

Novell.

NOVELL INC (NOVL)

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10-Q

3 Q FILING

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the Fiscal Quarter Ended July 30, 1994

or

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

Commission File Number: 0-13351

NOVELL, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

122 East 1700 South
Provo, Utah 84606
(Address of principal executive offices and zip code)

(801) 429-7000
(Registrant's telephone number, including area code)

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

YES NO

As of August 26, 1994 there were 363,047,498 shares of the registrant's common stock outstanding.

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Part I.
Financial Information, Item 1. Financial Statements

NOVELL, INC.
CONSOLIDATED UNAUDITED CONDENSED BALANCE SHEETS

Dollars in thousands, except per share data	Jul. 30, 1994	Oct. 30, 1993
ASSETS		
Current assets		
Cash and cash equivalents	\$ 167,155	\$ 383,596
Short-term investments	590,931	335,601
Receivables, less allowances (\$80,020 - July; \$50,202 - October)	384,197	395,334
Inventories	30,468	29,833
Prepaid expenses	72,476	40,076
Deferred taxes	86,872	72,969
Total current assets	1,332,009	1,257,409
Property, plant and equipment, net	406,840	403,752
Other assets	124,538	84,176
Total assets	\$1,863,387	\$1,745,337
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Short-term debt	\$ 2,254	\$ 9,436
Accounts payable	57,745	75,470
Accrued salaries and wages	62,930	69,061
Accrued marketing liabilities	63,966	51,553
Other accrued liabilities	106,370	103,204
Income taxes payable	61,837	55,589
Deferred revenue	40,514	33,788
Total current liabilities	395,616	398,101
Long-term debt	--	84,289
Deferred income taxes	10,814	--
Minority interests	13,215	10,205
Put warrants	--	106,716
Shareholders' equity		
Common stock, par value \$.10 a share		
Authorized - 400,000,000 shares		
Issued - 362,740,872 shares-July		
359,431,077 shares-October	36,274	35,943
Additional paid-in capital	626,559	485,253
Retained earnings	781,989	635,551
Unearned stock compensation	(5,867)	(9,814)
Cumulative translation adjustment	4,787	(907)
Total shareholders' equity	1,443,742	1,146,026
Total liabilities and shareholders' equity	\$1,863,387	\$1,745,337

See notes to consolidated unaudited condensed financial statements.

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NOVELL, INC.
CONSOLIDATED UNAUDITED CONDENSED STATEMENTS OF OPERATIONS

Amounts in thousands, except per share data	Fiscal Quarter Ended		Nine Months Ended	
	Jul. 30, 1994	Jul. 31, 1993	Jul. 30, 1994	Jul. 31, 1993
Net sales	\$488,924	\$433,872	\$1,512,132	\$1,321,194
Cost of sales	105,504	101,462	354,678	284,843
Gross profit	383,420	332,410	1,157,454	1,036,351
Operating expenses				
Sales and marketing	145,713	142,452	398,594	369,307
Product development	90,619	75,490	257,079	209,554
General and administrative	37,191	38,177	123,582	118,402
Write-off of purchased research and development	114,420	314,501	129,389	314,501
Restructuring charges	--	42,000	--	42,000
	387,943	612,620	908,644	1,053,764
Income (loss) from operations	(4,523)	(280,210)	248,810	(17,413)
Other income (expense)				
Investment income	7,062	6,615	25,923	19,806
Merger expenses	(5,778)	--	(5,778)	--
Other, net	(1,501)	1,063	(2,440)	3,225
	(217)	7,678	17,705	23,031
Income (loss) before taxes	(4,740)	(272,532)	266,515	5,618
Income taxes	(275)	(15,111)	80,156	67,681
Net income (loss)	\$(4,465)	\$(257,421)	\$186,359	\$(62,063)
Net income (loss) per share	\$(0.01)	\$(0.69)	\$ 0.51	\$(0.17)
Weighted average shares outstanding	368,313	372,379	368,290	366,923
Pro forma data:				
Income (loss) before taxes	\$(4,740)	\$(272,532)	\$266,515	\$ 5,618
Income taxes	(275)	13,396	95,704	106,990
Net income (loss)	\$(4,465)	\$(285,928)	\$170,811	\$(101,372)
Net income (loss) per share	\$(0.01)	\$(0.77)	0.46	\$(0.28)

See notes to consolidated unaudited condensed financial statements.

