a Reduction in Demand for Our SUSE Linux and Ximian Products

SCO filed legal action in March 2003 against IBM alleging misappropriation of trade secrets, tortious interference, unfair competition and breach of contract relating to IBM's sale of products based on the Linux operating system. Among other things, SCO maintains that Linux is an unauthorized derivative of UNIX and that portions of UNIX intellectual property that SCO alleges it owns have been included in the Linux operating system without authorization. SCO has warned that legal liability for the use of Linux may extend to commercial users, and SCO has threatened users with litigation and sought licensing fees from them. It is possible that SCO's actions may reduce general demand for Linux and Linux related products and services. In this event, demand for our Linux products and services could decrease, thereby reducing revenue.

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 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;
- Inability to respond to the decline in revenue through the distribution channel;
- Inability to derive benefits from the restructurings and our corporate strategy; and
- Inability to deliver solutions as expected by our customers and systems integration partners.

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 us.

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.

We May Not be Able To Attract and Retain Qualified Personnel Because of the Intense Competition for Qualified Personnel 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 personnel. Even in light of the current economic downturn, competition for personnel of the highest caliber is intense in the software and consulting industries. The loss of a significant group of key personnel would adversely affect our performance. The failure to successfully promote and hire suitable replacements in a timely manner could have a material adverse effect on our business.

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 recent acquisitions, a number of these employees come from diverse corporate cultural backgrounds. We are in the process of a culture initiative to bring us 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.

In The Event Significant Claims Are Brought Under Our Recently Announced Novell Linux Indemnification Program, We Could Incur Significant Expenses, Thereby Adversely Affecting Our Results Of Operations.

We recently announced our Novell Linux Indemnification Program. Under this program, indemnification is offered for copyright infringement claims made by third parties against registered Novell customers who obtain SUSE(R) Enterprise Linux Server 8 and who, after January 12, 2004, obtain upgrade protection and a qualifying technical support contract from us or a participating Novell or SUSE LINUX channel partner. Although indemnification programs for proprietary software are common in our industry, indemnification programs that cover open source software are not. Copyright infringement claims are not often brought against distributors of open source software, but because of the relatively unique nature of the Novell Linux Indemnification Program, the number and extent of claims that might be brought there under is uncertain. SCO has threatened to bring claims against end users of Linux for copyright violations arising out of the facts alleged in SCO's lawsuit against IBM and in SCO's public statements, and some of these claims could be indemnified under Novell's Linux Indemnification Program. In the event that claims for indemnification are brought under the Novell Linux Indemnification Program, we could incur significant expense reimbursing customers for their legal costs and, in the event those claims are successful, for damages.

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 it is 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 Novell alleging infringement 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. While we have no knowledge of grounds for any such claims, the cost and time of defending ourselves can be significant. In addition, we indemnify customers against certain 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 that protect our confidential information. In the event that our trade secrets or other proprietary information is 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 our 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 investments in public equity securities, small capitalization stocks in the high-technology industry sector, private companies, and funds managed by venture capitalists. Many of these investments might become other than temporarily impaired. During fiscal 2003, we recorded an impairment charge of \$35 million related to some of the investments in our portfolio

whose market value had experienced an other-than-temporary decline. As of October 31, 2003, we had net unrealized gains, net of taxes, on investments totaling approximately \$1 million; however, there can be no assurances that these gains will be realized and that losses will not occur. If the funds in which we have invested, suffer poor financial performance, or if the private companies in which we have invested are not successfully acquired or experience initial public offerings, the value of our investments will decrease.

Our Existing Relationships With Other IT 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 our 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 not 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 Client Requirements

The software industry and Internet professional services 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 facing us, are the needs to continue to:

- Effectively identify and use leading technologies;
- Develop 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 business solutions.

