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

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**Form 10-Q**

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(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the Quarterly Period Ended April 30, 2006

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

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**NOVELL, INC.**

(Exact name of registrant as specified in its charter)

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**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)

**NA**  
(Former name, former address and former fiscal year, if changed since last report)

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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 a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one)

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

As of May 31, 2006 there were 339,011,438 shares of the registrant's common stock outstanding.

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**Part I. Financial Information**  
**Item 1. Financial Statements**

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

	<u>April 30,</u> <u>2006</u>	<u>October 31,</u> <u>2005</u>
	<u>(unaudited)</u>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents.....	\$ 542,074	\$ 811,238
Short-term investments .....	796,967	843,666
Receivables (net of allowances of \$12,054 and \$16,638 at April 30, 2006 and October 31, 2005, respectively).....	219,242	293,627
Prepaid expenses .....	36,047	30,777
Other current assets .....	31,234	29,745
Total current assets .....	<u>1,625,564</u>	<u>2,009,053</u>
Property, plant and equipment, net.....	204,274	212,377
Long-term investments.....	56,856	54,340
Goodwill .....	454,163	395,509
Intangible assets, net .....	47,484	56,421
Deferred income taxes.....	1,582	1,384
Other assets .....	32,677	32,774
Total assets .....	<u>\$ 2,422,600</u>	<u>\$ 2,761,858</u>
<b>LIABILITIES, REDEEMABLE SECURITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable .....	\$ 46,713	\$ 45,445
Accrued compensation .....	105,146	113,760
Other accrued liabilities .....	80,022	131,105
Income taxes payable .....	57,829	56,869
Deferred revenue .....	345,768	405,751
Total current liabilities.....	<u>635,478</u>	<u>752,930</u>
Deferred income taxes .....	4,066	4,537
Senior convertible debentures.....	600,000	600,000
Total liabilities .....	<u>1,239,544</u>	<u>1,357,467</u>
Minority interests.....	2,974	8,555
Redeemable securities:		
Series B Preferred Stock, \$.10 par value, Authorized — 1,000 shares; Issued — 1,000 shares; Outstanding — 187 shares at April 30, 2006 and October 31, 2005 (at redemption value) .....	9,350	9,350
Stockholders' equity:		
Series A Preferred Stock, \$.10 par value, Authorized — 499,000 shares; no shares issued.....	—	—
Common stock, par value \$.10 per share, Authorized — 600,000,000 shares; Issued — 370,214,569 and 400,993,898 shares; Outstanding — 355,043,195 and 385,820,699 shares at April 30, 2006 and October 31, 2005, respectively .....	37,021	40,099
Additional paid-in capital.....	351,878	483,157
Treasury stock, at cost — 15,171,374 and 15,173,199 shares at April 30, 2006 and October 31, 2005, respectively.....	(124,860)	(124,875)
Retained earnings .....	897,571	984,107
Accumulated other comprehensive income.....	9,122	7,444
Unearned stock compensation.....	—	(3,446)
Total stockholders' equity.....	<u>1,170,732</u>	<u>1,386,486</u>
Total liabilities, redeemable securities, and stockholders' equity .....	<u>\$ 2,422,600</u>	<u>\$ 2,761,858</u>

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

**NOVELL, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(amounts in thousands, except per share data)

	Three Months Ended	
	April 30, 2006	April 30, 2005
	(unaudited)	
Net revenue:		
Software licenses .....	\$ 40,063	\$ 45,768
Maintenance and services .....	238,253	251,283
Total net revenue.....	<u>278,316</u>	<u>297,051</u>
Cost of revenue:		
Software licenses .....	4,041	4,863
Maintenance and services .....	100,408	112,478
Total cost of revenue.....	<u>104,449</u>	<u>117,341</u>
Gross profit .....	<u>173,867</u>	<u>179,710</u>
Operating expense (income):		
Sales and marketing .....	96,003	98,479
Product development .....	48,328	51,652
General and administrative .....	33,377	30,140
Restructuring expenses .....	—	5,361
Purchased in-process research and development .....	2,110	480
Gain on sale of property, plant and equipment .....	(2,190)	—
Gain on legal settlement.....	(1,225)	—
Total operating expense .....	<u>176,403</u>	<u>186,112</u>
Loss from operations.....	<u>(2,536)</u>	<u>(6,402)</u>
Other income (expense):		
Investment income .....	15,816	10,240
Impairment of investments .....	(226)	(917)
Interest expense and other, net.....	(2,213)	(1,868)
Total other income .....	<u>13,377</u>	<u>7,455</u>
Income before income taxes .....	10,841	1,053
Income tax expense.....	7,499	16,680
Net income (loss).....	<u>\$ 3,342</u>	<u>\$ (15,627)</u>
Net income (loss) available to common stockholders — basic.....	<u>\$ 3,282</u>	<u>\$ (15,752)</u>
Net income (loss) available to common stockholders — diluted.....	<u>\$ 3,178</u>	<u>\$ (15,752)</u>
Weighted-average shares outstanding — basic.....	378,403	378,219
Weighted-average shares outstanding — diluted.....	385,320	378,219
Net income (loss) per share available to common stockholders — basic and diluted .....	<u>\$ 0.01</u>	<u>\$ (0.04)</u>

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

**NOVELL, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(amounts in thousands, except per share data)

	Six Months Ended	
	April 30, 2006	April 30, 2005
	(unaudited)	
Net revenue:		
Software licenses .....	\$ 82,165	\$ 90,064
Maintenance and services .....	470,559	497,115
Total net revenue.....	<u>552,724</u>	<u>587,179</u>
Cost of revenue:		
Software licenses .....	8,337	9,495
Maintenance and services .....	197,374	219,897
Total cost of revenue.....	<u>205,711</u>	<u>229,392</u>
Gross profit .....	<u>347,013</u>	<u>357,787</u>
Operating expense (income):		
Sales and marketing .....	189,212	192,488
Product development .....	93,389	100,645
General and administrative .....	68,831	58,380
Restructuring expenses (benefit).....	(1,064)	11,780
Purchased in-process research and development .....	2,110	480
Gain on sale of property, plant and equipment .....	(2,190)	(1,589)
Gain on legal settlement.....	(1,225)	(447,560)
Total operating expense (income).....	<u>349,063</u>	<u>(85,376)</u>
Income (loss) from operations .....	<u>(2,050)</u>	<u>443,163</u>
Other income (expense):		
Investment income .....	30,805	19,693
Impairment of investments .....	(623)	(1,930)
Interest expense and other, net.....	(4,103)	(5,273)
Total other income .....	<u>26,079</u>	<u>12,490</u>
Income before income taxes .....	24,029	455,653
Income tax expense.....	18,822	76,119
Net income.....	<u>\$ 5,207</u>	<u>\$ 379,534</u>
Net income available to common stockholders — basic .....	<u>\$ 5,093</u>	<u>\$ 375,310</u>
Net income available to common stockholders — diluted.....	<u>\$ 5,021</u>	<u>\$ 378,296</u>
Weighted-average shares outstanding — basic.....	382,095	377,738
Weighted-average shares outstanding — diluted.....	389,657	434,962
Net income per share available to common stockholders — basic.....	<u>\$ 0.01</u>	<u>\$ 0.99</u>
Net income per share available to common stockholders — diluted.....	<u>\$ 0.01</u>	<u>\$ 0.87</u>

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

**NOVELL, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(amounts in thousands)

	Six Months Ended	
	April 30, 2006	April 30, 2005
	(unaudited)	
<b>Cash flows from operating activities</b>		
Net income.....	\$ 5,207	\$ 379,534
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock-based compensation expense .....	21,425	1,411
Tax effects of stock-based compensation plans .....	5,286	13,260
Excess tax benefits from stock-based compensation .....	(5,286)	—
Depreciation and amortization .....	22,378	29,790
Decrease in accounts receivable allowances .....	(4,903)	(5,789)
Utilization of previously reserved acquired net operating losses .....	3,520	29,600
Gain on sale of property, plant and equipment .....	(2,190)	(1,589)
Impairment of long-term investments, net of gains .....	498	1,930
Purchased in-process research and development .....	2,110	480
Changes in current assets and liabilities, excluding the effect of acquisitions:		
Receivables .....	81,683	66,815
Prepaid expenses .....	(5,195)	(5,298)
Other current assets .....	(1,326)	(264)
Deferred income taxes .....	(198)	(401)
Accounts payable .....	268	(8,184)
Accrued liabilities .....	(60,747)	(21,208)
Deferred revenue .....	(61,353)	(53,424)
Net cash provided by operating activities .....	<u>1,177</u>	<u>426,663</u>
<b>Cash flows from financing activities</b> .....		
Issuance of common stock, net .....	18,082	12,979
Excess tax benefits from stock-based compensation .....	5,286	—
Payment of cash dividends on Series B Preferred Stock.....	(47)	(250)
Repurchases of common stock — retired .....	(267,479)	—
Net cash (used in) provided by financing activities .....	<u>(244,158)</u>	<u>12,729</u>
<b>Cash flows from investing activities</b> .....		
Purchases of property, plant and equipment .....	(14,554)	(11,684)
Proceeds from the sale of property, plant and equipment .....	7,258	10,421
Purchases of short-term investments.....	(327,575)	(596,085)
Maturities of short-term investments .....	84,809	191,049
Sales of short-term investments .....	289,024	567,411
Cash paid for acquisition of e-Security, net of cash acquired .....	(71,550)	—
Cash paid for acquisition of Tally Systems and Immunix, net of cash acquired .....	—	(33,829)
Cash paid for equity investment in Open Invention Network, LLC .....	(4,225)	—
Purchase of intangible assets .....	—	(15,500)
Purchases of long-term investments .....	(7,129)	(6,070)
Proceeds from the sales of and distributions from long-term investments .....	4,115	3,052
Proceeds from repayment of note receivable .....	9,092	—
Other .....	4,552	4,318
Net cash (used in) provided by investing activities.....	<u>(26,183)</u>	<u>113,083</u>
Total (decrease) increase in cash and cash equivalents.....	(269,164)	552,475
Cash and cash equivalents — beginning of period .....	811,238	434,404
Cash and cash equivalents — end of period .....	<u>\$ 542,074</u>	<u>\$ 986,879</u>
<b>Supplemental disclosure of non-cash activities:</b>		
Contribution of patents to Open Invention Network, LLC .....	\$ 14,383	\$ —

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

**NOVELL, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**April 30, 2006**

**A. Quarterly Financial Statements**

The interim consolidated financial statements as of April 30, 2006 and for the three and six months ended April 30, 2006 and 2005 were prepared by Novell, Inc. ("Novell") pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial reporting. 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 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 Annual Report on Form 10-K for the fiscal year ended October 31, 2005. The accompanying financial statements are unaudited and include all normal recurring adjustments that we believe are necessary for a fair statement of the financial condition and results of operations of Novell as of and for the interim periods presented. The interim operating results are not necessarily indicative of the results for a full year.