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NOVELL, INC.

CONSOLIDATED UNAUDITED CONDENSED STATEMENTS OF CASH FLOWS

Amounts in thousands	Nine Months Ended	
	Jul. 30, 1994	Jul. 31, 1993
Cash flows from operating activities		
Net income (loss)	\$186,359	\$(62,063)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities		
Write-off of purchased research & development	129,389	314,501
Depreciation and amortization	62,531	55,301
Restructuring charges	--	42,000
Elimination of duplicate net income from WordPerfect	(39,856)	--
Stock plans income tax benefits	16,862	43,141
Minority interest in earnings (loss)	974	(781)
Decrease (increase) in receivables	11,137	(36,101)
(Increase) decrease in inventories	(635)	(4,059)
(Increase) decrease in prepaid expenses	(32,400)	(10,851)
(Increase) in deferred taxes	(50,387)	(50,662)
(Decrease) in accounts payable	(17,725)	(11,567)
(Decrease) in accrued salaries and wages	(6,131)	13,726
Increase in accrued marketing liabilities	12,413	7,970
Increase in other accrued liabilities	3,166	8,709
Increase (decrease) in income taxes payable	6,248	6,608
Increase (decrease) in deferred revenue	6,726	2,181
	288,671	318,053
Cash flows from financing activities		
Borrowings	26,809	--
Repayment of debt	(118,280)	(8,636)
Issuance of common stock, net	21,491	31,624
Distribution to shareholders	(65)	(20,211)
Repurchase of treasury stock	--	(60,556)
Sale/settlement of put warrants	(2,278)	1,975
	(72,323)	(55,804)
Cash flows from investing activities		
Expenditures for property, plant and equipment	(62,826)	(87,801)
(Increase) in short-term investments	(255,330)	163,716
Cash from acquisitions using common stock	--	37,242
Cash paid for acquisitions	(110,000)	(35,500)
Other	(4,633)	(2,848)
	(432,789)	74,809
Summary		
Increase in cash and cash equivalents	(216,441)	337,058
Cash and cash equivalents - beginning of period	383,596	346,562
Cash and cash equivalents - end of period	\$167,155	\$683,620

See notes to consolidated unaudited condensed financial statements.

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NOVELL, INC.

NOTES TO CONSOLIDATED UNAUDITED CONDENSED FINANCIAL STATEMENTS

A. Quarterly Financial Statements

The accompanying consolidated unaudited condensed financial statements have been prepared in accordance with the instructions to Form 10-Q but do not include all of the information and footnotes required by generally accepted accounting principles and should therefore, be read in conjunction with the historical consolidated financial statements of Novell, Inc. (Novell) and WordPerfect Corporation (WordPerfect). These statements do include all normal recurring adjustments which the Company believes necessary for a fair presentation of the statements. The interim operating results are not necessarily indicative of the results for a full year.

B. Mergers, Acquisitions, and Strategic Investments

On June 24, 1994 Novell completed a merger with WordPerfect, a developer of application software for personal computers, whereby WordPerfect was merged directly into Novell. Novell issued common stock in exchange for all of the outstanding common stock of WordPerfect. In addition, outstanding employee stock options to purchase WordPerfect common stock were converted into options to purchase approximately 7.8 million shares of Novell common stock. The transaction was accounted for as pooling of interests and therefore, the consolidated unaudited financial statements for all periods presented herein have been restated to reflect the combination of Novell and WordPerfect.