Our Consulting Services Contracts Contain Pricing Risks and, If Our Estimates Prove Inaccurate, We Could Lose Money

Our IT and Celerant consulting businesses derive a portion of their revenue 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 it 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 revenue from projects priced on a contingency basis. If results are not met, or if a dispute arises, we may not be able to realize a potentially large amount of revenue.

Our IT 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 our IT or Celerant 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, 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 professional services employees, causing significant reductions in operating results for a particular quarter.

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. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to financial market risks, including changes in interest rates, foreign currency exchange rates, and 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 January 31, 2004.

Interest Rate Risk

The primary objective of our short-term investment activities is to preserve principal while maximizing yields without significantly increasing risk. Our strategy 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 \$1.6 million decrease (less than 0.5%) 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 January 31, 2004, gross unrealized gains, before tax effect on the short-term public equity securities totaled \$0.6 million. A reduction in prices of 10% of these short-term equity securities would result in approximately a \$1 million decrease (less than 0.5%) in the fair value of our short-term investments.

In addition, we invest in equity securities issued by privately-held companies that are included in our long-term portfolio of investments, primarily for the promotion of business and strategic objectives. These investments are generally in thinly capitalized companies in the high-technology industry sector or venture capital funds. Because of the nature of these investments, we are exposed to equity price

risks. We typically do not attempt to reduce or eliminate our market exposure on these securities. A 10% adverse change in equity prices of long-term equity securities would result in an approximate \$5 million decrease in the fair value of our long-term securities.

Foreign Currency Risk

We use derivatives to hedge those net assets and liabilities that, when re-measured or settled according to accounting principles generally accepted in the U.S., impact our consolidated statement of operations. Currency forward contracts are utilized in these hedging programs. All forward contracts entered into by us 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 gains and losses on the net 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 (expense) in the same period as when the gains and losses on re-measurement 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 consolidated statements of cash flows. Our hedging programs reduce, but do not always entirely eliminate, the impact of foreign currency exchange rate movements. If we do 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 \$3 million. This number represents the exposure related to balance sheet re-measurement 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 January 31, 2004. 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 Notes K & L 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

Exhibit Number	Description
31.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	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 November 4, 2003, reporting Novell's entry into an agreement to acquire SUSE LINUX AG.

Form 8-K dated November 4, 2003, reporting the date and time of Novell's earnings conference call.

Form 8-K dated November 20, 2003, reporting the release of Novell's financial results for the quarter and year ended October 31, 2003, including financial statements.

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: March 12, 2004

By: /s/ JOSEPH S. TIBBETTS, JR.

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

CERTIFICATIONS

I, Jack L. Messman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Novell, Inc;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 12, 2004

/s/ JACK L. MESSMAN

Jack L. Messman

President and Chief Executive Officer

I, Joseph S. Tibbetts, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Novell, Inc;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 12, 2004

/s/ JOSEPH S. TIBBETTS, JR.

Joseph S. Tibbetts, Jr.

Senior Vice President and Chief Financial Officer

SECTION 906 CERTIFICATION BY THE CHIEF EXECUTIVE OFFICER

I, Jack L. Messman, Chief Executive Officer of Novell, Inc., a Delaware corporation (the "Company"), hereby certify that:

- (1) The Company's periodic report on Form 10-Q for the period ended January 31, 2004 (the "Form 10-Q") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

* * *

CHIEF EXECUTIVE OFFICER

/s/ JACK L. MESSMAN

Jack L. Messman

Date: March 12, 2004

SECTION 906 CERTIFICATION BY THE CHIEF FINANCIAL OFFICER

I, Joseph S. Tibbetts, Jr., Chief Financial Officer of Novell, Inc., a Delaware corporation (the "Company"), hereby certify that:

- (1) The Company's periodic report on Form 10-Q for the period ended January 31, 2004 (the "Form 10-Q") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

* * *

CHIEF FINANCIAL OFFICER

/s/ JOSEPH S. TIBBETTS, JR.

Joseph S. Tibbetts, Jr.

Date: March 12, 2004