*Reclassifications*

Certain amounts reported in prior years have been reclassified from what was previously reported to conform to the current year's presentation. These reclassifications did not have any impact on net income and net income per share available to common stockholders.

**B. Significant Accounting Policies**

*Share-based Payments*

On November 1, 2005, we adopted Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payment," which requires us to account for share-based payment transactions using a fair value-based method and recognize the related expense in the results of operations. Prior to our adoption of SFAS No. 123(R), as permitted by SFAS No. 123, we accounted for share-based payments to employees using the Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees," intrinsic value method and, therefore, we generally recognized compensation expense for restricted stock awards and did not recognize compensation cost for employee stock options. SFAS No. 123(R) allows companies to choose one of two transition methods: the modified prospective transition method or the modified retrospective transition method. We chose to use the modified prospective transition methodology, and accordingly, we have not restated the results of prior periods.

Under the fair value recognition provisions of SFAS No. 123(R), stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized as expense over the requisite service period of the award. The fair value of restricted stock awards is determined by reference to the fair market value of our common stock on the date of grant. Consistent with the valuation method we used for disclosure-only purposes under the provisions of SFAS No. 123, we use the Black-Scholes model to value service condition and performance condition option awards under SFAS No. 123(R). For awards with market conditions granted subsequent to our adoption of SFAS No. 123(R), we use a lattice valuation model to estimate fair value. For awards with only service conditions and graded-vesting features, we recognize compensation cost on a straight-line basis over the requisite service period. For awards with performance or market conditions granted subsequent to our adoption of SFAS No. 123(R), we recognize compensation cost based on the graded-vesting method.

Determining the appropriate fair value model and related assumptions requires judgment, including estimating stock price volatility, forfeiture rates, and expected terms. The expected volatility rates are estimated based on historical and implied volatilities of our common stock. The expected term represents the average time that options that vest are expected to be outstanding based on the vesting provisions and our historical exercise, cancellation and expiration patterns. We estimate pre-vesting forfeitures when recognizing compensation expense based on historical rates and forward-looking factors. We will update these assumptions at least on an annual basis and on an interim basis if significant changes to the assumptions are warranted.

We issue performance-based equity awards, typically to certain senior executives, which vest upon the achievement of certain financial performance goals, including revenue and income targets. Determining the appropriate amount to expense based on the anticipated achievement of the stated goals requires judgment, including forecasting future financial results. The estimate of expense is revised periodically based on the probability of achieving the required performance targets and adjustments are made as appropriate. The cumulative impact of any revision is reflected in the period of change. If the financial performance goals are not met, the award does not vest, so no compensation cost is recognized and any previously recognized compensation cost is reversed.

In the past, we have issued market condition equity awards, typically granted to certain senior executives, the vesting of which is accelerated or contingent upon the price of Novell common stock meeting specified pre-established stock price targets. For awards granted prior to our adoption of SFAS No. 123(R), the fair value of each market condition award was estimated as of the grant date using the same option valuation model used for time-based options without regard to the market condition criteria. As a result of our adoption of SFAS No. 123(R), compensation cost is recognized over the estimated requisite service period and is not reversed if the market condition target is not met. If the pre-established stock price targets are achieved, any remaining expense on the date the target is achieved is recognized either immediately or, in situations where there is a remaining minimum time vesting period, ratably over that period.

### C. Acquisitions and Equity Investments

#### *e-Security*

On April 19, 2006, we acquired 100% of the outstanding stock of e-Security, Inc. ("e-Security"), a privately held company headquartered in Vienna, Virginia. e-Security provides security information, event management and compliance software. e-Security's products are now part of our identity and access management sub-category. The purchase price was approximately \$71.7 million in cash, plus transaction costs of \$1.1 million. e-Security's results of operations were included in our consolidated financial statements beginning on the acquisition date.

The purchase price was allocated as follows:

	Estimated Fair Value	Estimated Useful Life
	(In thousands)	
Fair value of net tangible liabilities assumed.....	\$ (670)	N/A
In-process research and development.....	2,110	N/A
Identifiable intangible assets:		
Developed technology .....	6,920	3 years
Customer relationships .....	3,640	3 years
Trademarks/trade names .....	390	3 years
Goodwill.....	60,443	Indefinite
Total net assets acquired.....	<u>\$ 72,833</u>	

We estimated the fair values of the intangible assets as further described below. Developed technology, customer relationships, and trademarks/trade names are being amortized over their estimated useful lives. Goodwill is not amortized but is periodically evaluated for impairment.

The net tangible liabilities of e-Security consisted mainly of accounts payable and other liabilities reduced by cash and cash equivalents, accounts receivable, and fixed assets.

In-process research and development valued in the amount of \$2.1 million pertains to technology that was not technologically feasible at the date of the acquisition, meaning it had not reached the working model stage, did not contain all of the major functions planned for the product, and was not ready for initial customer testing. At the acquisition date, e-Security was working on the next two releases of its product called Sentinel, which were scheduled to be released for the third calendar quarter of 2006 and in the first calendar half of 2007. These future releases had not yet achieved technological feasibility. The in-process research and development was valued based on discounting estimated future cash flows from the related products. Completion of the development of the future upgrades of these products is dependent upon our successful integration of the e-Security products with Novell products and services. The in-process research and development does not have any alternative future use and did not otherwise qualify for capitalization. As a result, this amount was expensed upon acquisition.

Developed technology relates to e-Security products that are commercially available and can be combined with Novell products and services. Discounted expected future cash flows attributable to the products were used to determine the value of developed technology. This resulted in a valuation of approximately \$6.9 million related to developed technology that had reached technological feasibility.

The valuation of customer relationships in the amount of \$3.6 million, which relates primarily to customers under maintenance agreements, was determined based on discounted expected future cash flows to be received as a result of the agreements and assumptions about their renewal rates.

Goodwill from the acquisition resulted from our belief that the Sentinel products developed by e-Security are a valuable addition to our identity and access management offerings. We believe they will help us remain competitive in the security and compliance markets and increase our identity and access management revenue. The goodwill from the e-Security acquisition was allocated among our geographic operating segments (see Note G).

If the e-Security acquisition had occurred on November 1, 2004, the unaudited pro forma results of operations for the three and six months ended April 30, 2006 and 2005 would have been:

(amounts in thousands)	Three months ended		Six months ended	
	April 30, 2006	April 30, 2005	April 30, 2006	April 30, 2005
Net revenue .....	\$ 281,048	\$ 299,455	\$ 557,220	\$ 591,686
Net income (loss) available to common stockholders — diluted .....	\$ 1,505	\$ (17,250)	\$ 30	\$ 372,713
Net income (loss) per share available to common stockholders — diluted .....	\$ 0.00	\$ (0.05)	\$ 0.00	\$ 0.86

#### *Open Invention Network LLC*

In November 2005, Open Invention Network LLC (“OIN”) was established by us, IBM, Philips, Red Hat and Sony. OIN is a privately held company that has and will acquire patents to promote Linux and open source by offering its patents on a royalty-free basis to any company, institution or individual that agrees not to assert its patents against the Linux operating system or certain Linux-related applications. In addition, OIN, in its discretion, will enforce its patents to the extent it believes such action will serve to further protect and promote Linux and open source. Each party contributed capital with a fair value of \$20.0 million to OIN. We account for our 20% ownership interest using the equity method of accounting. Our \$20.0 million contribution consisted of patents with a fair value of \$15.8 million, including \$0.3 million of prepaid acquisition costs, and cash of \$4.2 million. At the time of the contribution, the patents had a book value of \$14.4 million, including \$0.3 million of prepaid acquisition costs. The \$1.4 million difference between the fair value and book value of the patents will be amortized to our investment in OIN account and equity income over the remaining estimated useful life of the patents, which is approximately nine years. Our investment in OIN of \$18.7 million is classified as other assets in the consolidated balance sheets.

#### *Onward Novell*

In December 2005, we acquired the remaining 50% ownership of our sales and marketing joint venture in India from our joint venture partner for approximately \$7.5 million in cash and other consideration. At October 31, 2005, \$7.5 million of our cash was held in an escrow account for the acquisition and classified as other assets in the consolidated balance sheet. The cash was paid out of the escrow account during the first quarter of fiscal 2006. At the time of the acquisition, the net book value of the minority interest was \$5.3 million. The \$2.0 million difference between the net book value of the minority interest and the amount we paid for the remaining 50% ownership was recorded as goodwill.

#### **D. Cash, Cash Equivalents, and Short-Term Investments**

We consider all investments with an initial term to maturity of three months or less at the date of purchase 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, such as auction dates within at least six months of the prior auction date or being available to be used for current operations even if some maturities may extend beyond one year. All auction rate securities are classified as 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 value. The unrealized gains and losses related to these securities are included in accumulated other comprehensive income in the consolidated balance sheets. Other than temporary declines in fair value are recorded in the consolidated statements of operations. Fair values are based on quoted market prices where available. If quoted market prices are not available, we use third-party pricing services to assist in determining fair value. In many instances, these services examine the pricing of similar instruments to estimate fair value.