WordPerfect had a calendar year end and, accordingly the WordPerfect statement of income for the year ended December 31, 1993 has been combined with the Novell statement of operations for the fiscal year ended October 30, 1993. In order to conform WordPerfect's year end to Novell's fiscal year end, the consolidated unaudited condensed statement of operations for the nine months ended July 30, 1994 includes two months (November and December 1993) for WordPerfect, which are also included in the consolidated statement of operations for the year ended October 30, 1993. Accordingly, an adjustment has been made in the nine months ended July 30, 1994 to retained earnings for the duplication of net income of \$39.9 million for such two month period. Other results for such two month period of WordPerfect include net sales of \$136.6 million, income before taxes of \$34.6 million and an income tax benefit of \$5.3 million. The consolidated financial statements for the nine months ended July 31, 1993 combine Novell's financial statements for the nine months ended July 31, 1993 with the WordPerfect's financial statements for the nine months ended September 30, 1993.

Additionally in June 1994, the Company acquired Borland International, Inc.'s QuattroPro spreadsheet product line for \$110 million of cash and assumed liabilities of \$10 million, and a three-year license to reproduce and distribute up to one million copies of current and future versions of Borland's Paradox relational database product for \$35 million of cash. The transaction was accounted for as a purchase and, on this basis, resulted in a one-time tax deductible write-off of \$114.4 million for purchased research and development in the third quarter of fiscal 1994.

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In January 1994, WordPerfect acquired all of the outstanding stock of SoftSolutions Technology Corporation (SoftSolutions), a developer of network document management software, for \$5.8 million of cash and notes payable of \$9.2 million. The transaction was accounted for as a purchase and, on this basis, resulted in a one-time write-off of \$15.0 million for purchased research and development in the first quarter of fiscal 1994.

In July 1993, the Company acquired all of the outstanding stock of Fluent, Inc. (Fluent), a developer of multimedia software for personal computers, for \$18.5 million of cash and assumed liabilities of \$3.0 million, whereby Fluent became a wholly owned subsidiary of Novell. The transaction was accounted for as a purchase and, on this basis, resulted in a one-time write-off of \$20.7 million for purchased research and development in the third quarter of fiscal 1993.

In June 1993, the Company acquired all of the outstanding stock of Software Transformation, Inc. (STI), a developer of software development tools, by issuing approximately 800,000 shares of Novell Common stock in exchange for all of the outstanding stock of STI. The transaction was accounted for as a pooling of interests, however, prior periods were not restated due to immateriality.

In June 1993, the Company purchased all of the outstanding stock not previously owned by Novell of Serius Corporation (Serius), a developer of object-based application tools, for \$17.0 million of cash and assumed liabilities of \$5.0 million, whereby Serius became a wholly owned subsidiary of Novell. Novell's previous ownership was a \$1.1 million cash investment. The transaction was accounted for as a purchase and on this basis, resulted in a one-time write-off of \$22.1 million for purchased research and development in the third quarter of fiscal 1993.

In April 1991, the Company purchased a minority equity position in UNIX System Laboratories, Inc., (USL) a subsidiary of AT&T that develops and licenses the UNIX operating system and other standards-based software to vendors worldwide. This cash investment of \$15.0 million was accounted for using the cost method. Later, in December 1991, the Company announced the formation of Univel, a 55% owned joint venture with USL, formed to accelerate the expanded use of the UNIX operating system in the personal computer and network computing marketplace. Novell and USL contributed cash and technology rights to Univel. In June 1993, the Company acquired the remaining unowned portion of USL by issuing approximately 11.1 million shares of Novell common stock valued at \$321.8 million in exchange for all of the outstanding stock of USL not previously owned by Novell and assumed additional liabilities of \$9.4 million. The transaction was accounted for as a purchase and, on this basis a one-time write-off of \$268.7 million for purchased research and development was incurred.

Univel has been included in the consolidated financial statements of Novell since December 1991 by virtue of Novell's 55% ownership interest. That ownership interest is now 100% since the June 1993 acquisition of USL, whereby both USL and Univel are now included in the consolidated financial statements of Novell.

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C. Income Taxes

Effective January 1, 1993, WordPerfect adopted Statement of Financial Accounting Standards No. 109 (SFAS 109), Accounting for Income Taxes. Under SFAS 109, the liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on the differences between financial reporting and the tax basis of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Prior to September 30, 1993, WordPerfect elected to be taxed as an S corporation whereby the income tax effects of WordPerfect's activities accrued directly to its shareholders; therefore, adoption of SFAS 109 required no establishment of corporate deferred income taxes. WordPerfect and its affiliated entities terminated their S corporation elections on either September 30, 1993 or December 31, 1993. As a result, deferred income taxes under the provisions of SFAS 109 were established on the dates the S corporation elections were terminated.

Novell adopted the provisions of SFAS 109 effective October 31, 1993 for fiscal year 1994. As permitted under the new rules, prior years financial statements have not been restated. Adoption of SFAS 109 had no material effect on the financial statements of Novell.

The Company's estimated effective tax rate for the first nine months of fiscal 1994 is 30%. Excluding non-tax deductible one-time charges related to the write-off of purchased research and development of \$15.0 million in fiscal 1994 and \$314.5 million in fiscal 1993 and adjusting both periods to reflect a provision for income taxes as if WordPerfect and its S corporation subsidiaries had been C corporations, the Company's estimated effective tax rate for the first nine months of fiscal 1994 would be 34% compared to 33.4% for the first nine months of fiscal 1993. The increase is attributable to non-tax deductible merger expenses. The Company paid cash amounts for income taxes of \$108.5 million and \$60.2 million, in the first nine months of fiscal 1994 and 1993, respectively.

D. Debt

At the time of the merger, WordPerfect had long-term notes payable to shareholders of \$78 million and other short and long-term debt of \$40 million, all of which was paid before July 30, 1994.

E. Commitments and Contingencies

On November 10, 1993, a suit was filed against Novell and certain of its officers and directors alleging violation of federal securities laws. Another lawsuit alleging similar claims was filed August 26, 1994. Both lawsuits were brought as purported class actions on behalf of purchasers of Novell common stock. Novell does not believe that the resolution of these legal matters will have a material adverse effect on its financial position or results of operations.

In December 1991, Roger Billings and his International Academy of Science, (the Academy) filed suit against Novell alleging that the Company infringes on a patent allegedly owned by the Academy. On June 6, 1994, Novell filed a petition with the U.S. Patent and Trademark office requesting that it invalidate the patent. In August 1994, the Patent Office granted Novell's request for re-examination of the patent, finding a "substantial new question of patentability". Also, in August of 1994, the trial court issued a ruling, which among other things, vacated the trial date which had been previously set in the action. The Company believes that the ultimate resolution of this legal proceeding will not have a material adverse effect on its financial position or results of operations.

The Company is a party to a number of additional legal proceedings arising

in the ordinary course of its business. The Company believes the ultimate resolution of these claims will not have a material adverse effect on its financial position or results of operations.

F. Put Warrants

During fiscal 1993, the Company sold put warrants on 5.0 million shares of its stock, callable on specific dates in the first quarter of fiscal 1994, giving third parties the right to sell shares of Novell common stock to the Company at contractually specified prices. The put warrant balance on the balance sheet at October 30, 1993 is the amount the Company would have been obligated to pay if all the put warrants were exercised at the strike price without a cash-out settlement. During the first quarter of fiscal 1994, the Company settled all of its put warrant obligations for cash of \$2.3 million and therefore reversed the put warrant obligation back to paid-in capital.

G. Export Sales

The Company markets internationally through distributors who sell to dealers and end users. For the nine months ended July 30, 1994 and July 31, 1993, sales to international customers were approximately \$632.6 million and \$535.4 million, respectively. In the first nine months of fiscal 1994 and fiscal 1993, 64% and 67%, respectively, of international sales were to European countries. No one foreign country accounted for 10% or more of total sales in either period. Except for one multinational distributor, which accounted for 13% of revenue in the first nine months of 1994 and 14% of revenue in the first nine months of fiscal 1993, no customer accounted for more than 10% of revenue in any period.