At April 30, 2006, approximately \$7.0 million of our equity securities were designated for deferred compensation payments, which are paid out as requested by the participants of the plan.

At April 30, 2006, contractual maturities of our short-term investments were:

(In thousands)	Cost	Fair Market Value
Less than one year.....	\$ 274,896	\$ 273,810
Due in one to two years.....	279,596	275,323
Due in two to three years.....	134,746	132,724
Due in more than three years.....	106,898	105,372
No contractual maturity.....	8,892	9,738
Total short-term investments.....	<u>\$ 805,028</u>	<u>\$ 796,967</u>

When securities are sold, their cost is determined based on the first-in first-out method. The realized gains and losses related to these securities are included in investment income in the consolidated statements of operations. Realized gains and losses on short-term investments were as follows:

(In thousands)	Three months ended		Six months ended	
	April 30, 2006	April 30, 2005	April 30, 2006	April 30, 2005
Realized gains.....	\$ 115	\$ 100	\$ 241	\$ 385
Realized losses.....	\$ 312	\$ 262	\$ 1,534	\$ 558

We had net unrealized losses related to short-term investments of \$8.1 million at April 30, 2006 compared to net unrealized losses of \$7.6 million at October 31, 2005. Our short-term investment portfolio includes gross unrealized gains and losses of \$0.8 million and \$8.9 million, respectively, as of April 30, 2006. We did not record any impairment losses on short-term investments during the first six months of fiscal 2006 or fiscal 2005.

#### E. Property, Plant and Equipment

At April 30, 2006, we had a corporate aviation asset with a net book value of approximately \$13.8 million that was classified as held for sale. We anticipate selling this asset during fiscal 2006 for at least net book value. During the second quarter of fiscal 2006, we sold one of our corporate aviation assets with a net book value of \$5.1 million for \$7.3 million, net of commissions, resulting in a gain of \$2.2 million.

#### F. Long-Term Investments

At April 30, 2006, long-term investments primarily consisted of investments made in venture capital partnerships. Long-term investments, over which we do not have the ability to exercise significant influence, 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 the forecasted financial performance of the investees and our estimate of the potential for investment recovery based on the financial performance factors. During the second quarters of fiscal 2006 and 2005, we recognized impairment losses on long-term investments totaling \$0.2 million and \$0.9 million, respectively. During the first six months of fiscal 2006 and 2005, we recognized impairment losses on long-term investments totaling \$0.6 million and \$1.9 million, respectively.

**G. Goodwill and Intangible Assets***Goodwill*

The following is a summary of goodwill as of the dates shown resulting from the indicated acquisitions:

(In thousands)	April 30, 2006	October 31, 2005
SUSE.....	\$ 176,963	\$ 176,963
SilverStream.....	111,117	112,622
e-Security.....	60,443	—
Ximian.....	33,607	33,852
Cambridge Technology Partners.....	24,452	25,903
Tally.....	16,147	16,308
Immunix.....	14,518	14,676
Salmon.....	5,867	6,146
Onward Novell.....	2,010	—
Other technology companies.....	9,039	9,039
Total goodwill.....	<u>\$ 454,163</u>	<u>\$ 395,509</u>

Goodwill is allocated to our reporting segments. In fiscal 2006, we changed our reporting segments to Americas, EMEA, Asia Pacific, and Celerant consulting (see Note S). Previously, Latin America was separate from North America, and Japan was separate from Asia Pacific.

Goodwill by reporting segment is as follows:

(In thousands)	Americas	EMEA	Asia Pacific	Celerant Consulting	Total
Balance as of October 31, 2005.....	\$ 191,498	\$ 150,487	\$ 27,621	\$ 25,903	\$ 395,509
Onward Novell.....	—	—	2,010	—	2,010
e-Security.....	38,683	16,320	5,440	—	60,443
Adjustments.....	(1,054)	(1,178)	(116)	(1,451)	(3,799)
Balance as of April 30, 2006.....	<u>\$ 229,127</u>	<u>\$ 165,629</u>	<u>\$ 34,955</u>	<u>\$ 24,452</u>	<u>\$ 454,163</u>

The adjustments to goodwill during the first six months of fiscal 2006 totaling \$3.8 million included an adjustment of approximately \$3.5 million, attributable to SilverStream, Celerant consulting (acquired through the acquisition of Cambridge Technology Partners), Ximian, Tally, and Immunix, related to the reversal of deferred tax asset valuation allowances attributable to acquired net operating loss carryforwards that were utilized by income generated in the first six months of fiscal 2006. Goodwill was reduced for this adjustment because a portion of it related to the valuation allowances on acquired net operating losses that were established during the allocation of the purchase price for each of these acquisitions.

*Intangible Assets*

The following is a summary of intangible assets:

(In thousands)	April 30, 2006			October 31, 2005			Asset Lives
	Gross Amount	Accumulated Amortization	Net Book Value	Gross Amount	Accumulated Amortization	Net Book Value	
Developed technology.....	\$ 29,770	\$ (18,541)	\$ 11,229	\$ 22,850	\$ (16,718)	\$ 6,132	3-4 years
Trademarks and trade names....	25,961	(45)	25,916	25,571	(20)	25,551	3 years or Indefinite
Patents.....	—	—	—	15,500	(1,392)	14,108	10 years
Customer/contractual relationships.....	23,002	(13,695)	9,307	19,362	(10,454)	8,908	1-3 years
Internal use software.....	5,193	(4,321)	872	5,193	(3,700)	1,493	3 years
Non-competes agreement.....	422	(262)	160	422	(193)	229	3 years
Total intangible assets.....	<u>\$ 84,348</u>	<u>\$ (36,864)</u>	<u>\$ 47,484</u>	<u>\$ 88,898</u>	<u>\$ (32,477)</u>	<u>\$ 56,421</u>	

During the second quarter of fiscal 2006, we recorded \$0.4 million for trademarks, \$3.6 million for customer relationships, and \$6.9 million for developed technology related to the acquisition of e-Security. During the first quarter of fiscal 2006, we contributed our patent portfolio towards our 20% ownership interest in OIN. At the time of the contribution, these patents, which we acquired for \$15.5 million, had a net book value of \$14.1 million.

Amortization of intangible assets for the second quarters of fiscal 2006 and 2005 was \$3.0 million and \$3.4 million, respectively. Amortization of intangible assets for the first six months of fiscal 2006 and 2005 was \$5.8 million and \$6.4 million, respectively. Amortization of intangibles is estimated to be approximately \$6.9 million for the remainder of fiscal 2006, \$7.9 million in fiscal 2007, \$5.2 million in fiscal 2008, and \$2.0 million in fiscal 2009.

#### **H. Income Taxes**

We are subject to income taxes in numerous jurisdictions and the use of estimates is required in determining our provision for income taxes. For the second quarter and first six months of fiscal 2006, we provided income taxes of \$7.5 million and \$18.8 million, respectively, based on the estimated annual effective tax rate for the year applied to "ordinary" income (pre-tax income excluding unusual or infrequently occurring discrete items). Due to the utilization of a significant amount of our net operating loss carryforwards during fiscal 2005, substantially all of the future benefit received from our remaining net operating loss carryforwards used to offset U.S. taxable income will be credited to additional paid-in capital or goodwill and not income tax expense. In addition, the windfall tax benefits associated with stock-based compensation will be credited to additional paid-in capital. In connection with our adoption of SFAS No. 123(R), we elected to follow the tax ordering laws to determine the sequence in which deductions and net operating loss carryforwards are utilized. Accordingly, during the second quarter and first six months of fiscal 2006, a tax benefit relating to stock options of \$1.2 million and \$5.2 million, respectively, was credited to additional paid-in capital and a benefit of \$3.0 million and \$3.5 million, respectively, was credited to goodwill.

The effective tax rate differs from the federal statutory rate of 35% primarily due to the effects of stock-based compensation plans, differences between book and tax items and foreign taxes. The effective tax rate for the second quarter of fiscal 2006 was 69% compared to the effective tax rate of 1,584% for the same period in 2005. The effective tax rate for the first six months of fiscal 2006 was 78% compared to the effective tax rate of 17% for the same period in 2005. The effective tax rates for the second quarter and the first six months of fiscal 2006 differ from the effective tax rates for the second quarter and the first six months of fiscal 2005 due to the use of net operating losses in the first quarter of fiscal 2005, which offset income tax expense associated primarily with the income generated from a settlement we reached with Microsoft in the first quarter of fiscal 2005. The effective tax rate for fiscal 2006 will be higher than the rate for fiscal 2005 primarily because the fiscal 2005 rate reflected a benefit recorded to income tax expense from the use of a significant amount of our net operating loss carryforwards.

In accordance with determinations made pursuant to the applicable accounting standards, we continue to believe that it is more likely than not that our remaining U.S. net deferred tax assets will not be realized based on the weight of all available evidence. As a result, we have provided a full valuation allowance on our U.S. net deferred tax assets. 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, goodwill or additional paid-in capital. It is reasonably possible that an adjustment to our valuation allowance will be required in the near term and the amount could be material.

We paid cash for income taxes of \$6.0 million in the second quarter of fiscal 2006 and \$9.5 million during the same period of fiscal 2005. We paid cash for income taxes of \$10.5 million in the first six months of fiscal 2006 and \$12.9 million during the same period of fiscal 2005. We continue to evaluate our tax reserves under SFAS No. 5, "Accounting for Contingencies," which requires us to accrue for losses we believe are probable and can be reasonably estimated. The amount reflected in the consolidated balance sheet at April 30, 2006 is considered adequate based on our assessment of many factors including, results of tax audits, past experience and interpretations of tax law applied to the facts of each matter. It is reasonably possible that our tax reserves could be increased or decreased in the near term based on these factors.

#### **I. Line of Credit**

We have a \$25.0 million bank line of credit available for letter of credit purposes. At April 30, 2006, there were standby letters of credit of \$15.1 million outstanding under this line, all of which are collateralized by cash. The bank line of credit expires on April 1, 2007. The bank line of credit 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 relating to this line of credit as of April 30, 2006. In addition, at April 30, 2006, we had outstanding letters of credit of an insignificant amount at other banks.