H. Restructuring Charges

In the third quarter of fiscal 1993, the Company recorded a \$42.0 million nonrecurring charge to restructure and streamline its operations. This provision includes employee severance costs, the write down of assets to estimated realizable values, outside professional fees and other expenses associated with the restructuring plan.

I. Net Income (Loss) Per Share

Net income (loss) per share is computed using the weighted average number of common shares outstanding during the periods, including common stock equivalents (unless antidilutive). Common stock equivalents consist of outstanding stock options.

J. Pro Forma Data

The consolidated unaudited condensed statement of operations include a pro forma presentation for income taxes which would have been recorded if WordPerfect had been a C corporation for all periods presented.

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

Introduction

Novell is a leading developer of network services, specialized and general purpose operating system products, both standalone and network applications, and programming tools. Over the past several years, in addition to its internal growth, the Company has issued common stock or paid cash to acquire technology companies, invested cash in other technology companies, and formed strategic alliances with still other technology companies. Novell undertook all of these transactions to promote the growth of the network computing industry and to also broaden the Company's business as a system software supplier.

On June 24, 1994 Novell, Inc. (Novell) completed a merger with WordPerfect, a developer of application software for personal computers, whereby WordPerfect was merged directly into Novell. Novell issued common stock in exchange for all of the outstanding common stock of WordPerfect. In addition, outstanding employee stock options to purchase WordPerfect common stock were converted into options to purchase approximately 7.8 million shares of Novell common stock. The transaction was accounted for as pooling of interests and therefore, the consolidated unaudited financial statements for all periods presented herein have been restated to reflect the combination of Novell and WordPerfect.

Additionally, in June 1994, the Company acquired from Borland International, Inc. its Quattro Pro spreadsheet product line for \$110 million of cash and assumed liabilities of \$10 million, and purchased a three year license to reproduce and distribute up to one million copies of current and future versions of Borland's Paradox relational database product for \$35 million of cash. The transaction was accounted for as a purchase and, on this basis, resulted in a one-time write-off of \$114.4 million for purchased research and development in the third quarter of fiscal 1994.

In January 1994, WordPerfect acquired all of the outstanding stock of SoftSolutions Technology Corporation (SoftSolutions), a developer of network document management software, for \$5.8 million of cash and notes payable of \$9.2 million. The transaction was accounted for as a purchase and, on this basis, resulted in a one-time write-off of \$15.0 million for purchased research and development in the first quarter of fiscal 1994.

In July 1993, the Company acquired all of the outstanding stock of Fluent, Inc. (Fluent), a developer of multimedia software for personal computers, for \$18.5 million of cash and assumed liabilities of \$3.0, whereby Fluent became a wholly owned subsidiary of Novell. The transaction was accounted for as a purchase and, on this basis resulted in a one-time write-off of \$20.7 million for purchased research and development in the third quarter of fiscal 1993.

In June 1993, the Company acquired all of the outstanding stock of Software Transformation, Inc. (STI), a developer of software development tools, by issuing approximately 800,000 shares of Novell common stock in exchange for all of the outstanding stock of STI. The transaction was accounted for as a pooling of interests, however, prior periods were not restated due to immateriality.

In June 1993, the Company purchased all of the outstanding stock not previously owned by Novell of Serius Corporation (Serius), a developer of object-based application tools, for \$17.0 million of cash and assumed liabilities of \$5.0 million, whereby Serius became a wholly owned subsidiary of Novell. Novell previously had invested cash of \$1.1 million in Serius. This transaction was accounted for as a purchase and, on this basis, resulted in a one-time write-off of \$22.1 million for purchased research and development in the third quarter of fiscal 1993.