**J. Restructuring and Merger Liabilities***Restructuring Liabilities*

Our restructuring activities in previous periods are disclosed in detail in our Annual Report on Form 10-K for fiscal 2005. The following table summarizes the restructuring reserve balance and activity during the first six months of fiscal 2006:

(In thousands)	Fiscal 2005 Restructurings	Fiscal 2004 Restructurings	Fiscal 2003 Restructuring	Fiscal 2002 Restructuring	Fiscal 2001 Restructurings	Total
<b>Balance at October 31, 2005:</b>						
Workforce reductions.....	\$ 28,492	\$ 1,243	\$ —	\$ —	\$ —	\$ 29,735
Excess facilities, property and equipment.....	6,451	1,457	3,121	3,660	327	15,016
Other restructuring-related costs.....	259	—	10	37	274	580
Total restructuring reserve balance .....	<u>35,202</u>	<u>2,700</u>	<u>3,131</u>	<u>3,697</u>	<u>601</u>	<u>45,331</u>
<b>Adjustments:</b>						
Workforce reductions.....	(707)	—	—	—	—	(707)
Excess facilities, property and equipment.....	(61)	—	—	—	—	(61)
Other restructuring-related costs.....	—	—	—	(37)	(259)	(296)
Total adjustments.....	<u>(768)</u>	<u>—</u>	<u>—</u>	<u>(37)</u>	<u>(259)</u>	<u>(1,064)</u>
<b>Payments:</b>						
Workforce reductions.....	(23,172)	(112)	—	—	—	(23,284)
Excess facilities, property and equipment.....	(3,266)	(806)	(747)	(803)	(310)	(5,932)
Other restructuring-related costs.....	(187)	—	(10)	—	(15)	(212)
Total payments.....	<u>(26,625)</u>	<u>(918)</u>	<u>(757)</u>	<u>(803)</u>	<u>(325)</u>	<u>(29,428)</u>
<b>Balance at April 30, 2006:</b>						
Workforce reductions.....	4,613	1,131	—	—	—	5,744
Excess facilities, property and equipment.....	3,124	651	2,374	2,857	17	9,023
Other restructuring-related costs.....	72	—	—	—	—	72
Total restructuring reserve balance .....	<u>\$ 7,809</u>	<u>\$ 1,782</u>	<u>\$ 2,374</u>	<u>\$ 2,857</u>	<u>\$ 17</u>	<u>\$ 14,839</u>

Adjustments to reduce the restructuring reserves during the first six months of fiscal 2006 of \$1.1 million related to changes in estimates, of which \$0.4 million was related to Asia Pacific, \$0.3 million was related to the Americas, \$0.3 million was related to EMEA, and \$0.1 million was related to Celerant consulting.

*Merger Liabilities*

The following table summarizes the merger liabilities balance and activity during the first six months of fiscal 2006:

(In thousands)	Balance at October 31, 2005	Additions From Acquisitions	Payments/ adjustments	Balance at April 30, 2006
Facilities related .....	\$ 17,606	\$ —	\$ (1,132)	\$ 16,474
Employee related.....	169	437	(105)	501
Other .....	76	646	33	755
Total merger liabilities .....	<u>\$ 17,851</u>	<u>\$ 1,083</u>	<u>\$ (1,204)</u>	<u>\$ 17,730</u>

Additions from acquisitions relates to merger liabilities from the acquisition of e-Security in April 2006.

As of April 30, 2006, the remaining unpaid restructuring and merger liability balances include accrued liabilities related to severance benefits which will be paid out over the remaining severance obligation period, lease costs for redundant facilities which will be paid over the respective remaining contract terms, and various employee-related severance costs which will be primarily paid over the next twelve months.

### **K. Senior Convertible Debentures**

On July 2, 2004, we issued and sold \$600.0 million aggregate principal amount of our senior convertible debentures ("Debentures") due 2024. The Debentures pay interest at 0.50% per annum, payable semi-annually on January 15 and July 15 of each year until maturity, commencing January 15, 2005. During the second quarter and first six months of fiscal 2006, we incurred interest expense of \$0.8 million and \$1.5 million, respectively, related to the Debentures and made cash payments for interest of \$1.5 million during the first six months of fiscal 2006.

In connection with the issuance of the Debentures, we incurred \$14.9 million of issuance costs, which primarily consisted of investment banker, legal and other professional fees. These costs are classified within Other Assets and are being amortized as interest expense using the effective interest method over the term from issuance through the date that the holders can first require repurchase of the Debentures (July 15, 2009). Amortization expense related to the issuance costs was \$0.7 million and \$1.5 million for both the second quarter and first six months of fiscal 2006 and fiscal 2005, respectively.

### **L. Guarantees**

We have provided a guarantee to a foreign taxing authority in the amount of \$2.5 million related to a foreign tax audit. It is expected that the term of the foreign tax audit guarantee will continue until the conclusion of the audit. In addition, we have provided a guarantee to a customer for the performance of one of our foreign subsidiaries on a maintenance contract in the amount of \$0.4 million, and a \$0.2 million guarantee to a vendor of our foreign subsidiaries to guarantee lease payments. At April 30, 2006, we had \$2.5 million accrued for these guarantees. We have also provided other guarantees of insignificant amounts for various purposes.

Like most software vendors, we are party to a variety of agreements, primarily with customers, resellers, distributors, and independent hardware and software vendors (generally, "customers"), pursuant to which we may be obligated to indemnify the customer against third party allegations of intellectual property infringement resulting from the customer's use of our offerings or distribution of our software, either of which may include proprietary and/or open source materials. In such circumstances, the customer must satisfy specified conditions to qualify for indemnification. Our obligations under these agreements may be limited in terms of time and/or amount, and in some instances we may have recourse against third parties.

It is not possible to predict the maximum potential amount of future payments under these guarantees and indemnifications, or similar agreements, due to the conditional nature of our obligations and the unique facts and circumstances involved in each particular agreement. To date, we have not been required to make any payment under these guarantees and indemnifications. 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 and estimable.

### **M. Commitments and Contingencies**

As of April 30, 2006, we had a carrying value of \$55.4 million related to long-term investments in various venture capital funds and had commitments to contribute an additional \$14.5 million to these funds at times and amounts as requested by the fund managers.

### **N. Legal Proceedings**

On November 12, 2004, we filed suit against Microsoft in the U.S. District Court, District of Utah. We are seeking treble damages under the Clayton Act, plus interest, in an amount to be determined at trial based on claims that Microsoft eliminated competition in the office productivity software market during the time that we owned the WordPerfect word-processing application and the Quattro Pro spreadsheet application. Among other claims, we allege that Microsoft withheld certain critical technical information about Windows from us, thereby impairing our ability to develop new versions of WordPerfect and other office productivity applications, and that Microsoft integrated certain technologies into Windows designed to exclude WordPerfect and other Novell applications from relevant markets. In addition, we allege that Microsoft used its monopoly power to prevent OEMs from offering WordPerfect and other applications to customers. On June 10, 2005, Microsoft's motion to dismiss the complaint was granted in part and denied in part. On September 2, 2005, Microsoft sought appellate review of the District Court's denial of its motion. On January 31, 2006, the Fourth Circuit Court granted interlocutory review of Microsoft's appeal with respect to the question of whether Novell lacked standing to assert the antitrust claims allowed by the District Court. As a result of Microsoft's appeal, on February 21, 2006 Novell filed a notice of appeal of the District Court's dismissal of Novell's other causes of action. Both Novell and Microsoft have filed opening briefs with the Court of Appeals, however, it is uncertain when a final decision can be expected. 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.

On January 20, 2004, the SCO Group, Inc. ("SCO") filed suit against us in the Third Judicial District Court of Salt Lake County, State of Utah. We removed the claim to the U.S. District Court, District of Utah. SCO's original complaint alleged 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. The District Court dismissed the original complaint, but allowed SCO an opportunity to file an amended complaint, which SCO did on July 9, 2004. On June 27, 2005, our motion to dismiss SCO's amended complaint was denied. On July 29, 2005, we filed an answer to the complaint setting forth numerous affirmative defenses and counterclaims alleging slander of title and breach of contract, and seeking declaratory actions and actual, special and punitive damages in an amount to be proven at trial. On February 3, 2006, SCO filed a Second Amended Complaint alleging that Novell has violated the non-competition provisions of the agreement under which we sold our Unix business to SCO, that we failed to transfer all of the Unix business, that we infringe SCO's copyrights, and that we are engaging in unfair competition by attempting to deprive SCO of the value of the Unix technology. 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 to cause us to pay actual, special and punitive damages in an amount to be proven at trial. Novell has filed separate motions to stay SCO's claims pending the outcome of an arbitration proceeding filed by SUSE as well as a motion for more definitive statement as to SCO's alleged unfair competition claim. As referenced, SUSE recently filed a demand for arbitration before the International Court of Arbitration in Zurich, Switzerland, pursuant to a "UnitedLinux Agreement" in which SCO and SUSE were parties. The result of such arbitration may impact our U.S. litigation with SCO and for that purpose, Novell has sought to stay such litigation pending the outcome of the arbitration proceeding. We believe that we have meritorious defenses to SCO's claims and meritorious support for our counterclaims. Accordingly, we intend to vigorously pursue our claims while defending against the allegations in SCO's complaint. 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.

On July 12, 2002, Amer Jneid and other related plaintiffs filed a complaint in the Superior Court of California, Orange County alleging claims for breach of contract, fraud in the inducement, misrepresentation, infliction of emotional distress, rescission, slander and other claims against Novell in connection with Novell's purchase of so-called "DeFrame" technology from the plaintiffs and two affiliated corporations (TriPole Corporation and Novetrix), and employment agreements Novell entered into with the plaintiffs in connection with the purchase. The complaint seeks unspecified damages including "punitive damages." The dispute (resulting in these claims) arises out of the plaintiffs' assertion that Novell failed to properly account for license distributions which the plaintiffs claim would have entitled them to certain bonus payouts under the purchase and employment agreements. After several preliminary motions and subsequent amendments to the complaint, Novell filed an answer and cross-complaint against the plaintiffs for breach of the purchase and employment agreements. Although certain of the plaintiffs' claims have been dismissed, the remaining claims, including Novell's counterclaims, are currently scheduled for trial to begin on July 17, 2006. We believe that we have meritorious defenses to plaintiffs' claims and meritorious support for our counterclaims. Accordingly, we intend to vigorously pursue our claims while defending against the allegations in the complaint. 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 a related case, TriPole Corporation filed a complaint against Novell on March 17, 2005 seeking to recover up to \$12 million in bonus "earn out" payments and for unspecified punitive damages for fraudulent inducement in connection with Novell's purchase of the DeFrame technology. Essentially, Tripole's claims are very much the same as those asserted by the plaintiffs in the case noted above, relative to the claim that Novell failed to properly account for license distributions which would have otherwise entitled Tripole to certain bonus payments under the purchase agreement. These claims have now been consolidated with the plaintiffs' case referenced above and are also scheduled for trial to begin on July 17, 2006. We believe that we have meritorious defenses to Tripole's claims and meritorious support for our counterclaims. Accordingly, we intend to vigorously pursue our claims while defending against the allegations in Tripole's complaint. 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, which we acquired in July 2002, 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 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 the issuers, including SilverStream. A Consolidated Amended Complaint with respect to all of these companies was filed in the U.S. District Court, Southern District of New York, on April 19, 2002. The plaintiffs are seeking monetary damages, statutory compensation and other relief that may be deemed appropriate by the Court. While we believe that SilverStream and its former officers and directors have meritorious defenses to the claims, a tentative settlement has been reached between many of the defendants and the plaintiffs, which contemplates a settlement of the claims, including the ones against SilverStream and its former directors and officers. The settlement agreement, however, has not been finally approved by the Court. 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.

During the second quarter of fiscal 2006, we recorded a gain of \$1.2 million related to a settlement we received from one of our insurance companies for past legal expenses that were covered under our insurance policies.

We account for legal reserves under SFAS No. 5, which requires us to accrue for losses we believe are probable and can be reasonably estimated. We evaluate the adequacy of our legal reserves based on our assessment of many factors, including our interpretations of the law and our assumptions about the future outcome of each case based on current information. It is reasonably possible that our legal reserves could be increased or decreased in the near term based on our assessment of these factors. We are currently party to various legal proceedings and claims including former employees, 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 flows.

#### O. Redeemable Preferred Stock

Holders of our Series B Preferred Stock are entitled to dividends of 2% of the redemption value per annum, payable quarterly in cash. Dividends on the Series B Preferred Stock during the first six months of fiscal 2006 amounted to \$94,000. We paid \$47,000 in dividends during the first six months of fiscal 2006.

#### P. Net Income Per Share Available to Common Stockholders

The following table reconciles the numerators and denominators of the net income per share calculation for the second quarters of fiscal 2006 and 2005:

	Three Months Ended	
	April 30, 2006	April 30, 2005
<i>(In thousands, except per share data)</i>		
<b>Basic net income per share computation:</b>		
Net income (loss) .....	\$ 3,342	\$ (15,627)
Dividends on Series B Preferred Stock .....	(47)	(125)
Allocation of earnings to holders of Series B Preferred Stock .....	(13)	—
Net income (loss) attributable to common stockholders .....	<u>\$ 3,282</u>	<u>\$ (15,752)</u>
Weighted-average common shares outstanding, excluding unvested restricted stock .....	378,403	378,219
Basic net income (loss) per share attributable to common stockholders ..	<u>\$ 0.01</u>	<u>\$ (0.04)</u>
<b>Diluted net income per share computation:</b>		
Net income (loss) .....	\$ 3,342	\$ (15,627)
Dividends on Series B Preferred Stock .....	(47)	(125)
Allocation of earnings to the holders of Series B Preferred Stock .....	(13)	—
Minority interest in diluted net income .....	(104)	—
Diluted net income (loss) attributable to common stockholders .....	<u>\$ 3,178</u>	<u>\$ (15,752)</u>
Weighted-average common shares outstanding .....	378,403	378,219
Incremental shares attributable to the assumed exercise of outstanding options, unvested restricted stock, and other stock plans .....	6,917	—
Total adjusted weighted-average common shares .....	<u>385,320</u>	<u>378,219</u>
Diluted net income (loss) per share attributable to common stockholders ...	<u>\$ 0.01</u>	<u>\$ (0.04)</u>

The 1.5 million shares of common stock attributable to the assumed conversion of outstanding Series B Preferred Stock and the 52.0 million shares attributable to the assumed conversion of outstanding Debentures were not included in the calculation of diluted net income per share in the second quarters of fiscal 2006 and 2005 as their effects were antidilutive. Incremental shares attributable to options with exercise prices that were at or greater than the average market price ("out of the money") at April 30, 2006 were also not included in the calculation of diluted net income per share as their effect would have been antidilutive. Out of the money options for the second quarters of fiscal 2006 and 2005 totaled 21,160,302 and 26,509,643, respectively.

The following table reconciles the numerators and denominators of the net income per share calculation for the first six months of fiscal 2006 and 2005:

(In thousands, except per share data)	Six Months Ended	
	April 30, 2006	April 30, 2005
<b>Basic net income per share computation:</b>		
Net income	\$ 5,207	\$ 379,534
Dividends on Series B Preferred Stock	(94)	(250)
Allocation of earnings to holders of Series B Preferred Stock	(20)	(3,974)
Net income attributable to common stockholders	<u>\$ 5,093</u>	<u>\$ 375,310</u>
Weighted-average common shares outstanding, excluding unvested restricted stock	382,095	377,738
Basic net income per share attributable to common stockholders	<u>\$ 0.01</u>	<u>\$ 0.99</u>
<b>Diluted net income per share computation:</b>		
Net income	\$ 5,207	\$ 379,534
Dividends on Series B Preferred Stock	(94)	(250)
Allocation of earnings to the holders of Series B Preferred Stock	(20)	(3,974)
Interest expense on the Debentures	—	1,500
Amortization of debt issuance costs	—	1,486
Minority interest in diluted net income	(72)	—
Diluted net income attributable to common stockholders	<u>\$ 5,021</u>	<u>\$ 378,296</u>
Weighted-average common shares outstanding	382,095	377,738
Incremental shares attributable to the assumed exercise of outstanding options, unvested restricted stock, and other stock plans	7,562	5,150
Incremental shares attributable to the assumed conversion of the Debentures	—	52,074
Total adjusted weighted-average common shares	<u>389,657</u>	<u>434,962</u>
Diluted net income per share attributable to common stockholders	<u>\$ 0.01</u>	<u>\$ 0.87</u>

The 1.5 million shares of common stock attributable to the assumed conversion of outstanding Series B Preferred Stock and the 52.0 million shares attributable to the assumed conversion of outstanding Debentures were not included in the calculation of diluted net income per share in the first six months of fiscal 2006 as their effects were antidilutive. Incremental shares attributable to options with exercise prices that were at or greater than the average market price ("out of the money") at April 30, 2006 were also not included in the calculation of diluted net income per share as their effect would have been antidilutive. Out of the money options as of April 30, 2006 and 2005 totaled 21,413,161 and 25,253,010, respectively.

#### Q. Comprehensive Income

The components of comprehensive income (loss) are as follows:

(In thousands)	Three Months Ended		Six Months Ended	
	April 30, 2006	April 30, 2005	April 30, 2006	April 30, 2005
Net income (loss)	\$ 3,342	\$ (15,627)	\$ 5,207	\$ 379,534
Change in net unrealized loss on investments	(1,711)	(1,615)	(441)	(3,826)
Change in pension liability	106	425	212	390
Change in cumulative translation adjustments	1,266	1,631	1,907	8,487
Comprehensive income (loss)	<u>\$ 3,003</u>	<u>\$ (15,186)</u>	<u>\$ 6,885</u>	<u>\$ 384,585</u>

Our accumulated other comprehensive income is comprised of the following:

	April 30, 2006	October 31, 2005
	(In thousands)	
Net unrealized loss on investments	\$ (8,061)	\$ (7,620)
Minimum pension liability .....	(421)	(633)
Cumulative translation adjustment.....	17,604	15,697
Total accumulated other comprehensive income	<u>\$ 9,122</u>	<u>\$ 7,444</u>

## R. Stock-Based Compensation

As discussed in footnote B, we adopted SFAS No. 123(R) on November 1, 2005. Prior to fiscal 2006, we accounted for stock based compensation under APB 25. The adoption of SFAS No. 123(R) had a significant impact on our results of operations. Our consolidated statement of operations for the second quarter and first six months of fiscal 2006 and 2005 includes the following stock-based compensation expense:

(In thousands)	Three months ended April 30, 2006	Three months ended April 30, 2005	Six months ended April 30, 2006	Six months ended April 30, 2005
Cost of revenue .....	\$ 923	\$ 1	\$ 1,985	\$ 2
Sales and marketing .....	3,044	224	6,576	358
Product development.....	1,750	329	4,387	653
General and administrative ..	2,013	398	8,477	398
Operating income.....	7,730	952	21,425	1,411
Tax benefit .....	—	—	—	—
Net income .....	<u>\$ 7,730</u>	<u>\$ 952</u>	<u>\$ 21,425</u>	<u>\$ 1,411</u>

Total unrecognized stock-based compensation expense expected to be recognized over an estimated weighted-average amortization period of 2.70 years was \$74.6 million at April 30, 2006.

SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under APB 25 and related interpretations. This requirement reduced our net operating cash flows and increased our net financing cash flows by \$5.3 million during the first six months of fiscal 2006. Our deferred compensation cost at October 31, 2005 of \$3.4 million, which was accounted for under APB 25, was reclassified into additional paid-in capital as required under SFAS No. 123(R). The cumulative effect related to outstanding restricted stock awards as of October 31, 2005, which are not expected to vest based on an estimate of forfeitures, was not material.