In April 1991, the Company invested \$15.0 million in UNIX System Laboratories, Inc. (USL), a subsidiary of AT&T that develops and licenses the UNIX operating system and other standards-based software to customers worldwide. In December 1991, the Company announced the formation of Univel, a joint venture with USL, formed to accelerate the expanded use of the UNIX

operating system in the personal computer and network computing marketplace. Novell and USL contributed cash and technology rights to Univel. Then in June 1993, the Company acquired the remaining portion of USL by issuing approximately 11.1 million shares of Novell common stock valued at \$321.8 million in exchange for all of the outstanding stock of USL not previously owned by Novell and assumed additional liabilities of \$9.4 million. The transaction was accounted for as a purchase and, on this basis, resulted in a one-time write-off of \$268.7 million for purchased research and development in the third quarter of fiscal 1993.

The Company will continue to look for acquisitions, investments, or strategic alliances which it believes will complement its overall business strategy.

Results of Operations

Net Sales	Q3	Change	Q3	YTD	Change	YTD
	1994		1993	1994		1993
Net sales (millions)	\$488.9	13%	\$433.9	\$1,512.1	14%	\$1,321.2

During the second quarter of fiscal 1994, the Company sold a one time fully paid license for UNIX technology to Sun Microsystems for \$80.5 million. This transaction accounted for 6% growth in net sales for the first nine months of fiscal 1994 compared to the first nine months of fiscal 1993. In addition, approximately 2% and 3% of the growth in the third quarter and first nine months of fiscal 1994 respectively, compared to the same periods of fiscal 1993 is attributable to the acquisition of USL in mid-June 1993, as its revenue was not included in the first six months of fiscal 1993.

The remaining growth in net sales in the third quarter and in the first nine months of fiscal 1994 compared to the same periods in fiscal 1993 is the result of increases in the Company's NetWare 3, NetWare J, software royalties, USL products, connectivity products, WordPerfect for Windows, Suite products, and training, offset by decreases in other NetWare products, other application group products, and WordPerfect for DOS.

Net sales were also favorably affected by growth in both domestic and international sales in the first nine months of fiscal 1994 compared to the first nine months of fiscal 1993. Excluding the Sun Microsystems transaction described above, international sales grew 18% while domestic sales grew 2% in the first nine months of fiscal 1994 compared to the first nine months of 1993. International sales were approximately 42% of net sales in the first nine months of fiscal 1994 and 41% in first nine months of 1993. The Company expects that total international sales will continue to grow during the remainder of fiscal 1994.

Gross Profit	Q3	Change	Q3	YTD	Change	YTD
	1994		1993	1994		1993
Gross profit (millions)	\$383.4	15%	\$332.4	\$1,157.5	12%	\$1,036.4
Percentage of net sales	78.4%		76.6%	76.5%		78.4%

In connection with the Sun Microsystems transaction described above, the Company revalued the software and other intangibles remaining on the balance sheet related to the USL acquisition in fiscal 1993. Accordingly, \$35 million of costs associated with the sale of the license to Sun Microsystems were charged to cost of sales during the second quarter of fiscal 1994. Excluding the Sun Microsystems revenue and the related costs, the gross profit percentage would have been 77.7% in first nine months of fiscal 1994.

The increase of 1.8 percentage points in the third quarter of fiscal 1994

compared to the third quarter of fiscal 1993 is attributable to relatively lower per unit material costs. Excluding the Sun Microsystems revenue and related costs impact, the gross profit margin is fairly flat for the first nine months of fiscal 1994 and fiscal 1993. The Company expects the gross profit margin in fiscal 1994 to be down slightly compared to the gross profit margin in fiscal 1993 primarily due to the Paradox license amortization, price changes, changes in sales mix by product or distribution channel, and special product promotions.