If we had not adopted SFAS 123(R) on November 1, 2005, our net income before income taxes, diluted net income attributable to common stockholders and our diluted net income per share attributable to common stockholders would have been the following pro forma amounts:

(In thousands)	Three months ended April 30, 2006	Six months ended April 30, 2006
Income before income taxes.....	\$ 16,205	\$ 42,002
Diluted net income attributable to common stockholders.....	\$ 8,521	\$ 25,910
Diluted net income per share attributable to common stockholders.....	\$ 0.02	\$ 0.06

### Stock Plans

We currently have five stock award plans that allow us to grant stock options, restricted stock, restricted units and other equity based awards to employees and consultants, and one stock option plan that allows us to grant stock options to members of the Board of Directors. All stock-based compensation awards are issued under one of these six stock award plans. When granting stock options, we typically grant nonstatutory options at fair market value on the date of grant. We also grant restricted stock and restricted stock units. These plans are discussed in more detail in our fiscal 2005 Form 10-K, Note R.

*Time-Based Stock Awards*

Our weighted-average assumptions used in the Black-Scholes valuation model for equity awards with time-based vesting provisions granted during the second quarter and first six months ended April 30, 2006 are shown below:

	Three months ended April 30, 2006	Six months ended April 30, 2006
Expected volatility .....	50%	50%
Expected dividends .....	0%	0%
Expected term .....	4 years	4 years
Risk-free interest rate .....	4.6 – 4.8%	4.3 – 4.8%

The expected volatility rate was estimated based on equal weighting of the historical volatility of Novell common stock over a four year period and the implied volatilities of Novell common stock. The expected term was estimated based on our historical experience of exercise, cancellation, and expiration patterns. The risk-free interest rates are based on four year U.S. Treasury STRIPS.

The pre-vesting forfeiture rate used for the six months ended April 30, 2006 was 10%, which was based on historical rates and forward-looking factors. As required under SFAS No. 123(R), we will adjust the estimated forfeiture rate to our actual experience.

A summary of the time-based stock awards, which includes stock options and restricted stock units, as of April 30, 2006, and changes during the six months then ended, is as follows:

<b>Stock Awards</b>	Shares (in thousands)	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (000s)
Outstanding at November 1, 2005 ....	47,042	\$ 6.68		
Granted .....				
Price equal to fair market value .....	1,667	\$ 8.38		
Price less than fair market value .....	3,994	\$ 0.00		
Exercised .....	(3,996)	\$ 4.39		
Forfeited or expired .....	(2,731)	\$ 8.56		
Outstanding at April 30, 2006 .....	45,976	\$ 6.25	4.76	\$ 122,691
Exercisable at April 30, 2006 .....	30,404	\$ 6.82	4.28	\$ 65,805

The weighted-average grant-date fair value of time-based stock awards granted during the second quarter and first six months ended April 30, 2006 was \$6.68 and \$6.07, respectively. The total intrinsic value of stock options exercised during the second quarter and first six months ended April 30, 2006 was \$5.1 million and \$16.3 million, respectively. As of April 30, 2006, there was \$66.6 million of unrecognized compensation cost related to time-based stock awards. That cost is expected to be recognized over a weighted-average period of 2.73 years.

A summary of time-based unvested restricted stock as of April 30, 2006, and changes during the six months then ended, is as follows:

<b>Unvested Restricted Stock</b>	Shares (in thousands)	Weighted- Average Grant Date Fair Value
Unvested at November 1, 2005 .....	984	\$ 4.85
Granted .....	275	8.33
Vested .....	(100)	3.64
Forfeited .....	(20)	7.33
Unvested at April 30, 2006 .....	1,139	\$ 5.77

As of April 30, 2006, there was \$3.7 million of unrecognized compensation cost related to unvested restricted stock. That cost is expected to be recognized over a weighted-average period of one and a half years. The total fair value of time-based restricted stock that vested during the six months ended April 30, 2006 was \$702,000.

*Performance-Based and Market-Condition Awards*

We have issued performance-based equity awards to certain senior executives. These awards have the potential to vest over one to four years upon the achievement of certain Novell-specific financial performance goals, specifically related to the achievement of budgeted revenue and operating income targets in each fiscal year. The performance-based options were granted at an exercise price equal to the fair market value of Novell common stock on the date the option was legally granted and have a contractual life ranging from two to eight years.

We have issued market-condition equity awards to certain senior executives the vesting of which is accelerated or contingent upon the price of Novell common stock meeting certain pre-established stock price targets. Certain of these awards will vest on the sixth anniversary of the grant date if the market-condition was not previously achieved. The market-condition options are generally granted at an exercise price equal to the fair market value of Novell common stock on the date of the grant and have a contractual life of eight years. No market-condition awards were granted during the six months ended April 30, 2006.

The fair value of each performance-based and market-condition option was estimated on the grant date using the Black-Scholes option valuation model without consideration of the performance measures or market conditions. The inputs for expected volatility, expected term, expected dividends, and risk-free interest rate used in estimating the fair value of performance-based awards in the six months ended April 30, 2006, are the same as those noted above under time-based stock awards.

A summary of the performance-based and market-condition awards as of April 30, 2006, and changes during the six months then ended, is as follows:

	Shares (in thousands)	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
<b>Stock Awards</b>				
Outstanding at November 1, 2005 ...	2,413	\$ 7.49		
Granted .....	535	\$ 8.29		
Exercised .....	(85)	\$ 6.35		
Forfeited or expired .....	(115)	\$ 8.66		
Outstanding at April 30, 2006.....	<u>2,748</u>	<u>\$ 7.72</u>	<u>6.45</u>	<u>\$ 2,892</u>
Exercisable at April 30, 2006 .....	<u>1,295</u>	<u>\$ 6.54</u>	<u>6.62</u>	<u>\$ 2,433</u>

The weighted-average grant-date fair value of options granted during the second quarter and first six months ended April 30, 2006 was \$4.46. As of April 30, 2006, there was \$3.2 million of unrecognized compensation cost related to performance-based and market-condition awards. That cost is expected to be recognized over a weighted-average period of 2.7 years.

A status of the unvested, performance-based and market-condition restricted stock as April 30, 2006, and changes during the six months then ended, is as follows:

	Shares (in thousands)	Weighted- Average Grant Date Fair Value
<b>Unvested Restricted Stock</b>		
Unvested at November 1, 2005.....	125	\$ 7.42
Granted .....	87	\$ 9.22
Vested .....	(25)	\$ 7.35
Forfeited.....	(7)	\$ 9.22
Unvested at April 30, 2006 .....	<u>180</u>	<u>\$ 8.96</u>

As of April 30, 2006, there was \$1.0 million of unrecognized compensation cost related to unvested, performance-based and market-condition restricted stock. That cost is expected to be recognized ratably over a one to four year period. No performance-based restricted stock vested during the six months ended April 30, 2006. The total fair value of market-condition restricted stock that vested during the six months ended April 30, 2006 was \$227,500.

As of April 30, 2006, there were 736,618 stock awards that have been legally granted but have not yet been valued because all of the conditions necessary to establish the grant date for SFAS No. 123(R) purposes have not yet occurred. The grant date of these stock awards will not occur until budgets are approved by our Board of Directors for the respective years specified in the performance targets.

*Celerant Stock Awards*

During the first six months of fiscal 2006, Celerant granted 135,700 time-based stock awards with the following terms: one-third of the options vest each year and the options are exercisable after five years from the date of grant, unless the employee leaves Celerant, in which case the vested options are subject to an earlier exercise date. Upon adoption of SFAS No. 123(R), we applied a forfeiture rate of 16% to the Celerant option expense, which was based on historical rates. As of April 30, 2006, there were 2.6 million time-based options outstanding for Celerant stock, of which 1.8 million were exercisable, and 1.7 million performance-based options outstanding for Celerant stock, of which 0.2 million were exercisable. The performance-based options vest upon meeting specified financial performance goals or five years from the date of grant, if the performance criteria are not met.

*Second Quarter and First Six Months of Fiscal 2005*

For the second quarter and first six months ended April 30, 2005, had we accounted for all employee stock-based compensation based on the fair value method as prescribed by SFAS No. 123, our net income and net income (loss) per share would have been the following pro forma amounts:

<i>(in thousands, except per share data)</i>	Three months ended April 30, 2005	Six months ended April 30, 2005
Net income (loss), as reported .....	\$ (15,627)	\$ 379,534
Less: total stock-based compensation expense determined under fair value-based method for all awards, net of related tax effects .....	(12,809)	(25,219)
Add: total stock-based compensation expense recorded in the statement of operations under APB 25 .....	952	1,411
Pro forma net income (loss) .....	<u>\$ (27,484)</u>	<u>\$ 355,726</u>
Net income (loss) per share available to common stockholders:		
As reported basic .....	\$ (0.04)	\$ 0.99
Pro forma basic .....	\$ (0.07)	\$ 0.93
As reported diluted .....	\$ (0.04)	\$ 0.87
Pro forma diluted .....	\$ (0.07)	\$ 0.81

For the purpose of the above table, the fair value of each option grant was estimated as of the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in the second quarter and first six months of fiscal 2005: a risk-free interest rate of approximately 4.01% and 3.90%; a dividend yield of 0% in both periods; a weighted-average expected life of 3.97 years and 4.47 years; and a volatility rate of 0.49 and 0.57, respectively. The expected volatility was estimated using the historical volatility over a period of five years. The weighted-average fair value of options granted in the second quarter and first six months of fiscal 2005 was \$2.45 and \$3.03.

*Employee Stock Purchase Plan*

Subsequent to the issuance of SFAS No. 123(R), we amended and re-introduced our Employee Stock Purchase Plan ("ESPP"). The amended ESPP eliminated the "look back" feature of the plan and reduced the purchase discount to 5% off of the end of offering period stock price. As a result of these amendments, our ESPP is considered non-compensatory under SFAS No. 123(R) and, accordingly, no compensation expense has been recorded for issuances under the ESPP.

**S. Segment Information**

We operate and report our financial results in four operating segments: three are based on geographic areas and the fourth is Celerant consulting. Our performance is evaluated by our Chief Executive Officer and our other chief decision makers based on reviewing revenue and segment operating income (loss) information for each 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, Southeast Asia, Australia, New Zealand, Japan, and India

Prior to fiscal 2006, Latin America and Japan were separate operating segments. All segment information has been recast to conform to the new segment presentation.

All geographic segments sell our software and services. These offerings are sold in the United States directly and through original equipment manufacturers, resellers, and distributor channels, and internationally directly and through original equipment manufacturers and distributors who sell to dealers and end users. Operating results by segment are as follows:

(in thousands)	Three Months Ended			
	April 30, 2006		April 30, 2005	
	Net revenue	Operating income (loss)	Net revenue	Operating income (loss)
Americas .....	\$ 129,344	\$ 62,988	\$ 130,565	\$ 64,744
EMEA .....	86,580	26,448	99,044	24,410
Asia Pacific .....	22,802	5,774	23,535	5,554
Common unallocated operating (costs) income .....	—	(92,887)	—	(104,449)
Stock-based compensation expenses .....	—	(7,662)	—	(952)
Total geographic segments .....	238,726	(5,339)	253,144	(10,693)
Celerant consulting .....	39,590	2,871	43,907	4,291
Stock-based compensation expenses .....	—	(68)	—	—
Total Celerant consulting .....	39,590	2,803	43,907	4,291
Total per statements of operations .....	\$ 278,316	\$ (2,536)	\$ 297,051	\$ (6,402)

(in thousands)	Six Months Ended			
	April 30, 2006		April 30, 2005	
	Net revenue	Operating income (loss)	Net revenue	Operating income (loss)
Americas .....	\$ 263,121	\$ 131,509	\$ 259,548	\$ 131,620
EMEA .....	175,416	56,666	194,595	45,606
Asia Pacific .....	42,483	8,095	45,080	10,418
Common unallocated operating (costs) income .....	—	(179,178)	—	249,533
Stock-based compensation expenses .....	—	(21,164)	—	(1,411)
Total geographic segments .....	481,020	(4,072)	499,223	435,766
Celerant consulting .....	71,704	2,283	87,956	7,397
Stock-based compensation expenses .....	—	(261)	—	—
Total Celerant consulting .....	71,704	2,022	87,956	7,397
Total per statements of operations .....	\$ 552,724	\$ (2,050)	\$ 587,179	\$ 443,163

Common unallocated operating (costs) income include corporate services common to all geographic segments such as corporate sales and marketing, product development, corporate general and administrative costs, corporate infrastructure costs, and litigation settlement income or expense. For management reporting purposes, Celerant consulting does not receive an allocation for these corporate services. In addition, common unallocated operating (costs) income in the first three months of fiscal 2005 also includes a \$447.6 million net gain on settlement of potential litigation with Microsoft. Stock-based compensation expenses have not been allocated for management reporting purposes

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

- Systems, security, and identity management (formerly Identity-driven computing solutions). Sub-categories include:
  - Resource management— major products include ZENworks
  - Identity and access management— major products include Identity Manager, Secure Login, iChain, and Sentinel
  - Other systems, security, and identity management products — major products include eDirectory and web services
- Open platform solutions. Sub-categories include:
  - Open Enterprise Server (OES)
  - Linux platform products — major products include SUSE LINUX Enterprise Server and Novell Linux Desktop
  - Other open platform products — major products include SUSE LINUX Professional
- Workspace solutions. Sub-categories include:
  - NetWare and other NetWare-related — major products include NetWare and Cluster Services
  - Collaboration — major products include GroupWise

- Other workspace — major products include BorderManager and Novell iFolder
- Global services and support — comprehensive worldwide IT consulting, training, and technical support services that apply business solutions to our customers' business situations, providing the business knowledge and technical expertise to help our customers implement our technology.
- Celerant consulting — operational strategy and implementation consulting services offered to a wide range of customers across various sectors, worldwide.

Prior to fiscal 2006, Open platform solutions and Workspace solutions were combined in a category called Linux and platform services solutions. Prior periods have been recast to conform to the new presentation. Net revenue by solution category and Celerant consulting are as follows:

(in thousands)	Three Months Ended		Six Months Ended	
	April 30, 2006	April 30, 2005	April 30, 2006	April 30, 2005
Resource management .....	\$ 33,799	\$ 31,329	\$ 66,957	\$ 61,298
Identity and access management.....	22,347	16,256	47,895	34,110
Other systems, security, and identity management products ....	5,061	5,170	9,358	10,005
Systems, security, and identity management .....	61,207	52,755	124,210	105,413
Open Enterprise Server .....	45,719	7,827	88,831	7,827
Linux platform products .....	10,307	8,606	20,689	17,099
Other open platform products .....	1,101	3,541	3,846	9,080
Open platform solutions.....	57,127	19,974	113,366	34,006
NetWare and other NetWare-related.....	11,566	60,463	29,822	129,210
Collaboration .....	22,830	23,656	46,507	47,996
Other workspace products.....	7,210	8,879	12,621	14,785
Workspace solutions .....	41,606	92,998	88,950	191,991
Total software licenses and maintenance .....	159,940	165,727	326,526	331,410
Global services and support .....	78,786	87,417	154,494	167,813
Total IT software and solutions.....	238,726	253,144	481,020	499,223
Celerant consulting .....	39,590	43,907	71,704	87,956
Total net revenue.....	\$ 278,316	\$ 297,051	\$ 552,724	\$ 587,179

For the second quarters of fiscal 2006 and 2005, revenues in the United States were \$121.0 million and \$127.7 million, respectively. Revenues from customers outside the United States were \$157.3 million and \$169.4 million in the second quarters of fiscal 2006 and 2005, respectively. For the second quarters of fiscal 2006 and 2005, 74% and 76%, respectively, of our revenues outside the United States were in EMEA. During the second quarter of fiscal 2006, sales to customers in the United Kingdom accounted for 11% of our net revenue. During the second quarter of fiscal 2005, sales to customers in the United Kingdom accounted for 12% of our net revenue. No single customer accounted for more than 10% of our total revenue for any period presented.

For the first six months of fiscal 2006 and 2005, revenues in the United States were \$244.0 million and \$250.2 million, respectively. Revenues from customers outside the United States were \$308.7 million and \$337.0 million in the first six months of fiscal 2006 and 2005, respectively. For the first six months of fiscal 2006 and 2005, 74% and 77%, respectively, of our revenues outside the United States were in EMEA. During the first six months of fiscal 2006, sales to customers in the United Kingdom accounted for 10% of our net revenue. During the first six months of fiscal 2005, sales to customers in the United Kingdom accounted for 11% of our net revenue. No single customer accounted for more than 10% of our total revenue for any period presented.

#### T. Derivative Instruments

A large portion of our revenue, expense, and capital purchasing activities is transacted in U.S. dollars. We do not currently hedge currency risks related to revenue or expenses denominated in foreign currencies. However, we hedge currency risks of some assets and liabilities denominated in foreign currencies to protect against reductions in value caused by changes in foreign exchange rates. We have established balance sheet and intercompany hedging programs that use one-month foreign currency forward contracts, primarily on the Euro, British Pound, 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 April 30, 2006 is insignificant. Gains and losses recognized during a quarter on these foreign currency contracts are recorded as other income or expense and generally offset corresponding gains and losses on the underlying hedged assets and liabilities, resulting in negligible effect to our financial statements.

**U. Share Repurchase Program**

On September 22, 2005, our board of directors approved a share repurchase program for up to \$200.0 million of our common stock through September 21, 2006. On April 4, 2006, our board of directors approved an amendment to the share repurchase program increasing the limit on repurchase from \$200.0 million to \$400.0 million and extending the program through April 3, 2007. As of April 30, 2006, 35.2 million shares of common stock had been repurchased and retired under this program at an average price of \$7.59 per share. The total amount paid for the repurchase of our common stock was \$267.5 million. Subsequent to April 30, 2006, we completed the share repurchase program by purchasing 16.3 million additional shares at a total cost of \$132.5 million.

**V. Subsequent Events**

On May 24, 2006, we sold our shares in Celerant consulting to a group comprised of Celerant management and Caledonia Investments plc for \$77.0 million in cash. There will be no further shareholding or operational relationship between us and Celerant going forward. The sale of Celerant consulting does not have an impact on our IT consulting business. We anticipate recording a gain, for book purposes, of approximately \$12.0 to \$14.0 million on the sale of Celerant. We will begin classifying Celerant's results of operations and cash flows as discontinued operations in our consolidated statement of operations beginning in our third quarter of fiscal 2006.

## 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 Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Act of 1934, as amended. All statements, other than statements of historical fact, regarding our strategy, future operations, financial position, estimated revenue, projected costs, projected savings, prospects, plans, opportunities, and objectives constitute "forward-looking statements." The words "may," "will," "expects," "plans," "anticipates," "believe," "estimates," "potential," or "continue" and similar types of expressions identify such statements, although not all forward-looking statements contain these identifying words. These statements are based upon information that is currently available to us and/or management's expectations, speak only as of the date hereof, and are subject to risks and uncertainties. We expressly disclaim any obligation, except as required by law, or undertaking to update or revise forward-looking statements contained herein to reflect any change or expectations with regard thereto or to reflect any change in events, conditions, or circumstances on which any such forward-looking statement is based, in whole or in part. Our actual results may differ materially from the results discussed in or implied by such forward-looking statements. We are subject to a number of risks, some of which may be similar to those of other companies of similar size in our industry, including pre-tax losses, rapid technological changes, competition, limited number of suppliers, customer concentration, failure to successfully integrate acquisitions, adverse government regulations, failure to manage international activities, and loss of key individuals. Risks that may affect our operating results include, but are not limited to, those discussed in the "Risk Factors" section of our Annual Report on Form 10-K for fiscal 2005 filed with the Securities and Exchange Commission on January 10, 2006.*

### Introduction

Novell designs, develops, maintains, implements, and supports proprietary and open source software for use in business solutions. With approximately 5,300 employees globally (approximately 4,800 without Celerant), we help our worldwide customers manage, simplify, secure and integrate their technology environments by leveraging best-of-breed, open source and open standards-based software. With over 20 years of experience, our employees, partners and support centers around the world help customers gain control over their information technology ("IT") operating environments while reducing the cost, complexity, and vulnerabilities of those environments. We provide security and identity management, resource management, desktop, workgroup, and data center solutions on several operating systems, including Linux, NetWare(R), Windows, and Unix. All of our solutions are supported by our global services and support, including consulting, training and technical support services.