Operating Expenses

	Q3 1994	Change	Q3 1993	YTD 1994	Change	YTD 1993
Sales and marketing (millions)	\$145.7	2%	\$142.5	\$398.6	8%	\$369.3
Percentage of net sales	29.8%		32.8%	27.8%*		27.9%
Product development (millions)	\$ 90.6	20%	\$75.5	\$257.1	23%	\$209.6
Percentage of net sales	18.5%		17.4%	18.0%*		15.9%
General and administrative (millions)	\$ 37.2	(3)%	\$38.2	\$123.6	4%	\$118.4
Percentage of net sales	7.6%		8.8%	8.6%*		9.0%
Write-off of purchased R&D	\$114.4	(64)%	\$314.5	129.4	(59)%	\$314.5
Percentage of net sales	23.4%		72.5%	9.0%*		23.8%
Restructuring charges	--	NA	\$42.0	--	NA	\$ 42.0
Percentage of net sales	--		9.7%	--		3.2%
Total operating expenses (millions)	\$387.9	(37)%	\$612.6	\$908.6	(14)%	\$1,053.8
Percentage of net sales	79.3%		141.2%	63.4 %*		79.8%

*Excludes the Sun Microsystems revenue of \$80.5 million in the second quarter of fiscal 1994.

Sales and marketing expenses were fairly flat at 28% of net sales in the first nine months of fiscal 1994 compared to the same period in fiscal 1993. Total sales and marketing expenses in the third quarter of fiscal 1994 decreased as a percentage of sales from 33% to 30% as compared to the same period in fiscal 1993. Sales and marketing expenses fluctuate as a percentage of net sales in any given period due to product promotions, advertising, or other discretionary expenses.

Product development expenses increased as a percentage of net sales from 16% in the first nine months of fiscal 1993 to 18% in the first nine months of fiscal 1994. They also increased from 17% in the third quarter of fiscal 1993 to 19% in the third quarter of fiscal 1994. These increases are a result of the acquisitions in fiscal 1993 and 1994 and from planned headcount increases in an effort to increase the Company's investment in new products. The acquisitions had relatively higher product development expenses as a percentage of net sales.

General and administrative expenses remained flat at 9% of net sales for both the first nine months of fiscal 1994 and fiscal 1993. Even though these expenses were flat between years, the comparative periods of fiscal 1994 had relatively higher legal fees and lower bad debt expense compared to the same periods of fiscal 1993, which tended to offset each other. General and administrative expenses decreased as a percentage of net sales from 9% in the third quarter of fiscal 1993 to 8% in the third quarter of fiscal 1994 due to lower legal expenses on a comparative basis.

During the third quarter of fiscal 1994, the Company wrote off \$114.4 million of tax deductible purchased research and development in connection with the acquisition of the Quattro Pro spreadsheet product line from Borland, International, Inc. During the first quarter of fiscal 1994, the Company also wrote off \$15.0 million of non-tax deductible purchased research and development in connection with the acquisition of SoftSolutions. During the third quarter of fiscal 1993, the Company wrote off \$314.5 million of non-tax deductible purchased research and development in connection with the acquisitions of USL, Serious, Fluent, and a personal information manager software product. An additional \$42.0 million tax deductible charge was incurred related to restructuring of operations.

Overall, excluding nonrecurring items, operating expenses have grown more

rapidly than revenues in both the third quarter and first nine months of fiscal 1994 compared to the same periods of fiscal 1993 due to the higher product development expenses related to acquisitions.

	YTD 1994	Change	YTD 1993
Employees	9,402	(10)%	10,451
Annualized revenue per employee (000's)	\$192	2%	\$189

Annualized revenue per employee in fiscal 1994 excludes the \$80.5 million of net sales from the Sun Microsystems transaction.

Other Income (Expense)

	Q3 1994	Change	Q3 1993	YTD 1994	Change	YTD 1993
Other income (expense), net (millions)	\$(0.2)	NA	\$7.7	\$17.7	(23)%	\$23.0
Percentage of net sales	0%		1.8%	1.2%		1.7%

The decrease in other income (expense) is primarily the result of merger expenses in the third quarter of fiscal 1994 of \$5.8 million related to the WordPerfect acquisition.