We deliver this value to our customers by developing, maintaining and delivering information solutions in the following categories:

*Systems, security, and identity management (formerly called Identity-driven computing solutions).* Our systems, security, and identity management products include applications that offer a broad set of capabilities that manage resources, assets, and people through the assignment of digital identities, including the following:

- resource management capabilities for both desktop and server environments;
- provisioning and de-provisioning capabilities; and
- secure authentication and authorization services.

We believe that customers have recognized the need to manage the access, utilization and optimization of assets through information systems that can help them understand, implement and administer business policies, not only within organizations, but also between organizations and their customers and trading partners. Our software solutions enable organizations to balance growing user demands for services and information with demands for increased security and agility. By using our products, customers can integrate business processes and systems, extending them within and across enterprise boundaries to interact with customers, employees, suppliers and partners. This affords organizations the opportunity to make changes to their business operations without incurring the cost of constantly changing individual software application components.

These identity-based technologies not only regulate user access to data and applications, but are increasingly becoming the basis for securing and managing other information assets, including devices such as mobile phones and the components that make up today's modern data centers. We believe that identity management will increasingly become the preferred means by which businesses will efficiently utilize all IT assets, and we have developed products for this market to help our customers take advantage of these opportunities. These products can be deployed across a number of systems, including Linux, Unix, NetWare, and Windows, recognizing the heterogeneous nature of today's IT departments. Our development strategy has been to develop systems, security and identity management technologies as a set of discrete software services that can be deployed as needed, as opposed to the use of a single monolithic application that can take years to implement and deploy without any immediate business benefit.

*Open platform solutions and workspace solutions.* Both our open platform solutions and workspace solutions categories include solutions that offer effective and open approaches to networking and collaboration services, including file, print, messaging, scheduling, and workspace while using a cross-platform approach. Both consist of operating systems, network services, and workgroup computing software solutions. We offer two major operating system platforms, SUSE(R) Linux Enterprise Server and NetWare.

Our open platform solutions category is comprised of our offerings based on Linux, Open Enterprise Server ("OES") and other related products. These solutions provide the foundation for value added network and workspace computing solutions deployed on both servers and desktops. OES consists of enterprise-ready, scalable networking and collaboration services — including file, print, messaging, scheduling and directory-based management modules that allow customers to manage their computing environment from a single, central console deployed on either of our major operating systems platforms.

A major focus of our open platform solutions is to embrace and promote open source computing. Open source is a term used to describe software source code that generally allows free use, modification, and distribution of source code, subject to certain conditions. Open source software is generally built by a community of developers, many of whom are unaffiliated with each other. Corporations also fund open source projects or contribute code into open source to further assist the development efforts. We believe that a major shift toward the use of open source software is underway as companies are more critically evaluating the cost effectiveness of their information technology investments, seeing value in having access to the source code, and looking for ways to avoid vendor lock-in.

We believe that we are uniquely positioned to drive the transition to greater use of open source software, as well as to benefit from this trend. Widespread adoption of Linux and open source software was initially hindered by weak technical support, a shortcoming that we are particularly well positioned to address. We leverage our financial stability, experience, and global services and support capabilities to help our customers integrate Linux and other open source software into their existing IT environments. While the flexibility and cost savings of Linux and open source have made it attractive to enterprise customers, we believe they continue to look to proprietary software vendors to provide applications, management and security. With our SUSE Linux Enterprise Server open source platform and our other Linux and platform services solutions, our customers can deploy the best of proprietary and open source software that many businesses find more attractive. As an example, our GroupWise product allows customers to collaborate seamlessly across their Windows and Linux environments. We also provide solutions allowing IT managers to centrally control Linux, NetWare and Windows systems in a consistent and straightforward way.

Our workspace solutions category is comprised of proprietary software products that provide customers with powerful solutions that are designed to operate within existing heterogeneous computing environments as well as to provide tools and strategies to allow easy migration between platforms to fit better with our customers' technology plans. Our primary server product in this solution category is NetWare. Our workspace solutions category also includes our GroupWise and collaboration technologies, Cluster Services, and BorderManager.

*Global services and support.* We provide worldwide IT consulting, training and technical support services to address our customers' needs. Our worldwide IT consulting practice provides the business knowledge and technical expertise our customers need to implement and achieve maximum benefit from our products and solutions. We also offer open source and identity-driven services that are focused on aiding our clients in rapidly integrating applications or migrating existing platforms to Linux.

Through our training services, we offer skills assessments, advanced technical training courses, and customized training directly and through authorized training service partners. We also offer testing and certification programs to systems administrators, engineers, salespeople, and instructors on a wide variety of technologies, including Linux. Over a decade ago, we introduced the concept of software engineer certifications. Building on this program, we introduced our Novell Certified Linux Engineer and Novell Certified Linux Professional programs to accelerate the adoption of Linux and open source in the enterprise.

We provide our customers with a global support structure covering proprietary and open source technical support. We deliver our technical support services through a variety of channels, including on-site dedicated resources as well as through telephone, web, e-mail, and remote systems management.

*Celerant consulting.* Celerant, a majority-owned subsidiary of Novell, provides value-based, operational strategy and implementation consulting services to a wide variety of customers mainly in Europe and the United States. Celerant specializes in improving the value derived from existing business processes by accelerating time to value and eliminating non-value creating activities. On May 24, 2006, we sold our shares in Celerant consulting to a group comprised of Celerant management and Caledonia Investments plc for \$77.0 million in cash.

## Overview

With respect to the U.S. economy, spending continues to improve in many of the areas of IT that we target such as security, regulatory compliance and server/function consolidation. We believe that strategic IT security projects put on hold in previous years are now being approved. Overall, increased IT funding is helping to attract new Linux and identity management business, which is driven by an increased focus on gaining efficiencies and lowering expenses. Sales cycles of our products and services are still relatively long, with customers frequently requiring a product pilot before a larger purchase will occur.

Internationally, following a period of sluggish growth, the European area of our EMEA segment is showing signs of recovery, particularly in the government sector. However, market spending is still below our expectations with long sales cycles and a clear focus on IT cost savings. Consolidation of platforms and security remain high priority items for our customers. Our EMEA segment remains a focus for our management and we expect to face continued financial challenges in that region. The economy in Asia Pacific, including Japan, is mixed as some regions continue to struggle with core economic issues and others are growing at or above global rates.

We continued to make progress on our key initiatives this quarter.

- One of our most important initiatives is to increase revenue from our Linux and open source product offerings. Revenues from our Linux platform products increased 20% during the second quarter of fiscal 2006 over the same period in the prior year. This quarter we announced our next-generation platform for the open enterprise, SUSE Linux Enterprise 10. With enhanced performance, scalability, security and usability, SUSE Linux Enterprise 10 is the basis for all of Novell's next-generation enterprise Linux offerings, including SUSE Linux Enterprise Server and the recently announced SUSE Linux Enterprise Desktop. SUSE Linux Enterprise Desktop and Server offerings are scheduled to be available in the second half of calendar 2006. We also introduced the first workgroup suite for the open enterprise, the Novell Open Workgroup Suite, which includes server and desktop components with robust management tools, e-mail, collaboration and the most advanced open source office products in the market. Strengthening our position as a leader in driving open source software adoption, we announced a near doubling in the size of our Market Start program in the second fiscal quarter. Launched in 2005 to accelerate open source adoption worldwide, Market Start gives enterprise open source companies access to Novell's global sales and marketing channels to bring their solutions to the marketplace.

- We continued to grow our positions in the resource management and identity markets by offering the most comprehensive products that address customer problems in the areas of security, compliance, risk mitigation and systems management. Our unique role-based, policy-driven approach has been well received, and we continue to experience strong growth in our identity and access management category, with large enterprise deals driving license growth. To further expand our lead in this market, we entered the security management market via the acquisition of e-Security in the second quarter of fiscal 2006. e-Security is a leader in compliance monitoring and reporting capabilities, producing the enterprise-class security information and event management product Sentinel 5. We expect revenue growth and strong performance in our systems, security and identity management areas throughout the remainder of fiscal 2006.

- We continued efforts to stabilize the decline of our revenue from traditional products, such as NetWare. Our traditional revenue base is an important source of cash flow and a potential opportunity for us to sell more products and services. Novell recognizes the need to continue supporting its loyal NetWare customers, and during our second fiscal quarter we reiterated our commitment to NetWare by reminding customers that Novell can and will support NetWare 6.5 for as long as customers choose to run it. With the release of our OES product in March 2005, we have taken steps to help maintain that installed base and address revenue declines of these products. Nevertheless, our combined NetWare and OES business declined 16% during the second quarter of fiscal 2006 compared to the same period in the prior year. We continue to work with our customers to help them migrate from NetWare and other platforms of our competitors to OES using tools, training and education emphasizing the return on investment of upgrading to Linux versus proprietary platforms.

- As we have discussed in the past, we have re-architected our go to market plans, selecting key geographies in which to deploy our resources and clearly defining our partner and channel strategy. In addition, we have restructured our sales incentive plans to motivate our direct sales and channel partners to focus on key product areas globally. Now we are focused on executing on those plans.