In order to achieve potentially higher returns, a limited portion of the Company's investment portfolio is invested in mutual funds which incur some market risk. The Company believes that the market risk has been limited by diversification and by use of a funds management timing service which switches funds out of mutual funds and into money market funds when preset signals occur.

Income Taxes

	Q3 1994	Change	Q3 1993	YTD 1994	Change	YTD 1993
Income taxes (millions)	\$(0.3)	27%	\$(15.1)	\$80.2	18%	\$67.7
Percentage of net sales	NA		NA	5.3%		5.1%
Effective tax rate	NA		NA	30.1%		NA

The Company's estimated effective tax rate for the first nine months of fiscal 1994 is 30%. Excluding non-tax deductible one-time charges related to the write-off of purchased research and development of \$15.0 million in fiscal 1994 and \$314.5 million in fiscal 1993 and adjusting both periods to reflect a provision for income taxes as if WordPerfect and its S corporation subsidiaries had never been S corporations, the Company's estimated effective tax rate for the first nine months of fiscal 1994 would be 34% compared to 33.4% for the first nine months of fiscal 1993. The increase is attributable to non-tax deductible merger expenses. The Company paid cash amounts for income taxes of \$108.5 million and \$60.2 million, in the first nine months of fiscal 1994 and 1993, respectively.

Net Income (Loss) and Net Income (Loss) Per Share

	Q3 1994	Change	Q3 1993	YTD 1994	Change	YTD 1993
Net income (loss) (millions)	\$4.5	NA	\$(257.4)	\$186.4	NA	\$(62.1)
Percentage of net sales	0.9%		(59.3)%	12.3%		(4.7)%
Net income (loss) per share	\$(0.01)		\$(0.69)	\$0.51		\$(0.17)

Excluding the impact of nonrecurring items and adjusting all periods to reflect a provision for income taxes as if WordPerfect and its S corporation subsidiaries had been C corporations, pro forma net income for the first nine months of fiscal 1994 would have been \$236.9 million or 16.5% of net sales compared to \$240.9 million or 18.2% of net sales in the first nine months of fiscal 1993.

Liquidity and Capital Resources

Cash and short-term investments increased to \$758.1 million at July 30, 1994 from \$719.2 million at October 30, 1993. The major reasons for this increase were the \$288.7 million of cash provided by operating activities and the \$26.8 million provided by borrowings and the \$21.5 million provided from the issuance of common stock for stock option exercises, offset by the \$118.3 million used to retire all of the short and long-term debt of WordPerfect, the \$62.8 million used for capital asset purchases and the \$110.0 million used for acquisitions. The investment portfolio is diversified among security types, industry groups, and individual issuers. The Company's principal source of liquidity has been from operations. At July 30, 1994, the Company's principal unused sources of liquidity consisted of cash and short-term investments and available borrowing capacity of approximately \$19.8 million under its credit facilities. The Company's liquidity needs are principally for the Company's financing of accounts receivable, capital assets, acquisitions and strategic investments and to have flexibility in a dynamic and competitive operating environment.

During fiscal 1994 the Company has continued to generate cash from operations. The Company anticipates being able to fund its current operations and capital expenditures planned for the foreseeable future with existing cash and short-term investments together with internally generated funds. Borrowings under the Company's credit facilities, or public offerings of equity or debt securities are available if the need arises. As the Company grows, investments will continue in product development in new and existing areas of technology. Cash may also be used to acquire technology through purchases and strategic acquisitions. Capital expenditures in fiscal 1994 are anticipated to be approximately \$80 million, but could be reduced if the growth of the Company is less than presently anticipated.

Part II. Other Information

All information required by items in Part II is omitted because the items are inapplicable, the answer is negative or substantially the same information has been previously reported by the registrant.

SIGNATURES

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

Novell, Inc.
Registrant

Date September 9, 1994

/s/ Robert J. Frankenberg
President, and Chief Executive
Officer
(Principal Executive Officer)

Date September 9, 1994

/s/ James R. Tolonen
Chief Financial Officer
(Principal Financial
and Accounting Executive
Officer)